



EUROPEAN CENTRAL BANK
EUROSYSTEM

ECB Legal Conference 2017

Shaping a new legal order for Europe:
a tale of crises and opportunities

4-5 September 2017

December 2017



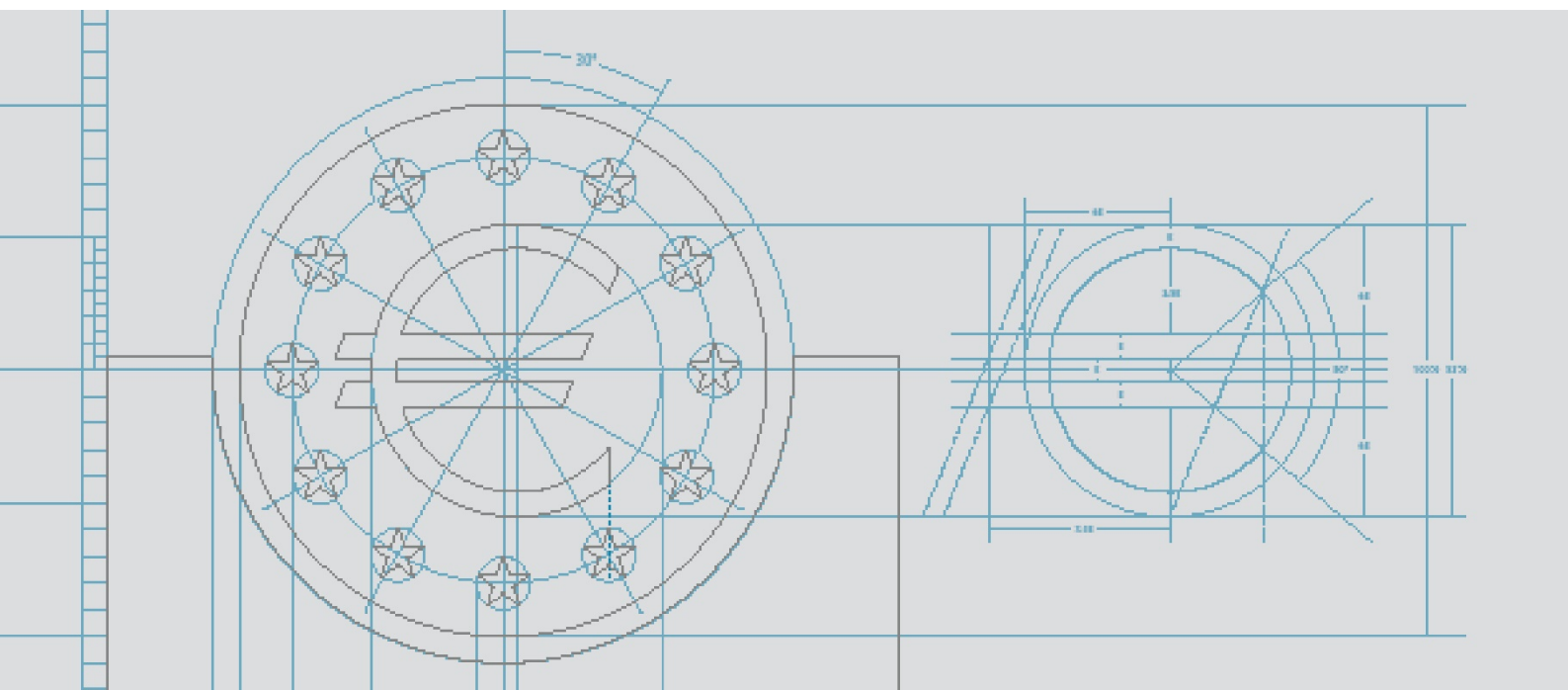


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Foreword

By Mario Draghi¹

In September 2017, the ECB was honoured and privileged to host many outstanding scholars and lawyers, both as panellists and in the audience, to consider some of the key legal issues for Europe and the European Central Bank.

The title of the 2017 ECB Legal Conference, 'Shaping a new legal order for Europe: a tale of crises and opportunities', fits well with the ECB's experience over the past decade. The global financial crisis and the subsequent sovereign debt crisis in Europe resulted in a deep recession across Europe and worldwide, a sharp increase in unemployment, and demonstrated the need for wide-ranging reforms to address the incompleteness of Economic and Monetary Union (EMU). Lawyers have an important role as experts in assessing the legislative and judicial responses to the crisis and in considering the reforms needed to address the key challenges faced by the European Union.

In 2015, I was involved in preparing the Five Presidents' report², which set out a roadmap for achieving a deep, genuine and fair EMU. Significant progress has been made towards the key objective of completing the banking union, with the creation of the Single Supervisory Mechanism and the Single Resolution Mechanism, placing responsibility for the supervision and resolution of large and cross-border banks at the European level.

The new EU institutional and regulatory framework for managing bank failures was one of the topics addressed in the conference. And there were also important discussions about a cross-sectoral approach to financial market policies and rules.

From a legal perspective, there is still work to be done to complete the three pillars of the banking union. First, a fiscally neutral financial backstop to the Single Resolution Fund is needed to ensure bank resolution is effective and avoids costs for taxpayers. Second, there is progress to be made to agree on a common European Deposit Insurance Scheme. And third, high priority should be given to measures to reduce risk in the banking sector. This includes adopting the European Commission's comprehensive risk reduction package aimed at increasing the resilience of the banking sector in the EU and enhancing financial stability.

Legal reforms are also required to underpin further progress on the capital markets union. Such reforms are key to providing more diverse sources of funding for businesses and households and more effective means of risk sharing via the private sector.

¹ President of the European Central Bank.

² The Five Presidents' Report: Completing Europe's Economic and Monetary Union, 22 June 2015, at https://ec.europa.eu/commission/publications/five-presidents-report-completing-europes-economic-and-monetary-union_en.

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I also welcome the focus of the conference beyond legislative changes to consider issues of transparency and accountability. Upholding the values embodied in the Treaties, including democracy and fundamental rights, requires that the ECB may be held to account for its actions. On accountability, an important democratic parameter, the legitimacy of the ECB as an institution relies on ensuring that the citizens of Europe can understand how we make decisions, and subjecting these decisions to greater scrutiny is essential. The views of the participants in the 2017 ECB Legal Conference, as the leading experts in these fields, on these important checks and balances matter to us.

The discussions that took place in the conference are now collected in this book, which is a valuable contribution to the ongoing debate on the changes that are necessary to improve the functioning of EMU and to ensure it is supported by a high level of trust among citizens.



Chiara Zilioli

Introduction

By Chiara Zilioli¹

Good morning Ladies and Gentlemen,

It is my great pleasure to welcome you to the 2017 ECB Legal Conference. I am very glad to welcome old friends back to the ECB, and to see new faces, who will also contribute new perspectives to the discussion.

As you can see from the full attendance we have this morning, from the variety of topics on the programme and from the eminence of the speakers and discussants, this Conference has a lot to offer.

The title of the Conference – “Shaping a new legal order for Europe: a tale of crises and opportunities” – already tells us a lot about what to expect over the next two days.

It tells us that we find ourselves, once again, in a Europe whose future is uncertain.

Ten years later, we are still dealing with the repercussions of the financial crisis and the sovereign debt crisis.

We are still fighting to realise the banking union and are still trying to reach out to citizens, to whom we are accountable, and protect their rights.

And, last but not least, one of the Member States has taken the decision to start the complex and arduous process of disentangling itself from the Union.

Uncertainty has potential: only out of chaos, stars are born.

The title of the Conference speaks of a new legal order that needs to be shaped and moulded to fit the needs of the Member States and ultimately its citizens.

I very much hope this Conference will play a role in this process, as a forum for open dialogue and a catalyst for new ideas.

I would like to thank the ECB for giving the Directorate General Legal Services, under the patronage of our Board Member Yves Mersch, the chance to gather together the great legal titans of academia, of the judiciary, of the European institutions and of the private sector to discuss all of these issues.

Following the Conference, we will gather and publish the contributions of the speakers in a book, which will help to spread these ideas and thoughts to a wider audience, thus making the legal reasoning and legal solutions discussed therein accessible beyond the walls of the institutions, universities and law firms.

¹ Director General Legal Services, European Central Bank, Professor at the Law Faculty of the Goethe University in Frankfurt am Main.

This effort at reaching out to the legal world – professional, institutional and academic – is part of a broader context which Yves Mersch will discuss in his keynote address, namely accountability and transparency. On this topic, let me mention the award that the European Ombudsman gave to the ECB earlier this year in recognition of our “Excellence in communications”, and the *Standard Eurobarometer* survey published in August showing that support for the euro has reached the highest level in over ten years.

Lawyers, too, should play a role in bringing Europe to its citizens.

I would like to conclude with the following remark.

Every morning, when I enter the building I see a quote from Jacques Delors written on the wall of the Grossmarkthalle: “Europe is like a bicycle. It has to move forward. If it stops, it will fall over”.

I was initially going to suggest that those present during the next two days are the ones trying to learn how to pedal the bicycle and move it forward. But that is not true; that is not our role. We are the ones with the repair kit and the bicycle pump; and the ones interested in designing new gears for optimal functionality.

Ladies and Gentlemen, I very much hope you will enjoy the Conference, and I look forward to the presentations and fruitful discussions.



Yves Mersch

Aligning accountability with sovereignty in the European Union: the ECB's experience

Keynote speech

By Yves Mersch¹

The European Central Bank (ECB) ultimately acts on behalf of the people and for the people. With the ratification of the EU Treaties, the citizens of Europe made the ECB independent and gave it a clear mandate. So it is entirely legitimate that the ECB is held to account: it needs to be able to show that it continues to act in accordance with its mandate. There is no need to enter into a contentious debate about changing it.

The demand for accountability has been increasing across advanced economies and across institutions. It is a trend that results from a combination of societal and technological factors. First, the crisis has led to lower trust in public institutions²: Europeans have questioned whether the policies put in place by the governing institutions, at national or at European level, have been or are still the right ones. Second, technological change (internet and social media in particular) has accelerated the pace of both information diffusion and public debate: people want more answers more quickly.

But direct, instant and constant communication does not necessarily translate into stronger accountability. In particular, it risks being either oversimplified, unilateral or prone to confirmation bias, as it does not necessarily allow for a proper exchange of views. In our constitutional democracies, parliaments and courts provide fundamental checks and balances for precisely this reason: they ensure that available information can be examined and debated in a democratically balanced, evidence-based framework.

The increased attention and stronger scrutiny the ECB faces also reflects the growing importance and more direct impact of decisions taken at European level. This increased importance is a longer-term trend – a reflection of the “ever closer union” sought by its Member States that has translated into further powers and competences being conferred upon EU institutions on the occasion of each revision of the EU Treaties. It has been particularly visible in the context of the crisis, with the further deepening of the Economic and Monetary Union, resulting for instance in the creation of the European Stability Mechanism (ESM) and the banking union. Citizens in Europe witness the power exercised by EU institutions – and they want to be able

¹ Member of the Executive Board, European Central Bank.

² For the EU, this evidence is provided by the Eurobarometer survey, available at ec.europa.eu/commfrontoffice/publicopinion/.

to see that it is not wielded arbitrarily or from behind closed doors, hence the demand for stronger transparency and accountability.

The ECB is a case in point. During the Great Recession, central banks of advanced economies faced considerable expectations and, at the same time, increased controversy as they went beyond their standard toolkit. Facing risks of deflation against the background of a double-dip recession and financial fragmentation, the ECB resorted to unconventional monetary policies. Moreover, the ECB assumed new responsibilities: the legislators conferred upon it new microprudential and macroprudential supervisory tasks as part of an effort to strengthen and “Europeanise” banking supervision. Finally, the ECB provided advice in financial assistance programmes, in a further example of its key role during the crisis.³ The extended scope of the ECB’s role has expectedly translated into increased attention and scrutiny.

This paper discusses how the above-mentioned trends are affecting the ECB. It aims to draw some conclusions on how to align accountability with sovereignty in the EU’s multilevel governance framework at a time when, according to the latest Eurobarometer survey⁴, 68% of those polled say they feel they are citizens of the EU as well as citizens of their own country.

1 Independent, accountable and European

The survey shows that trust in the ECB has increased, albeit from a lower level than trust in other EU institutions. Still, during the crisis, reduced trust in public institutions tempted some people to reopen the debate on central bank independence. They often argued that independence was incompatible with accountability.

A critical assessment of why trust in public institutions fell is important, but questioning central bank independence is not the right approach – subjecting central banks to political influence is unlikely to make them more trusted. The economic argument is known: empirical evidence shows that political influence is more likely to lead to short-termism and make the central bank less effective in preserving price stability.⁵ But there is also a political argument: political influence does not necessarily mean stronger legitimacy, precisely because it is likely to arouse the suspicion that the central bank is politically motivated and may therefore deviate from its mandate for political reasons. So in the case of central banks it can be argued that independence does not weaken accountability but strengthens it.

This is precisely why independence was enshrined in primary law by the Maastricht Treaty, which signals a high degree of commitment to this principle. The Treaty on the Functioning of the European Union (TFEU) and the Protocol on the Statute of the

³ The advisory role of the ECB is provided for in the Treaty Establishing the European Stability Mechanism and the EFSF Framework Agreement, but ultimately finds its legal basis in Article 127(4) TFEU and Articles 4 and 25 of the Statute of the ESCB.

⁴ *Standard Eurobarometer 87*.

⁵ Cukierman, A. (2008).

European System of Central Banks and of the European Central Bank (Statute of the ESCB) protect the ECB from any interference that may hinder the exercise of its statutory tasks.⁶

Accountability, in turn, is the necessary counterpart to independence. Accountability means being required or expected to justify actions or decisions.⁷ For the ECB, this means justifying and explaining its decisions by demonstrating that it is acting in accordance with its mandate. In this respect, various forms of accountability (e.g. democratic accountability, judicial accountability) and supporting channels (e.g. communication tools) can reinforce each other.

Accountability therefore ensures that independence does not lead to arbitrariness and that the mandate is fulfilled. Thus, proper accountability arrangements strengthen the case for independence. And they reinforce each other as cornerstones of central banks' legitimacy and effectiveness.

It should therefore come as no surprise that, similar to the ECB's mandate and independence, the ECB's accountability is enshrined in the EU Treaties. On the one hand, the EU Treaties⁸ and the Statute of the ESCB⁹ provide that the ECB is accountable to the European Parliament, as the representation of EU citizens, and has to report regularly to the Council of the European Union (EU Council), which represents Member States' governments. On the other hand, the ECB's decisions are subject to judicial review as they can be challenged at the Court of Justice of the European Union (CJEU).¹⁰

The ECB's monetary policy mandate is for the euro area as a whole. When governors of the national central banks (NCBs) attend the Governing Council

⁶ Article 130 TFEU states that the ECB, the NCBs and the members of their decision-making bodies shall not "seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body". At the same time, "Union institutions, bodies, offices or agencies and the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the European Central Bank or of the national central banks in the performance of their tasks". The concept of central bank independence has four features: institutional, functional, personal and financial independence. Similar classifications are used in the in ECB Convergence Reports, adopted on the basis of Article 140(1) of the Statute of the ESCB, which assess the progress made by non-euro area Member States in fulfilling their Treaty obligations regarding the achievement of Economic and Monetary Union. See "[Central bank independence revisited](#)", keynote address by the author at the *Symposium on building the financial system of the 21st century: an agenda for Europe and the United States*, 30 March 2017.

⁷ See the *Concise Oxford English Dictionary*.

⁸ Article 284(3) TFEU provides that "the European Central Bank shall address an annual report on the activities of the ESCB and on the monetary policy of both the previous and current year to the European Parliament, the Council and the Commission, and also to the European Council. The President of the European Central Bank shall present this report to the Council and to the European Parliament, which may hold a general debate on that basis. The President of the European Central Bank and the other members of the Executive Board may, at the request of the European Parliament or on their own initiative, be heard by the competent committees of the European Parliament."

⁹ Article 15(3) of the Statute of the ESCB.

¹⁰ Article 263 TFEU provides that "the Court of Justice of the European Union shall review the legality of legislative acts, [and] of acts of the [...] European Central Bank, other than recommendations and opinions intended to produce legal effects *vis-à-vis* third parties". Article 267 TFEU also grants the CJEU jurisdiction to give preliminary rulings concerning: (a) the interpretation of the Treaties; and (b) the validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union. In addition, attention is drawn to Article 268 TFEU, which grants the CJEU jurisdiction in disputes relating to compensation for damage provided for in cases where non-contractual liability is established pursuant to Article 340 TFEU.

meetings, they are not representing their respective countries. They are there in a personal capacity and represent the interests of everyone in the euro area.¹¹ It is therefore appropriate that the ECB is held to account at European level, while the NCBs explain monetary policy decisions at national level.

Importantly, explaining decisions is not synonymous with exercising accountability. In principle, where a competence, such as monetary policy, has been fully transferred to European level, accountability should be practised at that level. This ensures that everyone in Europe has the same ability to hold the ECB accountable through the same institutions – namely the European Parliament, complemented by judicial review by the CJEU. In other words, a single monetary policy requires single accountability, but in a multinational setting it can be explained through various channels.

Attempting to strengthen political ties to national political systems – “renationalising” accountability through the back door, if you will – would only risk undermining the singleness of monetary policy and threaten its independence. People and markets would end up suspecting that the ECB is responding to national interests instead of acting in the interests of the euro area as a whole.

Where accountability needs to be deepened in response to increased demand from citizens, this should be done at the European level. And the institutional framework has not hindered that: from the beginning, ECB accountability practices have made use of the possibilities offered by the Treaties. In the European Parliament, a “Monetary Dialogue” was established from the inception of the ECB, with the participation of the ECB’s President in regular quarterly hearings of the Committee on Economic and Monetary Affairs.¹² Moreover, Members of the European Parliament (MEPs) address written questions to the ECB, the replies to which are published on both institutions’ websites.¹³ Overall, a review of the literature suggests that the quality and intensity of the ECB’s interaction with the European Parliament is similar to that of the Federal Reserve System with the US Congress¹⁴ and plays a significant role in informing and involving MEPs and their constituencies.¹⁵

¹¹ Under Article 129(1) TFEU, the ESCB is governed by the decision-making bodies of the ECB, i.e. the Governing Council and the Executive Board. The Governing Council performs the tasks of the ESCB, as set out in Article 127 TFEU, taking decisions which affect the euro area as a whole. Article 130 TFEU also applies to individual members of the decision-making bodies, which must not seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body.

¹² This practice is in accordance with Rule 126(3) of the Rules of Procedure of the European Parliament, which provides that “the President of the European Central Bank shall be invited to attend meetings of the committee responsible at least four times a year in order to make a statement and to answer questions”.

¹³ Whilst not enshrined in primary legislation, according to Rule 131 of the Rules of Procedure of the European Parliament, MEPs can address written questions to the ECB, and since the establishment of this rule the ECB has regularly provided written replies to all of the questions.

¹⁴ De Grauwe, P. and Gros, D. (2009).

¹⁵ Collignon, S. and Diessner, S. (2016).

2 Accountability during crises

The ECB's accountability practices evolved further in response to the crisis.

Central banks played a key role in managing the crisis and implemented some controversial measures. Understandably, this triggered a demand for stronger scrutiny. The ECB was among the institutions that took such measures: preserving price stability was particularly challenging in an Economic and Monetary Union that was still incomplete. The ECB faced doubts about the integrity of the single currency, not to mention a unique institutional environment that lacked crisis management capacities and was based on imperfect coordination of national fiscal, economic and financial policies. Contrary to a federal constitutional set-up, there was no single financial rulebook and watchdog, no euro area budget to provide automatic stabilisers, and financial risk sharing was limited. Against this background, the crisis exposed economic divergence, fiscal imbalances and banking sector fragilities, resulting in financial fragmentation and a protracted balance-sheet adjustment.

In this context, the ECB played an essential role. It took resolute action within its mandate to stabilise prices, making use of both conventional and unconventional measures.¹⁶ These measures were subject to increased attention and debate as to whether they were appropriate and effective. It was questioned whether the ECB was overstepping its mandate.

The ECB increased its accountability and transparency. And this was not only driven by external demands. It was in the ECB's own interest to provide the public and the markets with a comprehensive analysis of the economic situation and monetary policy decisions. For instance, the ECB decided to publish the accounts of the Governing Council's monetary policy discussions.¹⁷ Of course, this higher level of transparency had to be counterbalanced by the need to maintain the frank and dynamic exchanges which make for efficient collegial decision-making. The accounts aim to provide clear and accurate information on policy deliberations that elucidates the message, rather than overload with detail. However, there is a caveat: the growing importance of forward guidance has increased the risk of self-censorship in the official discussions.

Since the start of the crisis, the ECB has considerably increased its interaction with the European Parliament – the ECB's key counterpart in terms of accountability. In addition to the regular hearings, the ECB has participated in several exchanges of views on more specific topics in the Parliament. The number of written questions that MEPs address to the ECB has also increased: the average number of replies to the European Parliament per year has risen tenfold compared with the pre-crisis period. This is partly a reflection of the fact that the ECB now has a broader role, albeit mostly in relation to financial assistance programmes and banking supervision. Furthermore, when submitting its annual report to the European Parliament, the ECB

¹⁶ Alvarez, I., Casavecchia, F., De Luca, M., Duering, A., Eser, F., Helmus, C., Hemous, C., Herrala, N., Jakovicka, J., Lo Russo, M., Pasqualone, F., Rubens, M., Soares, R. and Zennaro, F. (2017).

¹⁷ The accounts of the Governing Council's discussions are published four weeks after each monetary policy meeting.

now also publishes its feedback on the input provided by the Parliament as part of its resolution on the previous annual report. In line with the Parliament's request, this feedback is also published on the ECB's website and contains a detailed discussion of the various issues raised in the resolution.¹⁸

Alongside this increased accountability, the CJEU has become more involved in the judicial review of the ECB's actions in recent years. On the one hand, the Court has exercised its powers in relation to a wide range of central bank decisions and policies. Recent cases have seen it review not only monetary policy¹⁹ and supervisory decisions,²⁰ but also technical advice provided within the framework of the Troika²¹ and central banking policies, even where they do not involve the exercise of the ECB's decision-making power.²² On the other hand, the Court's decisions have far-reaching implications, as recent rulings have confirmed that individuals can also challenge the ECB's conduct by means of actions for damages, in addition to asking the Court to annul the ECB's decisions for reasons of illegality.²³ The ECB needs to ensure that all of its actions, even when it is not exercising its core decision-making powers, also comply with the legal requirements that are intended to confer fundamental rights on individuals at EU rather than national level.

Alongside the European Parliament and the CJEU, the European Ombudsman and the European Court of Auditors also play a role. The Ombudsman can act in matters involving the ECB regarding transparency and good governance, while the Court of Auditors examines the ECB's operational efficiency. Moreover, the European Anti-Fraud Office has the power to conduct administrative investigations within the ECB for the purposes of fighting fraud, corruption and other criminal activity, as well as to investigate serious matters relating to the discharge of officials' professional duties. Finally, the ECB is also subject to the scrutiny of the European Data Protection Supervisor, which monitors and ensures that data protection legislation is appropriately applied to our data-processing operations.

3 Aligning accountability with sovereignty in the EU

The ECB's monetary policy provides an example of how sovereignty and accountability can – and, ideally, should – be aligned when transferring a competence to European level. It also shows that it is possible to keep pace with events and meet society's demand for greater accountability, while respecting essential principles enshrined in primary law.

¹⁸ See the 2016 [Feedback on the input provided by the European Parliament as part of its resolution on the ECB Annual Report 2014](#).

¹⁹ Case C-62/14, *Gauweiler and others v Deutscher Bundestag*, ECLI:EU:C:2015:400.

²⁰ Case T-122/15, *Landeskreditbank Baden-Württemberg – Förderbank v European Central Bank* ECLI:EU:T:2017:337.

²¹ Joined Cases C-8/15 P to C-10/15 P, *Ledra Advertising Ltd and others v European Commission and European Central Bank*, ECLI:EU:C:2016:701; Joined Cases C-105/15 P to C-109/15 P, *Mallis and Malli v European Commission and European Central Bank*, ECLI:EU:C:2016:702.

²² Case T-496/11, *United Kingdom v European Central Bank*, ECLI:EU:T:2015:133.

²³ Joined Cases C-8/15 P to C-10/15 P, *Ledra Advertising Ltd and others v European Commission and European Central Bank*, ECLI:EU:C:2016:701.

However, it is worth discussing two challenges in this regard that have broader relevance for the EU, with its unique institutional framework.

First, the distinction between the euro area and the EU means that it is more difficult to fully tailor accountability to euro area tasks. In particular, the European Parliament does not sit in euro area composition when discussing euro area matters, even though it would be common sense for it to do so.

Second, accountability and sovereignty also need to be proportionate in areas that are not exclusively dealt with at EU level but are matters of shared competence.

For instance, more specific arrangements within the ECB's accountability framework have been established for banking supervision. The Single Supervisory Mechanism (SSM) Regulation specifies that the ECB is accountable to the European Parliament and the EU Council for its supervisory tasks.²⁴ The exact arrangements as to how ECB Banking Supervision discharges its accountability obligations are laid down in an Interinstitutional Agreement between the European Parliament and the ECB²⁵ and a Memorandum of Understanding between the EU Council and the ECB.²⁶ However, in addition, the SSM Regulation also provides for specific reporting obligations towards national parliaments.²⁷ This reflects the considerable potential impact of microprudential supervision on banks, their customers and public finances at the national level and justifies ad hoc reporting at different levels. At the same time, the national competent authorities remain accountable at national level for their tasks in the context of the SSM.

For other bodies such as the ESM, the situation is somewhat more complex and blurred. The ESM was created on the basis of intergovernmental arrangements and for tasks where the EU only has a coordination role and where the European Parliament is not yet a counterparty in terms of accountability. A balance therefore needs to be found. On the one hand, accountability should be assigned to national parliaments for decisions that are fully in the hands of national authorities. On the other hand, it would seem appropriate for the European Parliament to be the counterparty for accountability regarding decisions that affect the interests of the EU as a whole.

²⁴ Article 20 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).

²⁵ 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).

²⁶ [Memorandum of Understanding between the Council of the European Union and the European Central Bank on the cooperation on procedures related to the Single Supervisory Mechanism \(SSM\)](#).

²⁷ Article 21 SSM Regulation.

4 Addressing the risk of an “accountability deficit”

Accountability and sovereignty need to be aligned to address the risk of a perceived “accountability deficit” stemming from the possible gap between the powers conferred at the European level and the corresponding parliamentary and judicial scrutiny.

The development of the ECB’s accountability practices has ensured continued effective scrutiny, even as the ECB’s role has expanded as a result of the crisis. In turn, this has allowed the temptation of renationalisation to be resisted, in keeping with the ECB’s European mandate.

Public opinion surveys suggest that Euroscepticism is now receding.²⁸ But there is no reason to be complacent, as trust in the ECB is only gradually returning.²⁹

Moreover, while European policies have assumed a stronger role over time, reflecting the interdependence of our economies and destinies, in many areas they still overlap with national policies. In those areas, confusion over the distribution of responsibilities and the accountability arrangements threatens efficiency and legitimacy. Consideration should be given as to how it can be addressed.

Within the Economic and Monetary Union, there is a need to complete not only the banking union, but also the institutional set-up. This includes the ongoing debate on a euro area finance ministry and a euro area composition of the European Parliament, for example.

This is important for two reasons. First, it would be a true reflection of a functioning democracy where sovereignty has been either fully transferred to the European level (e.g. monetary policy) or is shared between national and European levels (e.g. prudential policies).

And second, liability and control need to be aligned: he who pays the piper calls the tune. When taxpayers’ money is involved at European level, a European control function is called for.

If, going beyond the Westphalian paradigm, EU citizens can receive rights and obligations not only through the national sovereignty channel but also directly through the EU channel, institutions need to be adjusted. This was already recognised at the Maastricht Treaty conference on political union in 1990. Conversely, a return to intergovernmentalism for fear of Treaty changes would

²⁸ The latest Standard Eurobarometer survey (EB 87), for which fieldwork was conducted in May 2017, indicates that support for “a European economic and monetary union with one single currency, the euro” has reached the highest level since the start of the series in autumn 2004: 73% of euro area respondents show support. Support for the EU is also recovering (at 42% of EU respondents) and stands at its highest level since autumn 2010. Optimism is on the rise, with 56% of EU respondents optimistic about the future of the EU. Finally, the share of respondents who feel that they are citizens of the EU (68% of EU respondents, 70% of euro area respondents) is the highest recorded since the start of the series in 2010.

²⁹ According to EB 87, 37% of euro area respondents have trust in the ECB. Distrust in the ECB is outnumbering trust in eight euro area Member States.

destroy the EU, as Europe, over the centuries, has repeatedly seen the breakdown of such alliances of dominant states.

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Panel 1

Transparency and accountability of
central banks and banking supervisors

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Transparency and accountability in monetary policy and banking supervision

By Sabine Lautenschläger¹

1 Introduction

Everyone, including central bankers and academics as well as market participants, agrees today that monetary policy should be transparent. However, this was not always self-evident. In the 1980s Alan Greenspan said that, as Chairman of the Federal Reserve Board, he had to learn “Fedspeak”. As he put it: “I’ve learned to mumble with great incoherence.”² Back then, it was standard practice for central banks to remain secretive about monetary policy and at best vague when communicating with markets.

Since then, a dramatic change has taken place as central banks have opened up to the world. The consensus that has emerged is that there is a strong case for transparency. Transparency enhances the accountability of central banks and makes monetary policy more effective.

But what makes a central bank transparent? Alan Blinder provides a useful definition. In his view a central bank is transparent if its actions are “easily detected”, its policies “readily understood” and its pronouncements “free from deceit”.³ Accordingly, transparency standards such as clarity, substantive content and openness to public scrutiny are a useful benchmark and should be applied by any central bank, including the European Central Bank (ECB).

And the ECB has another task that plays a role in this context: it is responsible not only for monetary policy but also for banking supervision. As these two functions are subject to the principle of independence, they benefit from increased transparency and accountability.

¹ Member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the ECB. The author would like to thank Cyril Max Neumann for his contribution to this article.

² Speaking to a Senate Committee in 1987, as quoted in the *Guardian Weekly*, 4 November 2005.

³ Blinder (2004), *The Quiet Revolution: Central Banking Goes Modern*, New Haven, Yale University Press.

2 Transparency in the monetary policy of the ECB

2.1 Transparency enhances the accountability of central banks...

The ECB is an independent central bank, and its monetary policy decisions affect the wealth of over 330 million citizens in the euro area. To counterbalance such significant powers, the ECB has to be accountable. This is required by EU primary law. However, the ECB can only be held accountable if it provides sufficient information for citizens to assess its policies. Therefore, the ECB maintains a high degree of transparency. It does so in three ways.

First, the ECB is transparent with regard to its objectives. It has adopted a quantitative definition of its main objective: price stability, which is defined as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below, but close to, 2% over the medium term.⁴ This definition provides a clear and measurable yardstick against which citizens can hold the ECB accountable.

Second, the ECB is committed to providing the analysis and reasoning underlying its monetary policy decisions through a number of channels. These include regular press conferences, monetary policy accounts, the Economic Bulletin, weekly financial statements, speeches, articles and interviews.

Third, the ECB is directly accountable to the European Parliament. The European Parliament holds regular hearings with the ECB President and exchanges of views with ECB Executive Board members. Members of the European Parliament (MEPs) can also send written questions to the ECB. In addition, the ECB presents an annual report describing its activities to the European Parliament. Lastly, the ECB is audited by the European Court of Auditors with regard to its operational efficiency.

Transparency thereby serves the objective of accountability and contributes to maintaining the ECB's legitimacy. However, transparency is also a powerful tool that helps the ECB to meet its policy objectives. If the ECB can promote a better understanding of its policies, it enhances their effectiveness. This is because being clear about the ECB's mandate and monetary policy strategy contributes to well-anchored price expectations in the long term, and that improves monetary policy transmission.

2.2 ... and their effectiveness

Relevant empirical studies indeed find that more transparency has led to a significant improvement in the predictability of monetary policy in many countries.⁵ "Short run"

⁴ [Definition of price stability as clarified by the Governing Council in 2003.](#)

⁵ Blinder, Alan S., Ehrmann, Michael, Fratzscher, Marcel, De Haan, Jakob, Jansen, David-Jan (2008), "Central Bank Communication and Monetary Policy – A Survey of Theory and Evidence", *Working Paper Series* No 898, ECB, Frankfurt am Main, May.

news, such as central bank communications on the economy and monetary policy, appears to have consistent effects on financial markets' inflation expectations. At the same time, announcements of goals and strategies, such as an inflation target or the definition of price stability, contribute to anchoring market expectations. More research on best practices in communication and the effects of central bank communication on the general public would help to further improve monetary policy.

Managing expectations in the economy has become all the more relevant since the financial crisis. Standard monetary policy ceased to be effective at the lower bound of interest rates, and the ECB had to enter uncharted territory, reverting to unconventional tools. Clearly explaining the justification and workings of these unconventional monetary policy tools has greatly contributed to reducing uncertainty with regard to the future path of monetary policy.⁶ Communication as a tool of the ECB's monetary policy has grown significantly in importance.

Being clear, however, is not always easy. In this regard Alan Greenspan once said: "I know you think you understand what you thought I said, but I'm not sure you realize that what you heard is not what I meant." The purpose of transparency is not to help people misunderstand. If central bankers communicate one thing but markets understand something else, this could have serious consequences for monetary policy. Clarity in communication matters. Thus, transparency can only be effective if what the ECB is communicating is properly understood – not only by experts but by the general public.

However, there are also downsides to using transparency as a monetary policy tool. These downsides are closely linked to credibility and trust, which are so important for central banks. Providing the markets with forward guidance on the future stance of monetary policy could create the wrong expectations. Markets might think that forward guidance irrevocably binds the central bank to a certain course no matter what happens. But, naturally, if the underlying facts that have justified a specific monetary policy measure change, so too must monetary policy. This could then be interpreted as the central bank not standing by its words. The result would be a loss of confidence and trust.

And finally, being clear cannot mean revealing every internal discussion word by word. Being too transparent might even defeat the purpose of being transparent. Disclosing all the information that is available would blur key policy messages and could lead to confusion and market disorder. In this regard, full disclosure of the proceedings of the Governing Council would not only breach EU primary law,⁷ but also damage the deliberative process and, as a consequence, disrupt policymaking.

⁶ Coenen, Günter, Ehrmann, Michael, Gabalo, Gaetano, Hoffmann, Peter, Nakov, Anton, Nardelli, Stefano, Persson, Eric, Strasser, Georg (2017), "Communication of monetary policy in unconventional times", *Working Paper Series* No 2080, ECB, Frankfurt am Main, June.

⁷ The proceedings of the Governing Council are confidential under Article 10.4 of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank; only the Governing Council may make the outcome of its deliberations public. Any disclosure of the proceedings would breach EU primary law and the principle of central bank independence.

3 Transparency of ECB Banking Supervision

3.1 A high degree of transparency and accountability is expected from ECB Banking Supervision

In 2014 the ECB assumed responsibility for directly supervising the largest banks in the euro area. Its core tasks have thus expanded beyond monetary policy. As a result, its role and its character have changed. Banking supervision is undoubtedly different from monetary policy.

While supervisory objectives are well defined, they are much harder to measure than those of monetary policy. The objective of price stability comes with a clear yardstick: as mentioned above, inflation should be below, but close to, 2%. With regard to the objectives of banking supervision, no such quantitative targets exist. Moreover, decisions taken by supervisors may have a considerable impact on the fundamental freedoms and rights of banks, investors and depositors. Consequently, the ECB's new task as a supervisor has relevant implications for transparency and accountability. The Single Supervisory Mechanism (SSM) Regulation⁸ makes that very clear: "The conferral of supervisory tasks implies a significant responsibility for the ECB to safeguard financial stability in the Union, and to use its supervisory powers in the most effective and proportionate way. Any shift of supervisory powers from the Member State to the Union level should be balanced by appropriate transparency and accountability requirements."⁹

Therefore, the ECB is accountable not only to the European Parliament, but also to the EU Council.¹⁰ Specific accountability requirements have been determined in an Interinstitutional Agreement between the European Parliament and the ECB¹¹ and in a Memorandum of Understanding between the EU Council and the ECB.¹² These requirements entail the following: regular hearings and exchanges of views with the European Parliament and the Eurogroup; the submission of records of proceedings of the Supervisory Board meetings to the European Parliament Committee on Economic and Monetary Affairs (ECON); written questions from the Eurogroup and MEPs; and annual reports submitted to the European Parliament, the EU Council, the Eurogroup, the European Commission and national parliaments. In addition, ECB Banking Supervision is also audited by the European Court of Auditors on its

⁸ 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).

⁹ Recital 55 of the SSM Regulation.

¹⁰ As national authorities continue to maintain an indirect role in supervision, Article 21 of the SSM Regulation envisages the need for appropriate channels of reporting to national parliaments and the possibility for the Chair, or a member of the Supervisory Board, to participate in an exchange of views with national parliament committees. Article 21 also contemplates national parliamentarians addressing questions to the ECB.

¹¹ [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.](#)

¹² [Memorandum of Understanding between the Council of the European Union and the European Central Bank on the cooperation on procedures related to the Single Supervisory Mechanism \(SSM\).](#)

operational efficiency; it is reviewed by the European Commission; and it is subject to the Financial Sector Assessment Programmes of the International Monetary Fund (IMF) as well as peer reviews by the Financial Stability Board and the Basel Committee on Banking Supervision.

ECB Banking Supervision has made great efforts towards transparency in order to allow citizens, their elected representatives, banks and markets to understand and assess its supervisory policies. On 23 March 2016, the Chair and Vice-Chair of the Supervisory Board held their first annual press conference, explaining how the ECB carried out its supervision. Moreover, the ECB published the Supervisory Review and Evaluation Process (SREP) methodology booklet, disclosing its main supervision tool. This includes the methods applied and the indicators used to evaluate the riskiness of banks. The ECB also uses many other channels to enhance transparency on its supervisory policies, namely: quarterly newsletters, thematic reviews, guides, speeches, presentations, interviews, public consultations, public inquiries, workshops and direct interaction with banks.

3.2 Transparency enhances the effectiveness of banking supervision, but there are limits

These efforts not only enhance transparency but also help to improve the quality of supervision. This is because transparency with regard to the ECB's supervisory methods and expectations gives banks the necessary information on how policy decisions are made and thereby increases their effectiveness. A comprehensive analysis by the IMF has indeed found a positive correlation between the transparency of the supervisor and the effectiveness of banking supervision.¹³

There are nevertheless specific limits to transparency in banking supervision.

- Banking supervisors have to adhere to strict professional secrecy rules imposed by the legislator.¹⁴ Individual bank data are confidential and protected by EU law. The disclosure of such data to the public could go against the commercial interests of banks.
- Disclosing sensitive information can have an impact on financial stability,¹⁵ which is what banking supervisors seek to safeguard in the first place.

¹³ The paper also focuses on the relationship between the transparency of the banking supervisor and the quality of banking supervision. The results show that supervisors with good governance (indicated by high transparency standards) also tend to have good banking supervision (indicated by high compliance with the Basel Committee's Core Principles for Effective Banking Supervision).

¹⁴ See Article 27 of the SSM Regulation and Article 53ff. 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).

¹⁵ See Case C-140/13, *Altmann and Others v Bundesanstalt für Finanzdienstleistungsaufsicht*, ECLI:EU:C:2014:2362; and Case C-110/84, *Commune de Hillegom v Cornelis Hillenius*, ECLI:EU:C:1985:495.

- If proprietary information is shared with the public, banks could proactively make the sharing of information with supervisors more complicated. Supervisors would then need to invest additional efforts to acquire comprehensive data to exercise supervision. Moreover, the joint work between supervisors could be hampered. This is because the supervisor of a Member State could not be sure that the proprietary data it provides to a supervisor in another Member State would remain confidential.
- And finally, in the case of troubled banks, the supervisor must be able to prepare measures that restore the viability of a bank without the bank having to disclose them prematurely.

ECB Banking Supervision has managed, within these limits, to work with banks so that they disclose a harmonised and comparable dataset. Since December 2016 high quality aggregate data on the balance sheet composition, profitability, solvency and credit risk of supervised banks are published on a quarterly basis on the ECB's banking supervision website. This contributes to a level playing field in the euro area as it allows for a direct comparison to be made of all significant credit institutions across 19 Member States.

4 Conclusion

Central banks need to be transparent. Transparency not only enhances the democratic accountability of independent central banks, but also makes their policies more effective.

The ECB is responsible for both monetary policy and banking supervision. And whereas monetary policy has a narrowly defined mandate and its policy decisions do not have specific addressees, ECB Banking Supervision has a broadly defined mandate and its decisions are directly addressed to banks. This has implications for the ECB's specific transparency requirements in terms of both monetary policy and banking supervision.

Yet the general idea remains the same: the ECB as a public institution has to be subject to scrutiny by democratically elected institutions and, ultimately, the citizens of Europe. It is on their behalf that the ECB pursues the objectives of a stable currency and a stable banking sector.

Safeguarding central bank autonomy: the role of transparency and accountability

By Wouter Bossu, Sean Hagan¹ and Hans Weenink

1 Introduction

The Global Financial Crisis has had a significant impact on central banks. Following an unprecedented meltdown of financial institutions and markets from mid-2007 onwards, central banks of the affected countries were forced to undertake exceptional action, first during an “acute” phase to safeguard financial stability, and next to avoid deflation. Specifically, central banks have first engaged in significant lender-of-last resort operations with troubled banks and other financial institutions, and subsequently in exceptional monetary policy operations resulting in the purchase very high amounts of public debt and other public and private sector debt securities, which has led to a significant expansion of their balance sheets.

In several countries, these actions of central banks have come under intense scrutiny from politicians and opinion makers. Central banks have been criticized for providing, in breach of the orthodoxy of the so-called Bagehot doctrine, emergency liquidity assistance to insolvent financial institutions and for camouflaging often prohibited “monetary financing” of the State budget as “unconventional” monetary policy operations. In the Euro Area, the unconventional monetary policy of the ECB has even led to litigation in national and European courts.²

On the governance of central banks specifically, the Global Financial Crisis has had a twofold impact.³ In one direction, the powers of some central banks have been curbed in some respects through legislative reform and their governance has been

¹ General Counsel and Director of the Legal Department at the International Monetary Fund. The views expressed herein are those of the authors and do not necessarily represent the views of the IMF, its Executive Board, or its management.

² The legal authority for the ECB's 2012 press release announcing that it stood ready to implement Outright Monetary Transactions was challenged in the German Constitutional Court, as well as the EU Court of Justice. In Case C-62/14, *Gauweiler and others v German Parliament and Government*, the Court ruled that the ESCB Statute permits the ECB to adopt an Outright Monetary Transactions (OMT) program for the purchase of Government bonds in secondary markets. The Court ruled that the ECB has a clear price stability mandate. It added that OMT's objectives – i.e. to safeguard appropriate monetary policy transmission and the singleness of monetary policy in the euro area – were such that OMT can be qualified as a monetary policy measure falling within its price stability mandate.

³ See IMF WP/17/101, which compares central bank legislation of selected countries before and after the Global Financial Crisis, and highlights changes in financial stability mandates, decision-making structures, and accountability mechanisms.

(somewhat) reformed.⁴ In another direction, the “financial stability” powers of some central banks have actually been strengthened, in particular to provide the central bank with so-called macro-prudential (i.e. crisis prevention) and resolution (i.e. crisis management) powers.⁵ In this case too, however, the governance of those central bank functions was often modified so as to delineate decision-making responsibilities between the central bank and the government, often with a stronger involvement for the latter than in traditional central bank activities.⁶

In this context, the question arises how central banks can maintain appropriate levels of autonomy, both for their core monetary policy and lender-of-last resort functions and for their novel crisis prevention and management functions. This article takes the position that to underpin appropriate levels of autonomy, central banks need to embrace robust levels of transparency and accountability. In this respect, transparency and accountability should be seen as enhancing, not undermining, autonomy.

This article is structured as follows. A first section will (i) briefly recall the conceptual underpinnings of central bank autonomy, transparency and accountability, (ii) share how the IMF contributes to strengthening those important aspects of central banks, and (iii) discuss how the Global Financial Crisis and its fall-out are impacting the autonomy, transparency and accountability of central banks. A second section will discuss how these aspects come practically into play in the context of the Lender-of-Last-Resort (“LOLR”) function of central banks, and make a parallel with the IMF’s own LOLR function towards its sovereign members.

2 Central bank autonomy, transparency and accountability

2.1 A conceptual framework

2.1.1 Autonomy

From a policy perspective, it remains generally accepted that, to be effective in the performance of their monetary policy formulating function, central banks need to enjoy a high degree of autonomy.

⁴ This was for instance the case of the Federal Reserve, through the reform of Section 13 of the Federal Reserve Act, as well as the governance reforms imposed by the Dodd-Frank Act. Section 13(3) of the Federal Reserve Act now *inter alia* provides that (i) no loans can be made to single institutions – they must be part of a broad program approved by the Secretary of the Treasury, (ii) all nonbank loans must be approved by the Secretary of the Treasury, (iii) discount window loans to banks cannot be used to fund their nonbank affiliates.

⁵ In some countries (see e.g. the UK and Belgium), the function of micro-prudential supervision, which was previously lodged with a separate supervisory authority, was returned to the central bank.

⁶ In the EU, a macro-prudential framework was established by Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (ESRB). Per Art. 6.1 (c), a member of the European Commission sits at the General Board of the ESRB with voting rights.

- In regard of monetary policy, the fundamental conceptual argument (already formulated in the 19th century by David Ricardo) in favor of central bank autonomy is that politicians should not be entrusted with the creation of money, as the incentive will always be there to abuse this power in the pursuit of short term political interests. This idea has been supported by both econometric studies and “the experience that inflation correlates negatively” with the degree of central bank autonomy.⁷
- In regard of other, “financial stability” functions that may be entrusted to central banks (such as micro-prudential supervision and bank resolution), international standards highlight the importance of “operational” autonomy to ensure a high degree of effectiveness.⁸

2.1.2 Transparency and accountability

A high degree of autonomy can only be achieved through commensurate levels of accountability. When the State delegates authority to exercise what are essentially sovereign functions to a central bank and grants the latter to that effect a high level of autonomy, the central bank must be made accountable to ensure appropriate “checks and balances” and to minimize any abuse of powers by any of the parties involved. The accountability framework should thus ensure that an autonomous central bank uses its delegated authority effectively and efficiently in executing its functions to achieve its objectives (in particular price stability), and manages its resources in a thrifty way. An autonomous central bank is ultimately accountable to the general public, but from a legal perspective the law or constitutional traditions will typically establish a direct form of accountability to one or more political institutions (the Executive, an individual minister, and/or the Legislature. It should be clear to which arm of government the central bank is formally accountable to avoid dilution of responsibilities. In any event, a strong oversight body within the central bank, an effective external audit mechanism, and an appropriate role for the Judiciary contribute to effective accountability.

Transparency is a prerequisite for accountability. Central banks laws habitually include explicit transparency mechanisms, the most important one of which is the publication of annual and audited financial statements⁹ and, in many countries, the monthly publication of an (unaudited) balance sheet. The publication of an annual

⁷ Otmar Issing, The Mayekawa Lecture: Central Banks – Paradise Lost, Monetary and Economic Studies, November 2012, p. 64. See also Stanley Fischer, Central Bank independence; speech delivered at the 2015 Herbert Stein Memorial Lecture National Economists Club, Washington DC, 4 November 2015.

⁸ The Basel Committee on Banking Supervision’s Core Principle 2 for Effective Banking Supervision provides that supervisors should have operational independence. This means that there should not be any government or industry interference that compromises a supervisor’s operational independence. The supervisor must have full discretion to take any supervisory actions or decisions on banks under its supervision. In turn, Principle 2.5 of the Financial Stability Board (FSB)’s Key Attributes for Effective Resolution Regimes requires operational independence for resolution authorities, transparent processes and rigorous evaluation and accountability mechanisms. It adds that resolution authorities should have adequate resources to enable the operational capacity to implement resolution measures.

⁹ For the ECB, Art. 26.2 of the Statute requires publication of the annual financial statements.

report reflecting upon the state of the economy and the financial system, and reporting on the central banks' actions to achieve its objectives, is another often required transparency tool.

2.2 Role of the IMF

The IMF has since long formally recognized the critical interaction between these three concepts, notably in the IMF's Code of Good Practices on Transparency in Monetary and Financial Policies in 1999.¹⁰ The design of good transparency practices in the Code rests on two principles. First, monetary and financial policies can be made more effective if the public knows the goals and instruments of policy and if the authorities make a credible commitment to meeting them. Second, good governance calls for central banks and financial agencies to be accountable, particularly where the monetary and financial authorities are granted a high degree of autonomy. The Code stresses that a transparent mandate and clear rules and procedures strengthen central banks' governance and facilitate policy consistency. In addition, the Code highlights the following best practices:

- the need to publicly disclose the framework, instruments and any targets used to pursue the objectives of monetary policy;
- the central bank should issue periodic public statements on progress toward achieving its monetary policy objective as well as prospects for achieving them;
- officials of the central bank should be available to appear before a designated public authority (e.g. Parliamentary Committee on financial affairs) to report on the conduct of monetary policy, explain the policy objectives, describe their performance in achieving the objectives and exchange views on the state of the economy;
- the central bank should publicly disclose audited financial statements of its operations and;
- standards for the conduct of personal financial affairs of a central bank's officials and staff and conflict of interest rules should be public.

The Legal Department of the Fund plays a central role in operationalizing these requirements in various ways.

- First, in support of the Fund's Finance Department, we are involved in the implementation of the IMF's "safeguards assessment policy," which consists of a diagnostic review of a central bank's (i) external audit mechanism; (ii) legal structure and autonomy; (iii) financial reporting framework; (iv) internal audit mechanism; and (v) internal controls system. This safeguards policy is applicable to the central banks of all members borrowing from the Fund and its

¹⁰ <https://www.imf.org/external/np/mae/mft/code/index.htm>. The Code was adopted by the Interim Committee on September 26, 1999. See in particular paragraph 4 and the principles 2.1, 2.4, 4.1, 4.3 and 4.4.

main objective is to mitigate the risks of misuse of Fund resources and misreporting of program monetary data under Fund arrangements.¹¹

Safeguards assessments are organized around a central bank's good governance, primarily autonomy, transparency and accountability.¹² In the context of safeguards assessment, the Legal Department analyses the organic laws of the relevant central banks and formulates recommendations on how assessed weaknesses can be addressed.

- Secondly, when the weaknesses in a central bank's governance framework are considered critical under a Fund-supported program, implementing remedial action can be established in the form of conditionality under an IMF financial arrangement. The Legal Department often plays a central role in formulating the measure that qualifies as conditionality, in particular when it entails central bank law reform.¹³
- Thirdly, the Legal Department has an intensive program of technical assistance in respect of the reform of central bank legislation. This assistance aims to contribute to the development of a robust legal framework, and generally focuses on central bank governance, including autonomy, transparency and accountability arrangements. Often the technical assistance is provided in the context of a Fund-supported program, to aid the member country in implementing central bank law reform conditionality. Over the years, the Department has established a set of advisory practices aimed at ensuring that a central bank's autonomy, transparency and accountability is given a robust legal foundation in the organic legal framework of the central bank.

It would be fair to say that the efforts of the IMF to promote appropriate degrees of central bank autonomy, transparency and accountability, and their legal underpinnings, have borne fruit. Through a combination of safeguards assessments, conditionality and technical assistance, many countries have upgraded their central bank legal framework to align it with international good practices.

2.3 Impact of the Crisis

As discussed in the introduction, the Global Financial Crisis has in many instances had a very significant impact on the autonomy, transparency and accountability of the affected central banks. In regard of unconventional monetary policy, the legal frameworks of the relevant central banks have not yet been modified to legally curtail their autonomy, but a debate is raging on what will over time be the impact of the largely expanded balance sheets. Central banks' balance sheets have indeed become more and more exposed to economic risk and political pressure. Eventually,

¹¹ <http://www.imf.org/en/About/Factsheets/Sheets/2016/08/02/21/43/Protecting-IMF-Resources-Safeguards>

¹² See for example International Monetary Fund, Operational Guidelines for Safeguards Assessments, March 9, 2017.

¹³ In the recent past, the Fund-supported programs for the Ukraine, Tunisia, Pakistan, Honduras and Egypt, to name just a few, included central bank law reform conditionality.

this may result in a substantial amount of negative capital in a central bank's balance sheet.¹⁴ In case this would require governments to recapitalize their central banks, this could be used as an opportunity to modify central bank laws and curtail central bank autonomy, as was done in the 1930s and 40s to address central bank financial weakness flowing from the Great Depression and the Second World War.

In the context of the design of new legal frameworks for financial stability, we have seen the development of legal rules that depart from the traditional monetary policy-centric autonomy prescriptions. In discussing these new approaches, we will follow a well-established conceptual framework used by many institutions to analyze central bank autonomy:

- *Institutional autonomy*: Following this and previous financial crises, some advanced economies have adopted legislation authorizing the government to instruct the central bank to engage in liquidity provision (beyond traditional emergency liquidity assistance) to financial institutions when that is required to maintain financial stability.¹⁵ Such power to instruct the central bank departs from general prohibitions to give the central bank instructions, seen in many central bank laws (and, in particular, in Art. 7 of the Statutes of the ESCB and the ECB).
- *Functional autonomy*: While various central banks have been allocated special resolution powers for banks that are failing, or likely to fail, governments also have retained specific decision-making powers, as financial stability is in many countries ultimately a responsibility of the government and resolution of systemic firms may well require the deployment of public funds out of the budget.¹⁶
- *Personal autonomy*: As central bank laws create different decision-making bodies for monetary and financial sector policies, it is conceivable that they require different ratios between insiders and outsiders for monetary policy and financial policy committees.¹⁷ Combined with “lower” personal autonomy requirements (e.g. the absence of incompatibility requirements vis-à-vis

¹⁴ Klaas Knot, Central Bank Independence and Unconventional Monetary Policy: Challenges for the ECB, at dnb.nl.

¹⁵ Article 38 of the Bank of Japan Act reads as follows: “(1) The Prime Minister and the Minister of Finance may, when they find it especially necessary for the maintenance of stability of the financial system, such as in the case where they find that serious problems may arise in the maintenance of stability of the financial system (...) request the Bank of Japan to conduct the business necessary to maintain stability of the financial system, such as to provide loans to the financial institution pertaining to the said consultation. (2) When a request has been made from the Prime Minister and the Minister of Finance as prescribed in the preceding, the Bank of Japan may conduct the business necessary to maintain stability of the financial system, including the provision of loans under special conditions (...).” In the UK, Section 61 (“Treasury power of direction”) of the Financial Services Act 2012 provides that under certain circumstances the Treasury “may give a direction to the Bank of England relating to the provision by the Bank to one or more financial institutions of financial assistance other than ordinary market assistance offered by the Bank on its usual terms.”

¹⁶ For example, pursuant to Section 65(7) of the Financial Services Act 2012, HM Treasury and the Bank of England have concluded a Memorandum of Understanding which provides, *inter alia*, that HM Treasury must authorize the use of any stabilization measure which would have implications for public funds, as well as the exercise of the temporary public ownership option.

¹⁷ In the Monetary Policy Committee of the Bank of England, internal members have a 5 to 4 majority, whereas in the Financial Policy Committee only 6 of the 13 members are internal.

Treasury officials¹⁸), this could lead to a situation where the overall degree of autonomy of the financial policy committees is lower than those of monetary policy committees.

- *Financial autonomy*: While the general administrative budget of the central bank should be established by the central bank itself to safeguard monetary policy autonomy, it is understandable that the political bodies seek a say in the budget allocated to financial stability related functions such as micro- and macro-prudential policies. For example, in the Netherlands, while DNB's budget is approved by its Supervisory Board, it has a separate budget for its (i) micro-prudential, (ii) resolution and (iii) management of the DGS functions; this latter budget is approved by the Minister of Finance.

These lower levels of autonomy are understandable, given that in the vast majority of countries financial stability is ultimately a governmental responsibility that may require deployment of a broad array of policy measures as well as, ultimately, public funds. This being said, two important caveats must be made here. First, both for unconventional monetary policy and for the LOLR function of central banks, the current high levels of autonomy should be maintained, lest the central bank become vulnerable to pressures to create money for political expediency. Second, to safeguard sound decision-making even in the context of the new financial stability functions, it will also be critical to provide the central bank with the high degree of *operational* autonomy in execution of the policy decisions taken in conjunction with government. It is well understood that this may require the design of sophisticated decision-making structures and enhanced transparency and accountability.

In that regard, we can observe how central bank legal frameworks impose higher transparency and accountability requirements for the new financial stability functions of central banks.

- The ECB is a good case at hand. For instance, the SSM Regulation (Art. 29) requires that the ECB's expenditure for carrying out its supervisory tasks shall be separately identifiable within the budget of the ECB. As part of the financial report, the ECB is required to report in detail on the budget for its supervisory tasks. The annual accounts of the ECB include the income and expenses related to the supervisory tasks. Also, the ECB has entered into an Inter-Institutional Agreement with the European Parliament and a Memorandum of Understanding with the Council that sets out very specific accountability mechanisms in the context of the SSM.
- In Belgium, the governor of the central bank is by law required to inform the Lower House of Parliament annually on how the central bank has pursued its micro-prudential and macro-prudential functions.¹⁹

¹⁸ See in the UK Section 9B of the Bank of England Act 1998, which authorizes a Treasury representative to sit on the Financial Policy Committee.

¹⁹ Art. 4 of the Law of 25 April 2014 on the Macro-Prudential Function.

- In the UK, the Financial Policy Committee of the Bank of England must produce semi-annually a financial stability report, to be chaired with Treasury, which must in turn lay the said reports before Parliament.²⁰

In fact, even for unconventional monetary policy measures, some central banks and the ECB in particular, have been pressured to develop specific transparency tools. Following press reports and parliamentarians' questions regarding the Eurosystem's corporate bond buying program, the ECB has released various details of such purchases.²¹ Such transparency is important to demonstrate that the institution continues to comply with the principle of an open market economy with free competition,²² and does not inadvertently favor specific entities.

3 A case study: the Lender-of-Last-Resort function

3.1 The case of central banks

Since the 19th century, central banks have been acting as “bank of banks” and stood ready to act as “lender of last resort” to commercial banks, by providing the latter liquidity when the money market could not or no longer provide it. The aim is to support a viable bank (and thus confidence in banks in general), providing a breathing-space to restore normal functioning. Central banks have fulfilled this role both under the gold standard, when banknotes were convertible in specie, and in the era of fiat money. In various jurisdictions, the LOLR function is offered in the form of (i) a discount window/marginal lending type of facility for bilateral assistance to a small group of solvent counterparties²³, or (ii) alternatively to individual solvent banks which have lost access to market based funding.

Jurisdictions differ in the degree to which they provide legal underpinnings to this function. The “older” central banks (i.e. those established in the 19th and early 20th centuries) typically will not have explicit legal provisions in their organic laws on such emergency lending, often called “emergency liquidity assistance” or “ELA.” An important argument for not including specific statutory provisions on this function has been that this allows maintaining a policy of “constructive ambiguity” where under commercial banks are never certain that the central bank will actually provide emergency funding to a troubled bank, thus avoiding or at least minimizing “moral hazard” risk.²⁴ In contrast, many newer central banks, especially those established

²⁰ See Section 9W of the Bank of England Act 1998.

²¹ For example, the question by MEP Ernest Urtasun to the ECB for information on the methodology and eligibility criteria for its corporate bond purchases (question Z-000090/2016).

²² Article 2 of the Statute of the European System of Central Banks and of the European Central Bank.

²³ It is noted that during the Global Financial Crisis central banks such as the Bank of England widened LOLR access to include not only commercial banks, but also other systemically important financial institutions. Specifically, the Bank of England provided access to the largest broker-dealers subject to UK regulation and to central counterparties.

²⁴ The organic laws of those central banks often authorize the central bank generally to enter into credit and other financial operations with banks (and sometimes other financial institutions).

after the decolonization of the 1960s and the fall of the Soviet Union in the 1990s, do include provisions on emergency lending in their organic laws. In some of those countries, the law will specifically authorize the central bank to act as lender of last resort.²⁵ In others, the central bank law will include detailed and specific provisions that were inserted to avoid abuse of the LOLR functions by lending to insolvent commercial banks.²⁶ The latter is considered to be pernicious as it amounts to a quasi-fiscal activity, with negative monetary consequences including a deterioration of the central bank's balance sheet.

Irrespective of the legal approach, since Bagehot laid out his famous principles in the late 19th century,²⁷ it is indeed a broadly accepted doctrine that central banks should only provide emergency liquidity assistance to illiquid but fundamentally solvent banks. In many countries, especially those with relatively recent central banks, this principle has been included in central bank laws as part of the broader framework mentioned in the previous paragraph. Other aspects of emergency liquidity assistance that are often included in law are its temporary nature, the category of recipients (in some countries only banks, in others also other financial institutions), the requirement of some type of collateral, and a “punitive” interest rate.

As mentioned in the introduction, there is a broad perception among opinion makers that during the crisis central bank emergency liquidity assistance was provided to insolvent firms, which in some countries stretched beyond the central bank's legal authority to do so.²⁸ For example, the Federal Reserve's LOLR to non-banks (e.g. AIG) was politically seen as an undesirable bailout of Wall Street.²⁹ In Europe, the provision of ELA to individual banks in program countries also raised concerns.

In the future, how can this problem be avoided? One of the reasons why central banks have provided ELA to institutions whose viability was doubtful is the absence, at the time, of robust legal frameworks allowing for the orderly resolution of troubled financial institutions. In this regard, it is submitted that the creation of effective resolution frameworks following the FSB's Key Attributes for Effective Resolution Regimes—for example the Dodd-Frank Act in the US and the BRRD³⁰ in Europe—should reduce the risk of central banks providing LOLR to potentially unviable banks. But beyond this, the broader policy and legal framework for ELA also deserves some more attention, in particular to avoid that insolvent firms become beneficiaries.

Even with a robust bank resolution framework, it will not always be easy to make in practice the determination which troubled firm has liquidity problems and which firm

²⁵ See for instance Art. 7.3 of the Law on the National Bank of Ukraine.

²⁶ See for instance Art. 23 of the Law on the Central Bank of Burundi, Art. 5.2.d and Art. 38 of the law on the Central Bank of Armenia, and Art. 22 of the law on the National Bank of Macedonia.

²⁷ Bagehot, Lombard Street, 1873.

²⁸ Paul Tucker, Re-thinking the lender of last resort; BIS Papers No 79, September 2014, p. 11.

²⁹ Hal Scott, Connectedness and Contagion, 2016, p. 93.

³⁰ 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 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, p. 190.

is insolvent.³¹ While illiquidity is relatively straightforward to identify—by banks being unable to meet payments due—in crisis times illiquidity and solvency issues tend to become inextricably linked, making the assessment of solvency more difficult particularly when timelines are tight. There are three main reasons why the assessment of solvency can be difficult. *First*, in crisis times the mark-to-market value of financial assets can become extremely volatile, making the true assessment of solvency difficult. *Second*, the valuation of non-tradable assets (e.g., loans) and collateral (e.g., commercial property, or industrial inputs funded by short-term commercial bills) may lie beyond the central bank’s scope of expertise, and can be significantly impacted by macroeconomic or sociopolitical shocks. *Third*, the solvency assessments by supervisors or analysts might be biased. Supervisors may wish to avoid the reputational risk of identifying a case of insolvency ‘under their watch’ and the potential systemic consequences that could come with this.

Policy makers have pointed to the need to develop and publish ex ante a methodology for this triage and to be held accountable ex post on how the methodology was applied. Paul Tucker has made some very interesting proposals on the substance, governance and accountability framework for LOLR by an autonomous central bank.³² Some of the main principles are the following:

- It would be important to stress upfront the discretionary nature of LOLR so that banks do not have any right, nor expectation with respect to such support;
- banks could qualify for access to liquidity from the central bank provided that they are solvent and viable. LOLR should in principle be limited to supervised banks, albeit that it might be considered whether CCPs should also be included in the scope of institutions which might receive LOLR;
- no lending to fundamentally insolvent firms;
- the central bank should publish how it values collateral and sets haircuts;
- micro-prudential supervisors should advise, disclosing all relevant information, but not vote on the provision of LOLR (conflicts of interest).
- Particularly relevant from the perspective of this article is that Mr. Tucker advocates that (i) the central bank should publish *ex ante* a comprehensive account of its LOLR regime; and that (ii) the central bank should report to the legislature at least annually on the adequacy of the regime and, in general terms, on its operations.

In turn, Fund staff has contributed to this debate by listing methods that can be developed ex ante to triage solvent from insolvent firms.³³ The standard solvency assessment can form part of the central bank’s overall consideration. From an operational perspective, while compliance with regulatory ratios could be a starting

³¹ See Dobler M., Gray S., Murphy D. and Radzewicz-Bak B, *The Lender of Last Resort Function after the Global Financial Crisis*, IMF WP/16/10.

³² Paul Tucker, Re-thinking the lender of last resort; BIS Papers No 79, Annex on pp. 39 and 40.

³³ See Dobler M., Gray S., Murphy D. and Radzewicz-Bak B, o.c., pp. 19-20.

point, judgment could also include qualitative elements, such as the market's perception of the institution. The assessment of solvency can also be "dynamic" and here it is useful to distinguish between "a point in time" assessment, where the solvency of the institution is assessed at the time of the application for liquidity support—likely based on the most recent available supervisory data reports—and a "forward looking" assessment, where the expected solvency is assessed over the near-term. No matter the level of capital at the outset, there may be a risk that the institution will suffer continued losses and so become insolvent during the life of a potential liquidity support operation. Such concerns may arise from an assessment of the exposure of the entity to what may be or become an underperforming part of the economy in the near future. The assessment could also incorporate an examination of the entity's "viability", to provide confidence that the recipient will be able to repay the LOLR funds. A viability assessment is "business model"-focused, undertaken to determine that the entity can reasonably be expected to have continued potential for generating sufficient cash flow to repay the LOLR. A bank that has sufficient capital today but is expected to run losses for the foreseeable future would not be viable.

3.2 The IMF experience: transparency and debt sustainability

The Fund's own experience in the area of sovereign debt is illustrative of the benefits of transparency. As a condition for Fund financing, a member country must adopt a program of adjustment that will resolve the underlying problems that give rise to the need for Fund assistance. In circumstances where the member country's debt level is considered sustainable, the program will envisage the member repaying its creditors under the original terms. However, where the debt is judged to be unsustainable, a debt restructuring will normally be required since, in these circumstances, a program of adjustment, on its own, will not be sufficient to resolve the member's underlying problems.

As with the distinction between "illiquidity" and "insolvency" in the bank context, making a determination as to whether a sovereign's debt is sustainable or unsustainable is very judgmental. Nevertheless, the Fund has developed a conceptual and operational framework that it uses for making this distinction—generally referred to as "Debt Sustainability Analysis in Market Access Countries".³⁴ As is set forth in the published guidance note that explains the framework (the "Guidance Note"):

- In general terms, public debt can be considered sustainable when the primary balance needed to at least stabilize debt under both the baseline and the realistic shock scenarios is economically and politically feasible, such that the level of debt is consistent with an acceptable level of rollover risk and with preserving potential growth at a satisfactory level. Conversely, if no realistic adjustment in the primary balance—i.e. one that is both economically and

³⁴ <https://www.imf.org/external/pubs/ft/dsa/mac.htm>

politically feasible—can bring down debt to below such a level, public debt would be considered unsustainable.

- In practice, assessing debt sustainability for market access countries involves probabilistic judgments about the trajectory of debt and the availability of financing on favorable terms. In making such an assessment, there are several important considerations: (i) are debt burden indicators projected, at a minimum, to stabilize at levels consistent with an acceptable rollover risk with preserving growth at a satisfactory level, taking into account cyclical considerations, not only in the baseline scenario but also under plausible stressed scenarios, (ii) are the level and trajectory of debt burden indicators underpinned by realistic projections for primary balance adjustment, (iii) are the assumptions for other key macroeconomic variables (e.g. growth and interest rates) realistic, and (iv) is the debt profile well balanced in terms of maturity, currency composition and investor base so as to facilitate continued market access.

Having laid out the above conceptual framework for making assessments regarding debt sustainability, the Guidance Note identifies a number of tools—debt thresholds and other indicators—that are to be used to make these assessments. These tools are only used as inputs into the decision-making process: judgments are still made on a case-by-case basis. Nevertheless, the Debt Sustainability Framework imposes discipline on the Fund’s analytical work when it makes assessments either in the context of programs or in the context of its annual surveillance exercise. Importantly, the result of the application of the Debt Sustainability Framework is published in the form of a “Heat Map” in the surveillance reports for each country. Clearly, this publication provides an important form of accountability since it is possible to assess the Fund decisions—including its lending decisions—against the judgments reflected in the Heat Map for the country in question.

4 Conclusion

The Global Financial Crisis has had a significant impact on the affected central banks. Their LOLR and unconventional monetary policy operations have raised important questions on their autonomy. This has translated in legal frameworks that, especially in regard of new financial stability functions, have anchored the central banks’ decision-making and operations into a broader framework of governmental action. While this course of action is understandable, it will going forward be imperative to maintain the pre-crisis high levels of autonomy in respect of the central bank’s monetary policy and LOLR functions, as well as robust levels of operational autonomy in executing financial stability policy. To achieve this, central banks will need to stand ready to operate under higher levels of ex ante transparency and ex post accountability, as illustrated by the case study of the LOLR functions of central banks and the IMF. Primary and secondary legal frameworks will be important tools to establish and operationalize such transparency and ex post accountability mechanisms.

Liability and accountability for policies announced to the public and for press releases

By Alexander Türk¹

1 Introduction

This chapter discusses the liability of the European Central Bank (ECB) in the European Union courts for policies announced to the public and for press releases in the pursuit of its monetary policy objectives. “Liability” can have different meanings. It can be understood in a political sense of responsibility or accountability. In a legal sense, it could have a narrow meaning of liability for damages in compensation claims. In this chapter liability will be discussed in a wider sense by looking at the legal triggers for the ECB’s accountability in a judicial forum. It can be observed that there are a wide variety of mechanisms to trigger the ECB’s liability in the Union courts, but that the thresholds of these triggers vary considerably and remain in some important respects unclear in the case-law, and that their relationship is not yet fully determined. The aim of this chapter is to offer a conceptual framework that will provide greater clarity in this respect. On the basis of this framework this chapter will argue that the ECB should be subject to the same legal standards of “liability” as other Union institutions. This is justified on the ground that the ECB’s “regulation by information” in the form of press releases and policy announcements has considerable impact on the Union’s legal order and third parties.

2 General liability of the ECB

The exercise of public authority in whatever form has to be subject to judicial control to ensure the observance of the rule of law. The Union courts thereby have been given the important role of enforcing the obligation and responsibility of EU institutions, bodies and agencies to act in accordance with Union law. This form of ex post accountability is intended to guarantee effective judicial protection.

The trigger for enforcing compliance with this obligation or responsibility (“liability”) can, however, take different forms, such as annulment proceedings under Article 263 TFEU, failure to act under Article 265 TFEU, indirect validity reviews under Articles 277 and 267 TFEU, and compensation claims under Article 340 TFEU. Each of these judicial avenues has, however, its own criteria raising the question as to the predictability of such actions and their mutual relationship.

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3 Reviewable acts under Article 263 TFEU

The main avenue for judicial review is Article 263 TFEU, which stipulates that the Court shall review legislative acts and acts of the Council of the EU, European Commission and ECB “other than recommendations and opinions”. On the other hand, the Court shall review acts of the European Parliament and European Council, as well as those of Union bodies, offices or agencies “intended to produce legal effects vis-à-vis third parties”. This raises the question as to whether the drafters wanted to make a legally relevant distinction between the two categories resulting in different notions of a reviewable act. While the difference in wording might suggest a difference in meaning,² it is more plausible that the drafters, without intending to alter the scope of reviewable acts, wanted to make the point that acts of the European Parliament, the European Council, and EU agencies often lack external effects. An intended difference in meaning would be difficult to reconcile with the case law of the Court, which employs a standard definition of acts capable of review³ interchangeably for both categories.⁴

The Court has from the beginning refused to reduce the notion of reviewable act to the forms of legally binding acts provided for in Article 288 TFEU⁵ and has opted instead for a substantive approach. The definition of a reviewable act was developed in the *ERTA* case, where the Court held that an action for annulment is available against “all measures adopted by the institutions, whatever their nature or form, which are intended to have legal effects”.⁶ In *IBM* the Court found that such legal effects occur, when the measure is “binding on, and capable of affecting the interests of, the applicant by bringing about a distinct change in his legal position”.⁷

The *ERTA* definition places emphasis on the substance of an act and not its form.⁸ The scope of reviewable acts is therefore considerably wider than the formal instruments laid down in Article 288 TFEU and includes “conclusions” by the Member States adopted in Council for negotiations concerning an international agreement,⁹ a letter written by Commission staff,¹⁰ a “communication” by a European agency,¹¹

² It is not inconceivable that the notion of “acts other than recommendations and opinions” would result in a narrower scope of reviewable act encompassing only legally binding acts, whereas the notion of “acts intended to produce legal effects vis-à-vis third parties” are given a wider scope, including measures that produce external legal effects without being binding.

³ The Court generally uses the notion of “acts open to challenge” or in the French version “actes attaquables”.

⁴ See Case C-261/13 P, *Schoenberger v EP*, EU:C:2014:2423, at para. 13; Case T-673/13, *European Coalition to End Animal Experiments v ECHA*, EU:T:2015:167, para. 22.

⁵ Previously Article 249 EC and Article 189 EEC.

⁶ Case 22/70, *Commission v Council*, EU:C:1971:32, para. 42.

⁷ Case 60/81, *IBM v Commission*, EU:C:1981:264, para. 9.

⁸ *ibid.*, para. 9. This also means that formal defects in the act, such as the absence of its proper identification by its author as decision, the lack of legal basis, the lack of notification, are irrelevant for the determination of the act as reviewable. See Case C-322/09 P, *NDSHT v Commission*, EU:C:2010:701, para. 47.

⁹ Case 22/70, *Commission v Council*.

¹⁰ See Case T-84/97, *BEUC v Commission*, EU:T:1998:81, para. 48; Case T-113/00, *DuPont and others v Commission*, EU:T:2002:214, para. 45; Case C-322/09 P, *NDSHT v Commission*, para. 60.

¹¹ Case C-402/11 P, *Jager & Polacek v OHIM*, EU:C:2012:649, at para. 70.

provisions in a “Policy Framework”,¹² and even oral decisions.¹³ The underlying concern of the Court is that an assessment purely based on the form of the act would allow the author of the act to avoid judicial review by choosing an atypical form for its actions.¹⁴ Conversely though, not every formal act contains sufficiently binding content to be reviewable.

A substantive assessment begs, however, the question as to which criteria should be applied to determine the reviewability of an act. This issue arose in the recent case of *United Kingdom v European Central Bank*.¹⁵ In this case the United Kingdom argued that the ECB’s document entitled “Eurosysteem Oversight Policy Framework”, in which the ECB imposed a requirement for central counterparties providing clearing services for euro-denominated securities beyond certain thresholds to be located within the euro area, was a reviewable act in the meaning of Article 263 TFEU. The ECB argued that formally the document did not fall within one of the categories of binding acts which the ECB can adopt, that the act had no binding legal effects, and that it merely restated existing policy. The first argument, based on the form of the measure, was clearly at odds with established case-law¹⁶ and was consequently dismissed by the General Court (GC) without further debate. The second argument, that the act had no legal effects, required the GC to elaborate more clearly on the criteria and the perspective to be employed for assessing the reviewable nature of an act. The GC made it clear that the relevant criteria to be applied were the wording and context, as well as the substance of the act, but also the intention of its author.¹⁷ The examination of wording and context, argued the GC, would enable “the way in which the parties concerned could reasonably have perceived that act to be assessed”.¹⁸ This indicates that for wording and context of an act the perspective of a reasonable addressee mattered more than the subjective view of the author of an act. From this perspective it had to be found whether the parties could have concluded that the act merely proposed a course of conduct or whether instead the act was meant to require compliance. In this respect the GC made it clear that publication was a necessary, but not sufficient precondition for the binding nature of an act.¹⁹ As regards the wording of the document, the GC pointed out that

¹² Case T-496/11, *UK v ECB*, EU:T:2015:133.

¹³ See Joined Cases 316/82 and 40/83, *Kohler v Court of Auditors*, EU:C:1984:49, paras. 9-13; Case T-3/93, *Air France v Commission*, EU:T:1994:36, paras. 57-59; Case T-85/03, *Government of the Cayman Islands v Commission*, EU:T:2003:83, para. 60.

¹⁴ Case T-496/11, *United Kingdom v ECB*, para. 30.

¹⁵ *ibid.*

¹⁶ See however the ambiguous statement of the Court in Joined Cases C-463/10 P and C-475/10 P, *Deutsche Post and Germany v Commission*, EU:C:2011:656, para. 44, where the Court argued that because Union legislation had chosen the form of a decision for an information injunction, the act had to be understood as decision in the meaning of Article 288 TFEU. This formal approach is seemingly at odds with an otherwise overwhelmingly substantive assessment of measures challenged before the Union courts.

¹⁷ Case T-496/11, *United Kingdom v ECB*, para. 31. See also Case C-362/08 P, *Internationaler Hilfsfond v Commission*, EU:C:2010:40, para. 52; Case T-369/08, *EWRIA and Others v Commission*, EU:T:2010:549, para. 34. For the criteria applied to determine a data management measure as reviewable act, see Case T-320/09, *Planet v Commission*, EU:T:2015:223, para. 39.

¹⁸ Case T-496/11, *United Kingdom v ECB*, para. 32.

¹⁹ *ibid.*, para. 33. The GC made it clear that while publication as such was not decisive, the absence of publication could be indicator for a purely internal act. See also Case C-322/09 P, *NDSHT v Commission*, para. 47, where the Court held that the fact that the MS in issue was not notified was irrelevant for the assessment of the nature of the act.

descriptive language did not rule out that the content could be perceived as mandatory. In this respect the GC regarded the statement in the policy framework about the location requirement to be mandatory, as the wording was “particularly specific, facilitating application”.²⁰ The GC then assessed the differing perception of the wording and context of the document by its various addressees. While it acknowledged that the document could not be understood as requiring central counterparties outside the euro area to cease their activities, the GC pointed out that one also needed to consider “the perception of the Policy Framework on the part of the euro area Member States’ regulatory authorities, which are liable, in the exercise of their powers, to impede clearing services activity carried out by CCPs situated outside the euro area”.²¹ As regards the substance of the document, the General Court held that the location requirement amounted to the addition of a new rule in the legal order, not contained in any previous legal provision.²² And finally, in respect of the intention of the author, the GC found that the location policy was not merely a hypothetical statement, but, given its particularly specific nature, set out the definitive position of the ECB.²³

While a substantive, rather than formal, assessment widens the scope of reviewable acts to include policies announced to the public and for press releases by the ECB, the requirement that the measure must affect the applicant’s “legal position” seems to considerably limit access to the Union courts. Recent case-law clarified, however, that the Union courts apply this requirement only to the addressee of a measure, but not third parties. This was made clear by the Court in *Deutsche Post*.²⁴ In this case the Court on appeal had to review an order of the General Court, which had ruled that a Commission decision under Article 10(3) of Regulation 659/1999 requiring Germany to provide information in case of State aid to Deutsche Post could not be considered as a reviewable act for Deutsche Post, as it did not bring about a distinct change in its legal position. The Court pointed out that the requirement of a distinct change in the applicant’s position “was developed in the context of actions brought before the EU judicature by natural or legal persons against measures of which they were the addressees”.²⁵ The Court noted that in case of a third party this requirement overlapped with the requirement of direct concern, which was part of the standing assessment under Article 263(4) TFEU. In case of measures which were not addressed to the applicant a reviewable act therefore existed where the act “is intended to produce binding legal effects”²⁶, in this case for Germany, even if it did

²⁰ *ibid.*, para. 39. Compare with Case T-22/07, *US Steel Košice v Slovak Republic*, EU:T:2009:158, para. 47, where the General Court, made the point that the more categorical formulations of the Commission’s measure had to be assessed in their proper context and found them to be purely informative and hence not reviewable. The classification of an act as reviewable often hinges on the legal context in which it was adopted, see Case C-402/11 P, *Jager & Polacek v OHIM*, paras. 48-53; Case C-322/09 P, *NDSHT v Commission*, paras. 49-58.

²¹ *ibid.*, para. 42.

²² *ibid.*, para. 51.

²³ *ibid.*, para. 53. In Case T-22/07, *US Steel Košice v Slovak Republic*, paras. 44-46, the General Court made the point that the measures represented an opinion of the services of the Commission, but were not authorised by the Commission itself. In light of the judgments in Case C-322/09 P, *NDSHT v Commission*, and Case C-402/11 P, *Jager & Polacek v OHIM*, this seems however doubtful authority.

²⁴ Joined Cases C-463/10 P and C-475/10 P, *Deutsche Post and Germany v Commission*.

²⁵ *ibid.*, para. 38.

²⁶ *ibid.*, para. 45.

not produce such effects for the applicant. This clarification, or perhaps better change, in the case-law is welcome as it clarifies the previously unclear relationship of the concept of reviewable act with that of direct concern and thereby aligns the position of natural and legal persons with that of Member States as privileged applicants.²⁷ Moreover, the Court's approach also resolves a number of inconsistencies in the previous case-law in relation to triangular situations in funding,²⁸ State aid²⁹ and merger³⁰ cases.³¹

Two further issues require clarification. First, it might be conceivable that an act is legally binding but does not, or perhaps not itself, change anyone's legal position. A second, distinct, question is under what circumstances an act can be considered as changing someone's legal position. It is clear from the case-law that it is a necessary requirement for an act to be regarded as reviewable that it produces binding legal effects.³² In *Srinivasan*³³ the GC considered an action against a decision of the European Ombudsman to take no further action on the applicant's position as inadmissible on the ground that it lacked legal effects given that "the Ombudsman does not have the power to take binding measures".³⁴ Conversely, such binding legal effects were held in *Deutsche Post* to occur where the Commission issued a request for information under Article 10(3) of Regulation 659/1999. The Court argued that the act was reviewable, as such requests have to be made by "decision", which according to Article 288 TFEU is legally binding for its addressee.³⁵ If, as the Union courts have consistently argued, it is the substance of an act and not its form that determines the binding nature of an act, then the Court's argument is insufficient. Rather it seems necessary to establish in what way such an information injunction alters the Member State's legal position, in particular, as the Court conceded in this case, since non-compliance does not result in any sanctions. The Court's suggestion that such a "decision" could lead to an infringement procedure under Article 258

²⁷ Case T-154/10, *France v Commission*, EU:T:2012:452, para. 37. But compare with Case T-37/11, *Hungary v Commission*, EU:T:2012:310, paras. 33-34.

²⁸ Compare Case 126/83, *STS Consorzio per Sistemi di Telecomunicazione via Satellite v Commission* EU:C:1984:257, para. 18, and Case T-185/94, *Geotronics v Commission*, EU:T:1995:184, para. 32, with the appeal in Case C-395/95 P, *Geotronics v Commission*, EU:C:1997:210, para. 14, setting aside the judgment of the General Court in Case T-185/94, *Geotronics v Commission*. These cases concerned the question as to whether a funding decision by the Commission concerned the legal position of a third party applicants or merely affected the relationship between the Commission and the state disbursing the funds to the applicants.

²⁹ Compare Case T-9/98, *Mitteldeutsche Erdoel-Raffinerie v Commission*, EU:T:2001:271, para. 52, with Case 169/84, *Cofaz and others v Commission*, EU:C:1990:301, para. 13. In the latter case it seemed to have been doubtful as to whether the applicant as competitor of the beneficiary was affected in its legal position by a Commission decision on State aid by a Member State.

³⁰ Case T-2/93, *Air France v Commission*, EU:T:1994:55, paras. 40-48, and Case T-114/02, *BaByliss v Commission*, EU:T:2003:100, para. 89 with a reference to Case T-2/93, *Air France v Commission*, para. 80. See also Case T-158/00, *ARD v Commission*, EU:T:2003:246, para. 60. In these cases the third parties seemed to have been concerned merely in their economic position, but not in their legal position.

³¹ For a more detailed discussion of these inconsistencies, see Türk A. (2009), *Judicial Review in EU Law*, Elgar Publishing, pp. 37-40.

³² In this sense Joined Cases C-463/10 P and C-475/10 P, *Deutsche Post and Germany v Commission*; Case T-673/13, *European Coalition to End Animal Experiments v ECHA*, EU:T:2015:167.

³³ Case T-196/08, *Srinivasan v European Ombudsman*, EU:T:2008:470.

³⁴ *ibid.*, para. 11. See also Case T-327/13, *Mallis and Malli v Commission and European Central Bank*, EU:T:2014:909, para. 53, where the General Court held that the Euro Group is not empowered to adopt legally binding decisions.

³⁵ Joined Cases C-463/10 P and C-475/10 P, *Deutsche Post and Germany v Commission*, paras. 43-45.

TFEU in case of non-compliance is circular, as in this case the act would have to be legally binding. Similarly unconvincing is the Court's assertion that an information injunction under Article 10(3) of Regulation 659/1999 is similar to that under Article 18(3) of Regulation 1/2003. While non-compliance in case of Regulation 18(3) can be sanctioned with severe fines and penalty payments, non-compliance with Article 10(3) merely means, according to Article 13(1) of Regulation 659/1999, that the Commission can decide the case based on the available information. While an information injunction can therefore be regarded as having legal effects, those set out in Article 13(1), it is difficult to see how the act itself is capable of altering the legal position of a Member State.

In the absence of a clear conceptual framework for the determination of legally binding effects in the case-law it is difficult to predict with any certainty as to when Union acts are considered as reviewable. Conceptual clarity is therefore not only of theoretical interest, but also a practical necessity if the Union courts do not want to risk shrouding the notion of reviewable act in obscurity. The following is an attempt to provide such a framework.

A person's legal position consists of rights and obligations created within a legal system. Any legally binding alteration of a person's rights and obligations constitutes therefore a change in a person's legal position.³⁶ Legal obligations could be defined as duties to do something or refrain from doing something, which are enforceable in a court of law. It is suggested that a distinction be made between measures that (i) produce primary legal effects, (ii) only have secondary legal effects, and (iii) do not entail any legal effects at all.

Primary legal effects encapsulate binding legal effects that arise either directly or indirectly from an act by imposing obligations on and/or by determining rights of a person. Binding legal effects arise directly, where an act itself imposes new or modifies existing legal obligations. Such direct obligations can result for example from a Commission act ordering the Member State to recover aid declared incompatible with the internal market,³⁷ an exemption from anti-dumping duties in amended provisional or definitive anti-dumping Regulations,³⁸ the determination of a Member State penalty in infringement cases,³⁹ a final report concerning the Schengen facility for aid in Hungary imposing a payment obligation,⁴⁰ an ECB Policy Framework imposing a requirement for central counterparties providing clearing services for euro-denominated securities beyond certain thresholds to be located within the euro area,⁴¹ or an obligation to carry out animal tests imposed by ECHA.⁴² Similarly, primary legal effects can occur on the basis of a determination of a right, such as the grant of a right, its modification or its denial. Examples of direct determinations in the form of an authoritative determination of a right by the

³⁶ An act that is not legally binding can therefore not lead to a change in a person's legal position.

³⁷ See the Commission decision in Case C-274/12, *Telefónica v Commission*, EU:C:2013:852.

³⁸ Case T-507/13, *SolarWorld and Others v Commission*, EU:T:2015:23, para. 48.

³⁹ Case T-33/09, *Portugal v Commission*, EU:T:2011:127, para. 64.

⁴⁰ Case T-37/11, *Hungary v Commission*, EU:T:2012:310, para. 41.

⁴¹ Case T-496/11, *United Kingdom v European Central Bank*, para. 54.

⁴² Case T-673/13, *European Coalition to End Animal Experiments v ECHA*, EU:T:2015:167, para. 43.

competent authority are the act to consider aid granted by a Member State incompatible with the internal market,⁴³ or the rejection by the Commission of the initiation of a partial interim review in anti-dumping cases,⁴⁴ or the rejection of a petition by the European Parliament.⁴⁵

On the other hand, binding legal effects arise indirectly, where an act triggers obligations, which have their sources in other rules or principles of the legal system. An example for an indirect obligation would be the initiation by the Commission of the formal investigation procedure in State aid cases. The formal initiation of the State aid procedure concerning aid, which has been classified as new aid and has not yet been implemented, imposes certain obligations on the Member State to suspend the application of the measure, but also on the national courts, which must draw the necessary consequences from an infringement of Article 108(3) TFEU.⁴⁶ It is clear that in particular the obligation on the national court does not arise from the act initiating the formal procedure, but from the duty of sincere co-operation laid down in Article 4(3) TEU.⁴⁷ Similarly, the classification of a measure as aid in State aid cases does not impose itself any obligations, but triggers, even where it declares the aid compatible with the internal market, the obligations set out in Articles 17-19 of Regulation 659/1999.⁴⁸ Another example of an indirect obligation can be seen in the request by OLAF to register an entity in an Early Warning System set up by the Commission.⁴⁹ The entry of a warning as such is merely a factual act, but it triggers obligations for the authorising officer, in case of such a warning being entered, to adopt reinforced monitoring measures against the registered entity.⁵⁰ In turn, the affected entity bidding for EU funding has to comply with the conditions imposed on it by the authorising officer.⁵¹ An indirect obligation also results from the act identifying a substance as a result of the procedure set out in Article 59 of the ECHA Regulation.⁵² While the act itself is merely a factual determination, it triggers information obligations laid down in other provisions of the ECHA Regulation.⁵³ The determination of rights can however also be indirect. The closing of a file in State aid proceedings, as such merely a factual act, has as a consequence that the participation rights laid down in Article 108(3) TFEU will not be granted.⁵⁴ Also, the communication on the admissibility of the opposition procedure in trademark cases

⁴³ See Case T-154/10, *France v Commission*, EU:T:2012:452, para. 40.

⁴⁴ Case T-369/06, *EWRIA and Others v Commission*, EU:T:2009:319, para. 43.

⁴⁵ Case C-261/13 P, *Peter Schönberger v European Parliament*, para. 22.

⁴⁶ Case T-332/06, *Alcoa Trasformazioni v Commission*, EU:T:2009:79, para. 36. See also Case T-251/13, *Gemeente Nijmegen v Commission*, EU:T:2015:142, paras. 30 and 32.

⁴⁷ See Case C-284/12, *Deutsche Lufthansa*, EU:C:2013:755, para. 41.

⁴⁸ Case C-279/08 P, *Commission v Netherlands*, EU:C:2011:551, para. 40-42.

⁴⁹ See Commission Decision of 16 December 2008 on the Early Warning System for the use of authorising officers of the Commission and the executive agencies, OJ L 344/125 of 20 December 2008.

⁵⁰ These obligations result from Articles 15 to 17 and 19 to 22 of Decision 2008/969, [2008] OJ 344/125.

⁵¹ Case T-320/09, *Planet AE v Commission*, EU:T:2015:223, para. 48.

⁵² Regulation (EC) No 1907/2006 of 18 December 2006 concerning the Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH), establishing a European Chemicals Agency, [2006] OJ L 353/1.

⁵³ See Case T-94/10, *Rütgers and Others v European Chemicals Agency*, EU:T:2013:107, para. 33.

⁵⁴ Case C-322/09 P, *NDSHT v Commission*, para. 52.

has as a legal consequence that the procedure is terminated and the applicant is denied any participation rights in the procedure.⁵⁵

The second category of legal effects, namely the measures that only have secondary legal effects, brings about legal changes in a legal system where a primary act provides the basis for a subsequent act, which produces legally binding effects. An example would be the initiation by the Commission of the formal investigation procedure in State aid cases, where the aid has already been implemented, as in the case examined by the General Court in *Gemeente Nijmegen*.⁵⁶ While not imposing any obligations, directly or indirectly, or determining any rights, such a measure can be the basis for a decision by a national court.⁵⁷ It is apparent that such legal effects do not occur because of the legally binding nature of the primary act. Instead, the primary act constitutes an enabling provision for such secondary action. The General Court in *Gemeente Nijmegen* found the Commission act not to be reviewable. This contrasts with the Court's ruling in *Deutsche Post*, discussed above, which also falls into this category. In this case, the information injunction under Article 10(3) of Regulation 659/1999 seems to have merely secondary legal effects. First, even if we accept the rather circular argument that the Commission may bring an action under Article 258 TFEU, the injunction does not impose an obligation on the Commission to do so. Second, an information injunction is not enforceable in a court of law, but rather allows the Commission to decide the case on the basis of the available information.⁵⁸ This is even a weak version of secondary effects, as the injunction is not an enabling provision, in that it does not provide the basis for a final decision. Its legal effect consists rather in the fact that it allows the Commission to make a decision without breaching its duty of careful examination. But any argument that the injunction has binding legal effects seems difficult to sustain, making the ruling in *Deutsche Post* questionable. In this category one can also place the OMT programme in issue in *von Storch*.⁵⁹ The action concerned the review of decisions of the ECB of 6 September 2012, which approved a number of technical features regarding the Eurosystem's outright transactions in secondary sovereign bond markets and additional measures to preserve collateral availability in order to maintain the access of counterparties to the Eurosystem's liquidity-providing operations. These decisions were announced in a press conference and a subsequent press release which was published on the ECB's website. The General Court held that the measures did not directly concern the applicants. The OMT decision required further implementing measures to take effect. The General Court left it expressly open whether the measures in issue had binding legal effects and were thus reviewable. Any adverse consequences of the decision affected the applicants' factual, but not legal, position. A different view of the legal effects of the OMT decision was taken by AG Villalón in the *Gauweiler* case.⁶⁰ As part of his assessment of whether the decision constituted an act subject to validity review

⁵⁵ Case C-402/11 P, *Jager & Polacek v OHIM*, para. 53.

⁵⁶ Case T-251/13, *Gemeente Nijmegen v Commission*, EU:T:2015:142.

⁵⁷ *ibid.*, paras. 37 and 44-46.

⁵⁸ See Article 13(1) of Regulation 659/1999.

⁵⁹ Case T-492/12, *von Storch and others v ECB*, EU:T:2013:702.

⁶⁰ Case C-62/14, *Gauweiler and Others v Deutscher Bundestag*, EU:C:2015:400.

under Article 267 TFEU, the AG found that the announcement had significant impact on the market.⁶¹ On the other hand, elsewhere in his Opinion the AG suggested that the OMT programme is capable of having “a decisive impact on the legal situation of third parties”,⁶² but it is not clear from the opinion how the programme does that. It is difficult to see to what extent the programme directly imposes any obligations or determines any rights. This does, however, not mean that the programme is without legal effects. The OMT programme did have legal effects in that it assumed that it was part of the ECB’s monetary policy (an exclusive competence of the Union). If the ECB is right to adopt such programmes, then this has (secondary) legal effects for Member States, since the announcement sets out general criteria, which would have constituted the basis for actual market interventions. The impact of the measure therefore lies in its (potential) impact on the legally protected sphere of the Member States and therefore the vertical allocation of competences.

The third and final category of acts comprises those that do not entail any legal effects at all. This can be difficult to determine in individual cases, as the case-law demonstrates. A Commission decision to accept undertakings in anti-dumping cases was held not to have any legal effects, which only result from provisions in amended provisional or definitive anti-dumping duties.⁶³ Similarly, the Court found that only the final report concerning the account of the Schengen facility for aid in Hungary, but not the invoice which followed it, had binding legal effects.⁶⁴ Also, a Commission opinion on the interpretation of a provision in an Annex to the Act of Accession 2003⁶⁵ did not constitute a legally binding act.⁶⁶ More controversially, a rejection by the European Parliament on the merits of a petition was considered to be without legal effects, as it was essentially of a political nature.⁶⁷

An act can have more than one legal effect. The objection of the Council against a Commission proposal under Article 5(6) of Comitology Decision 1999/468⁶⁸ imposes on the Commission the obligation to re-examine the act. This obligation is indirect, as it does not follow from the objection itself, but from the legal consequences which Article 5(6) attaches to it. At the same time, such an objection can also have as legal consequence the determination of a person’s right, as was the case in *Makhteshim-Agan*.⁶⁹ The objection had here as legal consequence that the person’s application for the inclusion of an active plant protection substance was rejected. The legal consequence did not follow directly from the objection itself or even any provision of

⁶¹ *ibid.*, para. 84.

⁶² *ibid.*, para. 76.

⁶³ Case T-507/13, *SolarWorld and Others v Commission*, para. 48.

⁶⁴ Case T-37/11, *Hungary v Commission*, paras. 41-43. See also Case T-42/13, 1. *garantovaná v Commission*, EU:T:2013:621, para. 27. But see Case T-275/94, *Groupement des Cartes Bancaires v Commission*, EU:T:1995:141, para. 32.

⁶⁵ [2003] OJ L 236/33.

⁶⁶ Case T-22/07, *US Steel Košice v Slovak Republic*, EU:T:2009:158, para. 47.

⁶⁷ Case C-261/13 P, *Peter Schönberger v European Parliament*, para. 24.

⁶⁸ [1999] OJ L 184/23, as amended by Council Decision 2006/512, [2006] OJ L 200/11.

⁶⁹ Case T-393/06, *Makhteshim-Agan and Others v Commission*, order of 26 November 2008, [2008] ECR II-293.

the Comitology Decision, but was the result of the procedure for inclusion in Article 8(2) of Directive 94/414.⁷⁰

Given that Article 263 TFEU is based on the premise that only binding legal acts, whatever their form, are reviewable, acts having primary, but not secondary, legal effects should be regarded as reviewable acts under Article 263 TFEU. This means that policy announcements and press releases are reviewable, where, as in the case of the “Policy Framework” in *United Kingdom v ECB*, they have primary legal effects. In contrast, the OMT programme in issue in *von Storch* is not reviewable under Article 263 TFEU, as it can be considered to have only secondary legal effects.

4 Acts subject to validity review under Articles 277 and 267 TFEU

The EU system of judicial remedies provides that EU measures can be challenged not only directly on the basis of Article 263 TFEU, but also indirectly by way of preliminary reference of a national court requesting the review of the validity of a Union act under Article 267 TFEU or by way of plea of illegality under Article 277 TFEU. The Court has repeatedly emphasised that the TFEU “has established, by Articles 263 and 277, on the one hand, and Article 267, on the other, a complete system of legal remedies and procedures designed to ensure judicial review of the legality of European Union acts, and has entrusted such review to the Courts of the European Union. [...] Accordingly, natural or legal persons who cannot, by reason of the conditions of admissibility stated in the fourth paragraph of Article 263 TFEU, challenge directly European Union acts of general application do have protection against the application to them of those acts. Where responsibility for the implementation of those acts lies with the European Union institutions, those persons are entitled to bring a direct action before the Courts of the European Union against the implementing measures under the conditions stated in the fourth paragraph of Article 263 TFEU, and to plead, pursuant to Article 277 TFEU, in support of that action, the illegality of the general act at issue. Where that implementation is a matter for the Member States, such persons may plead the invalidity of the European Union act at issue before the national courts and tribunals and cause the latter to request a preliminary ruling from the Court of Justice, pursuant to Article 267 TFEU”.⁷¹

Indirect avenues for judicial redress are of considerable importance, even after the (limited) reform of Article 263(4) TFEU in favour of broadening access of non-privileged applicants. First, while acts that are not considered to be reviewable under Article 263 TFEU cannot be subject to an annulment action, they can be subject to indirect review under Articles 277 and 267 TFEU. This is clear from the wording of both provisions and their interpretation in the case-law of the Court.

⁷⁰ *ibid.*, para. 37.

⁷¹ Case C-583/11 P, *Inuit Tapiriit Kanatami and Others v European Commission*, EU: C:2013:625, paras. 92 and 93.

Article 277 TFEU refers in general to “acts of general application” that can be subject to a plea of illegality. This formulation reflects the case-law of the Court which pre-Lisbon has allowed pleas of illegality against a wide range of acts of general application beyond the more narrow wording of Article 241 EC, which only allowed indirect challenges against a “regulation”. Consequently, challenges under Article 277 TFEU can be considered against acts of general application⁷² in diverse forms, such as “notices of invitation to tender”,⁷³ “Staff Rules”⁷⁴ or “evaluation guides”.⁷⁵ The Union courts have even accepted challenges under Article 277 TFEU against certain internal measures laid down by Union institutions. In *Libéros v Commission*⁷⁶ the Court found that “internal measures adopted by the administration [...] may not be regarded as rules of law which the administration is always bound to observe, they nevertheless form rules of practice from which the administration may not depart without giving the reasons which led it to do so, which must be compatible with the principle of equal treatment. Consequently, the officials and other staff concerned may invoke their illegality in support of an action against the individual decision taken on the basis of the measures”.⁷⁷ In *Dansk Rørindustri v Commission*⁷⁸ the Court held that this ruling also applied to rules of conduct designed to produce external effects, such as the “Guidelines on the method of setting fines imposed pursuant to Article 15(2) of Regulation No 17 and Article 65 of the ECSC Treaty”.⁷⁹ The Court argued that “[i]n adopting such rules of conduct and announcing by publishing them that they will henceforth apply to the cases to which they relate, the institution in question imposes a limit on the exercise of its discretion and cannot depart from those rules under pain of being found, where appropriate, to be in breach of the general principles of law, such as equal treatment or the protection of legitimate expectations”.⁸⁰ It could therefore not be ruled out that such rules of general application might produce legal effects. Consequently, given their legal effects and their general application such guidelines could form the subject matter of a challenge under Article 277 TFEU.⁸¹ On the other hand, in *Guggenheim v Cedefop*⁸² the General Court considered a challenge to a note written by the Director of the European Centre for the Development of Vocational Training (Cedefop)⁸³ as inadmissible on the ground that the note did not produce any legal effects binding for the administration.

⁷² More precisely, the provision which forms the subject of a challenge under Article 241 must be of general application, see Case T-251/02, *E v Commission*, EU:T:2004:357, para. 122.

⁷³ Case 92/78, *Simmenthal v Commission* [1979] ECR 777, at para. 34 et seq.

⁷⁴ See C-301/02 P, *Tralli v ECB* [2005] ECR I-4071.

⁷⁵ Case F-19/05, *Ferriz v Commission*, EU:F:2006:55, para. 36.

⁷⁶ Case C-171/00, *Libéros v Commission*, EU:C:2002:17.

⁷⁷ *ibid.*, para. 35. The case concerned a Commission decision which laid down the criteria applicable to grade and step classification on recruitment of officials.

⁷⁸ Joined Cases C-189/02 P etc., *Dansk Rørindustri and Others v Commission*, EU:C:2005:408, paras. 214 and 237. See also Case T-329/01, *Archer Daniels Midland v Commission*, EU:T:2006:268, paras. 38-54 et seq. And in Case T-176/01, *Ferriere Nord v Commission*, EU:T:2004:336, para. 136, the Court of First Instance considered guidelines on State aid in relation to environmental protection as challengeable under Article 241.

⁷⁹ [1998] OJ C 9/3.

⁸⁰ Joined Cases C-189/02 P etc., *Dansk Rørindustri and Others v Commission*, para. 211.

⁸¹ *ibid.*, para. 237.

⁸² Case T-373/04, *Guggenheim v Cedefop*, EU:T:2006:224, para. 35.

⁸³ [1975] OJ L 39/1.

In respect of Article 267 TFEU the wording of what constitutes an act is wider under Article 267 TFEU than under Article 263 TFEU. Article 267(1)(b) TFEU refers to “the validity [...] of acts of the institutions, bodies, offices or agencies of the Union”. Unlike Article 263 TFEU, which expressly prohibits the review of recommendations and opinions, Article 267 TFEU does not require that an act must intend to produce legal effects vis-à-vis third parties for it to be subject to the Court’s scrutiny. This is also confirmed by the case-law of the Court. In *Grimaldi*,⁸⁴ the Court recognised that it can give preliminary rulings on the validity of all acts of the institutions of the Union, including the ones that do not have binding legal effects, such as recommendations.⁸⁵ This has been further affirmed in *Tillack*,⁸⁶ where the applicant contested the OLAF’s decision to transfer certain information to national authorities. In that case, the General Court concluded that, while the transfer of the information cannot per se be regarded as reviewable act under Article 263 TFEU, the applicant had the right to ask the national court to make a preliminary reference to the Court of Justice on the question of validity of that EU act. It follows, that an EU measure which is part of a process leading to the adoption of a national act but which does not meet the requirements of reviewable act under Article 263 TFEU may be reviewed by the Court under Article 267 TFEU.⁸⁷

In this context, it is submitted that the conceptual approach set out above can also be employed to identify which acts can be subject to indirect review under Articles 267 and 277 TFEU. While it has been argued above that reviewable acts in Article 263 TFEU should be understood as acts having primary legal effects, acts that the Court is asked to review by way of a reference from a national court under Article 267 TFEU or by way of plea of illegality under Article 277 TFEU should include not only those that have primary legal effects, but also secondary legal effects. Acts that cannot be considered as having any legal effects fall therefore outside the remit of Articles 277 and 267 TFEU. This is also supported by the rationale of *Foto Frost*, where the Court made it clear that Union acts could only be set aside by Union courts.⁸⁸ It would be incompatible with the rule of law and effective judicial protection if acts that produce legal effects could not be set aside within the Union legal order.

What does that mean for the famous *Gauweiler* case?⁸⁹ First, it is suggested that the Court wrongly chose to treat the reference as one on interpretation.⁹⁰ In essence the German Court was concerned that the OMT programme was ultra vires. It is of course possible to argue that every validity review also contains a question of interpretation followed by a question of compatibility. In this case the Court found

⁸⁴ Case 322/88, *Grimaldi*, EU:C:1989:646, paras. 8-9.

⁸⁵ See also Case 113/75, *Giordano Frecassetti v Amministrazione delle finanze dello Stato*, EU:C:1976:89; Case 90/76, *Van Ameyde v UCI*, EU:C:1977:101; C-188/91, *Deutsche Shell v Hauptzollamt Hamburg-Harburg*, EU:C:1993:24.

⁸⁶ Case T-193/04, *Tillack v Commission*, EU:T:2006:292, para. 80.

⁸⁷ Türk A. (2009), *Judicial Review in EU Law*, Elgar, p. 216.

⁸⁸ Case 314/85, *Foto-Frost*, EU:C:1987:452.

⁸⁹ Case C-62/14, *Gauweiler and Others v Deutscher Bundestag*, EU:C:2015:400.

⁹⁰ Tridimas T. and Xanthoulis N. (2016), “A Legal Analysis of the Gauweiler case: Between Monetary Policy and Constitutional Conflict”, *Maastricht Journal of European and Comparative Law*, Vol. 23, Issue 1, pp. 1-39.

compatibility after a wide enough interpretation of the relevant EU provisions. This should not detract from the fact that, as the Advocate General found, this was a question about validity.

Second, the arguments, though not the result, of the AG's Opinion in support of his finding that the act of the Governing Council of the ECB, followed by a press release which was published on the website, was an act subject to review under Article 267 TFEU, are doubtful. As set out above, the Opinion at the same time emphasises the factual impact of the OMT programme on the market, while also suggesting that the OMT programme was capable of having a decisive impact on the "legal" situation of third parties, albeit without demonstrating how the programme would achieve that. As argued above it seems more convincing to find that the OMT programme, while not having any primary legal effects, should be considered as having secondary legal effects by providing the legal basis for further action by the ECB and NCBs. Although such secondary legal effects would not be sufficient to trigger an action under Article 263 TFEU, they would be sufficient for a validity review under Article 267 TFEU or a plea of illegality under Article 277 TFEU.

5 Acts triggering compensation claims

The liability of the ECB is regulated in Article 340(3) TFEU complementing the general liability regime for the Union in Article 340(2) TFEU. Since the liability of the ECB is set out separately in Article 340(3), one could assume that the ECB's liability regime was intended to be tailored to the liability regime commonly applicable to central banks in the Member States. In practice it is, however, doubtful that the regime under Article 340(3) TFEU will differ from that set out in Article 340(2) TFEU. This is, firstly, because it is difficult to establish a common liability regime across 28 jurisdictions. Secondly, as a matter of principle it is difficult to see why the ECB should benefit from a less stringent liability regime than other EU institutions. In any event it is submitted that the current regime is flexible enough to accommodate any policy discretion on the part of the ECB in the exercise of its monetary policy mandate. This is confirmed by the recent case of *Accorinti v ECB*,⁹¹ where the General Court, without discussion, applied the same test as in Article 340(2) TFEU. At the same, the General Court emphasised that the broad discretion of the ECB in the pursuit of defining and implementing monetary policy meant that a sufficiently serious breach of a Union rule conferring rights on individuals had to be based on a "manifest and serious failure to have regard for the limits of the broad discretion enjoyed by the ECB when exercising its powers in monetary policy matters".⁹²

Article 340(3) TFEU states that the Union is liable for an act that can be attributed to the ECB or its civil servants in the performance of their duties. The concept of "act" has been given a wide meaning and comprises "measures or conduct attributable to

⁹¹ Case T-79/13, *Accorinti v ECB*, EU:T:2015:756.

⁹² *ibid*, para. 68.

a Community institution or body”.⁹³ The concept is therefore wider than the concept of reviewable act under Article 263 TFEU or Articles 277 and 267 TFEU. It includes a report by OLAF terminating an anti-fraud investigation,⁹⁴ press releases by OLAF⁹⁵, the handling of a complaint by the Ombudsman,⁹⁶ the bringing of proceedings in the USA by the Commission,⁹⁷ and even physical acts, such as driving a car.⁹⁸ It can also comprise omissions, but “only where the institutions have infringed a legal obligation to act under a provision of Community law”.⁹⁹ Any type of conduct may therefore give rise to the non-contractual liability of the ECB, including press releases and public announcements, such as the public announcement of new bond-purchasing programmes (e.g. the OMT).¹⁰⁰

For an “act” to engage the liability of the ECB it must be attributable to it. This raises the question as to whether the ECB can be liable under Article 340 TFEU where the legal effects are attributable to another body. This is illustrated in the case of *Ledra Advertising*, where despite the fact that the Memorandum of Understanding was attributable to the ESM, the Court on appeal found that the action of the Commission and the ECB was, in principle, liable to engage the liability of the Union.¹⁰¹ And in *Accorinti v ECB* the General Court rejected the argument that public statements made by the ECB President and an Executive Board member could give rise to legitimate expectations as they did “not constitute precise, unconditional and consistent [assurances] tending to preclude any restructuring of the Greek public debt, nor do they originate from authorised and reliable sources”.¹⁰² It is, however, not precluded that if statements by the ECB’s President or an Executive Board member contain assurances of the kind required by the General Court that fall within the competence of the ECB, then they could give rise to legitimate expectations and potentially render the ECB liable for damages.

The relationship of Article 340(3) TFEU with Articles 263 and 265 TFEU is of importance. The restrictive requirements of locus standi for private parties under Article 263 TFEU make Article 340(3) TFEU an attractive remedy. This can, however, only be the case where reliance on an action for compensation does not require that the act in question be first annulled under Article 263 TFEU. Where an applicant brings an action for damages the Court will therefore not require the act that

⁹³ Case T-250/02, *Autosalone Ispra v EAEC*, EU:T:2005:432, para. 41, for liability under Article 188(2) EA, which is similar in wording to Article 288(2) TFEU.

⁹⁴ Case T-309/03, *Grau v Commission*, EU:T:2006:110.

⁹⁵ See Case T-193/04, *Tillack v Commission*, EU:T:2006:292, para. 126.

⁹⁶ See Case C-234/02 P, *European Ombudsman v Lamberts*, EU:C:2004:174, at para. 63.

⁹⁷ Case C-131/03 P, *Reynolds and Others v Council*, EU:C:2006:541, para. 82.

⁹⁸ See Case 9/69, *Sayag v Leduc*, EU:C:1969:37.

⁹⁹ Case T-196/99, *Area Cova SA and Others v Council and Commission*, EU:T:2001:28, para. 84. See also Case T-514/93, *Cobrecraf v Commission*, EU:T:1995:49, para. 70; Joined Cases T-344/00 and T-345/00, *CEVA and Pfizer v Commission*, EU:T:2003:40, para. 103, and the appeal in Case C-198/03 P, *Commission v CEVA and Pfizer*, EU:C:2005:445; Case T-195/00, *Travelex and Others v Commission*, EU:T:2003:111, para. 143.

¹⁰⁰ In *Accorinti*, the Court considered that certain ECB acts fall within the “legislative activity” of the EU institutions. Case T-79/13, *Accorinti v ECB*, EU:T:756, para. 69. This is doubtful, as formally the Treaties reserve the term legislation to acts adopted in the ordinary or special legislative procedure.

¹⁰¹ Joined Cases C-8/15 to C-10/15 P, *Ledra Advertising and Others v Commission and ECB*, EU:T:2016:701, para. 55.

¹⁰² Case T-79/13, *Accorinti v ECB*, para. 81.

allegedly caused the damage first to be annulled under Article 263 TFEU.¹⁰³ The Court might, however, as in *Cobrecaf v Commission*, reject a compensation claim as inadmissible due to the inadmissibility of the annulment action, where “the action for damages is actually aimed at securing withdrawal of an individual decision which has become definitive and would, if upheld, have the effect of nullifying the legal effects of that decision”.¹⁰⁴ In contrast, where the applicant claims damages, which the annulment of the act could not have prevented, then an action for compensation is admissible, even if the applicant could have challenged the act under Article 263 TFEU.¹⁰⁵

Another important aspect of the ECB’s liability pertains to situations that give rise to joint liability, particularly when this involves both the ECB and national authorities. An individual may suffer loss at the hand of a national authority that applies an unlawful Union act.¹⁰⁶ In such cases, the individual might not only have a remedy in a national court against the national authority, but also in the Court against the respective EU institution.¹⁰⁷ Such cases of joint liability might also arise, where a Union institution wrongfully authorises or instructs a national authority to take a certain course of action. In such instances, the question is whether the applicant must bring an action before national courts or Union courts. As a matter of principle, the Court has held that the applicant has first to seek its remedy in the national court, which can refer the question of the validity of the EU act to the Court under Article 267 TFEU,¹⁰⁸ unless such a remedy does not provide effective protection of the individual’s rights.¹⁰⁹

6 Conclusion

The conceptual approach outlined in this chapter is designed to provide clearer criteria for the respective triggers of liability of the ECB for press releases and public announcements in the pursuit of monetary policy. Where an act has primary legal effects only a direct action under Article 263 TFEU would be available, while acts that have primary and secondary legal effects could also be reviewed indirectly under Articles 277 and 267 TFEU. On the other hand, where acts that do not have

¹⁰³ See Case T-178/98, *Fresh Marine v Commission*, EU:T:2004:265.

¹⁰⁴ Case T-514/93, *Cobrecaf and Others v Commission*, EU:T:1995:49, para. 59. See also Case T-180/00, *Astipesca v Commission*, EU:T:2002:249, para. 139; Joined Cases T-44/01, T-119/01 and T-126/01, *Eduardo Vieira and Others v Commission*, EU:T:2003:98, para. 214, and Case T-47/02, *Danzer and another v Council*, EU:T:2006:167, para. 28, Case T-186/98, *Inpesca v Commission*, EU:T:2001:42, para. 76; Case T-539/12, *Ziegler and Ziegler Relocation v Commission*, EU:T:2015:15, para. 42; Case T-79/13, *Accorinti v ECB*, para. 60.

¹⁰⁵ Case T-514/93, *Cobrecaf and Others v Commission*, EU:T:1995:49, para. 59. See also Case T-79/13, *Accorinti v ECB*, para. 62.

¹⁰⁶ For example, an ECB guideline that needs to be implemented by the national central banks.

¹⁰⁷ See Case T-206/14, *Hüpeden v Council*, EU:T:2015:672, where national authorities imposed duties on the basis of an unlawful Union anti-dumping regulation.

¹⁰⁸ Case T-47/02, *Danzer and another v Council*, EU:T:2006:167, paras. 31-33. See also Case T-317/12, *Holcim v Commission*, EU:T:2014:782, paras. 73-83, where actions for compensation have been brought simultaneously in the national and EU courts.

¹⁰⁹ See Case 281/82, *Unifrex v Commission and Council*, EU:C:1984:165. See also Case T-195/00, *Travellex and Other v Commission*, EU:T:2003:111, para. 87; Case C-80/04 P, *DLT Trading v Council*, EU:C:2005:216, para. 47; Case T-206/14, *Hüpeden v Council*, para. 19.

any legal effects the ECB could only be liable under the more stringent requirements imposed for compensation claims under Article 340(3) TFEU. It also finally suggested that acts, which have primary and secondary effects, or impact on subjective rights, need to be based on measures, which formally and substantively comply with Union law. Such measures need to be adopted before (and not after) the press release or public announcement to offer greater transparency and ensure effective judicial protection.

Accountability and audit requirements in relation to the SSM

By Frédéric Allemand¹

1 Foreword: the accountability issue in modern democracies

The European Union is a democratic political project. Democracy, the fundamental value of living together,² is embodied in a series of principles and rules that form the backbone of the Union's structure and operation: the rule of law, the separation of powers and the cooperation principle,³ the right of citizens to participate directly and indirectly in the exercise of power,⁴ the principle of openness and transparency,⁵ and recognition of the rights, freedoms and principles set out in the Charter of Fundamental Rights of the European Union.⁶ Accountability of EU institutions and organs is vital for the implementation of the democratic principle – it is what guarantees the effectiveness of all the other dimensions of democracy. The notion of accountability can be traced back to the French word *aconte*;⁷ it originally referred to a list of monies received or due upon presentation of accounts. The modern definition of accountability alludes to the general obligation of office holders to give an account of the exercise of their mandate to the principal. When applied to a democratic political regime, it refers to the obligation of those governing to report to those being governed, or their representatives, in order to account for their conduct of public affairs. Accountability serves a dual purpose. It reflects the fact that power originally stems from those being governed, and also that decision-makers are duty bound to exercise their power in accordance with the will of the people.⁸ This notion therefore encapsulates both strands of the legitimation of political power: firstly the way in which power is conferred on decision-makers (input legitimacy), and secondly the arrangements made to supervise the effective performance of that power (output legitimacy).⁹

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² Article 2 of the Treaty on European Union (TEU).

³ Article 13(2) TEU.

⁴ Articles 10 to 12 TEU.

⁵ Article 11 TEU; Article 15 of the Treaty on the Functioning of the European Union (TFEU).

⁶ Article 6 TEU.

⁷ *Oxford English Dictionary* (2017); "Aconte", in Godefroy (1881), p. 72.

⁸ European Central Bank (2002), p. 46.

⁹ Scharpf (1999).

The sheer diversity of democratic regimes means that accountability cannot be reduced to a single form of legal arrangements; instead it is reflected in a series of interactions between the “accountable body” and the “accountee”.¹⁰ Some common features can, however, be systematically observed: the accountable body is answerable to the parliamentary representation and is therefore obliged to publish regular reports or take part in public debates, and its performance is also subject to evaluation by an independent organisation with a sufficient level of expertise, namely an external, public and/or private auditor. These two ways to give account are complementary.¹¹ The increasingly technocratic approach to public affairs requires a high level of expertise and specialisation that tends to be lacking in parliaments; but parliaments are in need of “easy-to-read”¹² information to exercise their own surveillance.¹³ Furthermore, technical supervision is only effective if it is sufficiently visible to command the attention of society as a whole. These technical and political aspects are mutually reinforcing. Supervision by no means weakens accountees; on the contrary, it strengthens them by guaranteeing the effective performance of their missions.

2 The accountability issue: from a local concern to a European misgiving

Until the 2008-2009 financial crisis, little attention was paid to the accountability of authorities responsible for the prudential supervision of credit institutions. The task of supervision was mainly performed by the Member States’ national competent authority (NCA).¹⁴ These duties were qualified as “other functions” that the NCBs could perform on their own responsibility and liability.¹⁵ When this matter was referred to the ECB in its advisory capacity, firstly it stated that there should be a clear separation between monetary and banking supervisory responsibilities if this task was conferred on a national central bank;¹⁶ and secondly it emphasised that the performance of any additional tasks must not restrict the NCB’s human or financial resources for the performance of its responsibilities within the European System of

¹⁰ Amtenbrink and Lastra (2008), pp. 115-132.

¹¹ Mitchell (2014).

¹² Conclusion and Recommendations of the 23rd UN/INTOSAI Symposium: UN Post-2015 Development Agenda: The Role of SAIs and Means of Implementation for Sustainable Development, 2-4 March 2015, Vienna, Austria, point 1.

¹³ Brandsma (2012), p. 79; Vesel (2017), p. 346.

¹⁴ Louis (1995a); Doherty and Lenihan (2005), pp. 213-232; Vesel (2017), *op. cit.*, p. 346. One of the most thorough studies of the independence and accountability regimes of prudential supervisory authorities is that annexed to an address by Lorenzo Bini-Smaghi. See Bini-Smaghi (2006).

¹⁵ Article 14(4) of the ESCB Statute of the ESCB.

¹⁶ See for example opinion of the ECB of 5 June 2002 at the request of the Irish Department of Finance on a draft Central Bank and Financial Services Authority of Ireland Bill, 2002 (CON/2002/16), pt 6; Opinion of the ECB of 22 September 2004 at the request of Národná banka Slovenska on a draft law on supervision of the financial market and on amendments to certain laws (CON/2004/31), pt 12.

Central Banks (ESCB).¹⁷ National central banks may be supervised by supreme audit institutions¹⁸ (SAIs), under certain conditions. As public (albeit independent) authorities, SAIs are different from the “external auditors” in the sense of Article 27(1) of the ESCB Statute. They cannot examine the sections of NCBs’ financial accounts that are linked with the ESCB-related tasks. This restriction does not prevent SAIs from “carry[ing] out financial and management audits of those activities of the [NCB] that are not related to its ESCB tasks and competences, provided that [their] reports and audit activities do not impinge on the [NCB’s] independence”¹⁹ or on the review of the ESCB-related tasks of the national central bank to be undertaken by the central banks’ independent external auditors.²⁰

2.1 The audit gap issue in relation to the diversity of SAIs’ mandates

The financial crisis emphasised the shortcomings of the supervision applied to credit institutions and the weakness of the audit framework for banking supervisors.²¹ It led to a major overhaul in the prudential supervision of credit institutions, at both Member State and EU level.²² At the same time, the considerable financial support provided by Member States to the banking sector justified a strengthening of SAIs’ powers. Guaranteeing the smooth operation of the banking sector and preventing the emergence of a further crisis would also require better public audit of banking supervisors.²³ In several Member States, SAIs were given new responsibilities to increase their auditing powers over the activities performed by authorities responsible for banking supervision, including NCBs. This led the ECB to clarify the scope of Article 27 of the ESCB Statute and the interaction between the principles of NCB independence and accountability: the scope of public audits should be clearly defined by law and should be without prejudice to the powers of external private auditors. Audits should be conducted on a non-political, independent and purely professional basis.²⁴ The ECB identified incompatibilities between national legislation and the independence applicable to NCBs to pursue their ESCB-related tasks. It was neither the intention nor the effect of this negative harmonisation to impose a uniform audit framework. The missions and powers of SAIs therefore vary considerably from

¹⁷ See for example European Central Bank (2007), p. 12; opinion of the ECB of 21 February 2008 at the request of the German Ministry of Finance on a draft law amending the Law on the Deutsche Bundesbank (CON/2008/9), pt 2.2; opinion of the ECB of 27 January 2009 at the request of the Banque centrale du Luxembourg on the legal framework for the compilation of statistics and the role of the Banque centrale du Luxembourg in the fields of balance of payments and quarterly financial accounts statistics (CON/2009/7), pt 3.1.

¹⁸ We make no distinction between the terms “supreme audit institutions” and “courts of audit”.

¹⁹ Opinions of the ECB of 28 June 2006 and of 26 October 2006, both at the request of the Cypriot Ministry of Finance on a draft provision amending the draft law amending the Central Bank of Cyprus Laws of 2002 and 2003, CON(2006/33), point 2.2 and CON(CON/2006/50), point 2.2.

²⁰ *ibid.*

²¹ Sikka (2009), pp. 868-873; see also: Commission (2010).

²² National Audit Office of Finland (2015).

²³ European Court of Auditors (2011); Sanchez Barrueco (2015), pp. 70-85.

²⁴ European Central Bank (2008), p. 21; also: Opinion of the ECB of 29 September 2009 on the public audit of Lietuvos banks (CON/2009/77); Opinion of the ECB of 22 June 2011 on the Hungarian State Audit Office in relation to its audit of the Magyar Nemzeti Bank(CON/2011/53); Opinion of the ECB of 14 February 2011 on amendments to the Polish Constitution concerning adoption of the euro (CON/2011/9), point 3.3.

one Member State to another.²⁵ This has a significant impact on the effectiveness of audits performed on banking supervisors. It could even weaken the quality of banking supervision at European level, since the supervisors are not subject to the same audit requirements.²⁶

The Algemene Rekenkamer (Netherlands Court of Audit) paid particular attention to this situation, given the importance and highly international nature of the banking industry in the Netherlands. The merger of the Pension and Insurance Supervisory Authority of the Netherlands (PVK) with De Nederlandsche Bank (DNB) in 2004 retained the Court's powers of audit over supervisory tasks;²⁷ this development did not give rise to any particular observations from the ECB.²⁸ In 2007, the audit powers of the Court were extended to cover all the DNB's activities.²⁹ At the Netherlands' request, the list of addressees of confidential banking information was extended when the Capital Requirements Directive (2006/48/EC) was revised.³⁰ According to Article 59 of the new directive (known as CRD IV), the Member States may authorise the disclosure of certain information relating to the prudential supervision of institutions to courts of auditors in their Member State on the condition that "the entities have a precise mandate under national law to investigate or scrutinise the actions of authorities responsible for the supervision of institutions or for laws on such supervision."³¹ This legislative development was transposed and took effect in Dutch law in 2014. The Algemene Rekenkamer obtained the right to access confidential information related to banking supervision held by the DNB, provided that this information was strictly necessary for the performance of its duties.³² The transposition of Article 59 of the directive remains optional for the Member States. The situation in terms of public audit had therefore barely progressed from the previous state of the law.

The Algemene Rekenkamer raised the issue of the diversity of SAIs' statutes in 2011 within the Contact Committee of the Supreme Audit Institutions of the European Union. A working group coordinated by the Dutch Court was set up with the aim of carrying out a pilot study among European Courts of Audit,³³ "in order to identify possible public audit deficits related to SAI mandate coverage and information access rights".³⁴ Fourteen SAIs took part in the study. It concluded that only half the

²⁵ See the report produced by the OECD (1998) on four Member States: Germany, Ireland, the Netherlands and Sweden.

²⁶ D'Hulster (2011), p. 13.

²⁷ Bovenschen (2016), pp. 192-193.

²⁸ Opinion of the ECB of 24 October 2003 at the request of the Ministry of Finance of the Netherlands on a draft law on provisions concerning the merger of De Nederlandsche Bank and the Pensions and Insurance Supervisory Authority Foundation (CON/2003/23).

²⁹ Bovenschen (2016), p. 193.

³⁰ Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (OJ L 177, 30 June 2006).

³¹ Article 59(2a) 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 June 2013).

³² Article 59(2b) of Directive 2013/36/EU.

³³ Contact Committee Resolution CC-R-2011-05. Not published.

³⁴ Contact Committee of the Supreme Audit Institutions of the European Union (Contact Committee) (2011).

courts had been mandated to audit banking supervisory authorities; of these, six had access to the bank records of these authorities, but were restricted in their publishing policy by confidentiality clauses regarding certain information on banks³⁵.

2.2 The audit gap issue in relation to the establishment of the SSM

2.2.1 The two-speed accountability regime

Council Regulation (EU) No 1024/2013 (SSM Regulation) confers specific tasks on the ECB in the area of prudential supervision of credit institutions. This regulation revived the debate over how accountability should be exercised in the field of prudential supervision. Enhanced accountability requirements should balance the considerable responsibility given to the ECB in the area of financial stability.³⁶ Under Article 20 of the Regulation, the ECB has to draw up an annual report on its SSM-related activities that it submits to the European Parliament, the Council, the Commission and the Eurogroup. The report is presented to and debated in the European Parliament and the Eurogroup.³⁷ They may also each put questions to the ECB on prudential supervision, and the ECB has to reply in writing or orally. The Chair of the ECB's Supervisory Board has specific obligations. He or she may be invited to provide explanations on the fulfilment of the ECB supervisory tasks to the European Parliament or the Eurogroup at any time during the year; if required for parliamentary work, he or she may also hold confidential discussions behind closed doors with the Bureau of the European Parliament's Economic and Monetary Affairs Committee.³⁸

The local impact of decisions that the ECB might take in connection with its supervisory powers over credit institutions³⁹ results in specific features with respect to the national parliaments.⁴⁰ The latter are sent the ECB's annual report on

³⁵ Contact Committee [Resolution on the results of the pilot study on the access of supreme audit institutions to the main financial supervisors in EU Member States](#), Lisbon, 2012, CC-R-2012-03.

³⁶ See recital 34 of the Commission proposal for a Council regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, Brussels, 12 September 2012, COM(2012) 511 final.

³⁷ The representatives of the Member States not in the euro area but participating in the SSM also attended this meeting of the Eurogroup. The regulation formalised a practice approved by the Luxembourg European Council on 13 December 1997, namely the opening of the Eurogroup to Member States outside the euro area when matters of common interest are discussed.

³⁸ Detailed arrangements are provided for the ECB's accountability to the European Parliament and the Eurogroup under the SSM. See 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 (2013/694/EU). OJ L 320, 30 November 2013; Memorandum of Understanding between the Council and the ECB on the cooperation on procedures related to the SSM, Brussels, 11 December 2013, Frankfurt am Main, 4 December 2013.

³⁹ See recital 56 of SSM Regulation.

⁴⁰ Art. 21 of SSM Regulation. This article extends the general obligation of Article 12 TEU on the contribution of national parliaments to the functioning of the Union. Under this article, the EU institutions must forward any draft legislative acts to the national parliaments. Annual reports are not included in the documents that need to be forwarded, including for the European Commission. See Art. 1 and 2 of the Protocol (No 1) on the role of national parliaments in the European Union.

prudential supervision; they may submit observations and questions to the ECB and invite the Chair or a member of the Supervisory Board to participate in an exchange of views in relation to the supervision of credit institutions based in that Member State together with a representative of the NCA.

Article 21 of SSM Regulation states that this accountability regime applicable to the ECB is without prejudice to the accountability of national supervisory authorities to national parliaments. It is important to point out that the SSM Regulation admits that national authorities may be accountable for the implementation of some supervisory tasks attributed to the ECB (for example the supervision of “less significant” credit institutions), and also for the performance of assistance functions to the ECB in its supervisory tasks. This should be read alongside Article 6(3) of the Regulation, which states that the assistance provided by national supervisory authorities is without prejudice to the responsibility and accountability of the ECB for the tasks conferred on it in the area of prudential supervision. A national authority may not be accountable for the measures taken by the ECB with respect to a “significant” credit institution, and vice versa; on the other hand, it may be held responsible and accountable for the measures conferred on it in connection with its cooperation with the performance of the ECB’s tasks. Finally, national authorities remain accountable for the other tasks they perform outside the framework of the single supervisory mechanism (SSM), in accordance with applicable national law.

However, audit of prudential supervision in the EU is restricted in two respects⁴¹. Firstly, the SSM Regulation only explicitly refers to the situation of the ECB with respect to the European Court of Auditors (ECA). Under Article 20(7), “When the European Court of Auditors examines the operational efficiency of the management of the ECB under Article 27(2) of the ESCB Statute, it shall also take into account the supervisory tasks conferred on the ECB by this Regulation.” Inserted between two paragraphs, one addressing the questions that may be raised by the European Parliament and the other the closed-door discussions of the parliamentary committee, this paragraph illustrates the functional role attributed to the ECA’s auditing activities, namely to inform parliamentary debates. This provision, not included in the legislative proposal from the Commission, was inserted by the Cypriot Presidency in its compromise text of 3 December 2012.⁴² It did not give rise to debate in the ad hoc working group of the Council, in Council or in Parliament: no amendments were tabled in the parliamentary committee or in the plenary session.

Moreover, the responsibility of national SAs in the framework of the SSM is anything but clear. Articles 6(3) and 21(4) of the SSM Regulation lay down the principle of the maintenance of national accountability regimes over national banking supervisors. Article 21(4) appears specifically to refer to accountability to national parliaments,

⁴¹ A third limitation derives from the scope of the SSM Regulation limited to the euro area Member States or Member States participating in the SSM.

⁴² Art. 17(8) of the proposal for a Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions. Presidency compromise. Brussels, 3 December 2012, 17141/12 EF 287 ECOFIN 1011. I owe this point to Kroppenstedt (2016), p. 176.

leaving uncertainty as to the situation of SAIs.⁴³ This interpretation should be ruled out – the audit performed by SAIs with regard to local supervisory authorities remains applicable, as long as it does not affect the independence, the attribution of responsibilities or the accountability of the ECB and of national authorities in the application of SSM Regulation.⁴⁴ This interpretation is confirmed by recital 34 of the legislative proposal initially presented by the Commission, which provided in general that “Where national supervisors take action under this Regulation, accountability arrangements provided under national law should continue to apply.”⁴⁵ It would also be illogical to allow the continued application of accountability regimes provided by national law for the benefit of national parliaments and not SAIs, when the audits of the latter inform the work of the former. In the same way, recognising the ECA’s supervision of the ECB implies that national SAIs should be able to supervise the authorities tasked with prudential supervision in their states, as long as they are given such a responsibility under national law. On this specific point, it should be noted that, in accordance with the principle of procedural and institutional autonomy, it is not up to the EU to impose accountability applicable at the national level.⁴⁶ Finally, this interpretation is in line with the concern of the legislator and the ECB to ensure high standards in terms of accountability in the field of banking supervision. As suggested by Marianne Thyssen, Member of the European Parliament and rapporteur on the proposed regulation, “Any shift of supervisory powers from the Member State to the Union level should be balanced by appropriate transparency.”⁴⁷

⁴³ On this see Bovenschen (2016), p. 193. The author gives an incorrect interpretation of the scope of Article 21(4), when he suggests that “one could consider the accountability of an NCA vis-à-vis a State auditor to be part of parliamentary accountability.” [Our emphasis] He rejects this interpretation as it contradicts with recital 56 of the regulation. The error comes from the fact that he believes it seeks to extend the scope of Article 21(4) to the situation of SAIs. This was never the intention of the legislator. The work of the European Parliament shows that the legislator was seeking to strengthen its position and the position of the national parliaments in the new supervisory regime; its requirements are part of a broader debate on the general demands made by the European Parliament to play a greater role in European economic governance (see Allemand and Martucci (2017), pp. 315-338). However, the strengthening of accountability obligations based on EU law was not intended to weaken the arrangements provided under national law in the interest of national parliaments. Such a development would have run counter to the principle laid down in Article 12 TEU of a stronger contribution of national parliaments to the functioning of the Union.

⁴⁴ In its Opinion on the auditing of Banka Slovenije’s business operations, the ECB clarified the limitations on audits carried out by Courts of audit on Central banks’ supervisory tasks. The audit should “(a) not extend to the application and interpretation of supervisory law and practices in the context of the SSM; (b) not interfere with and not include the tasks conferred on the ECB by [SSM Regulation], and (c) not extend to result in an indirect audit of the ECB”. In addition, “the audit should also be carried out on a non-political, independent and purely professional basis.” See opinion of the ECB of 13 December 2016 on the auditing of Banka Slovenije’s business operation (CON/2016/59), pt 2.5.

⁴⁵ COM(2012) 511 final.

⁴⁶ Article 127(6) TFEU, the basis for the adoption of Regulation (EU) No 1024/2013, enables specific tasks to be conferred on the ECB; it does not give the Union any substantive powers to define accountability regimes in the Member States. The first paragraph of Protocol (No 1) on the role of national parliaments is quite clear as to the supervisory role exercised by national parliaments over national institutions and bodies: “the way in which national Parliaments scrutinise their governments in relation to the activities of the Union is a matter for the particular constitutional organisation and practice of each Member State”. This principle, stated in the Judgment of the Court of Justice in the *International Fruit Company* case (CJEC, 15 December 1971, Cases 51 to 54/71, ECR 1971, p. 1116) and protected by Article 5(1) TEU, applies *mutatis mutandis* to the supervisory role exercised by SAIs. It is this principle that is reiterated in both Article 21(4) and recital 56 of the SSM Regulation.

⁴⁷ See amendment 10 on recital 34 of the draft report presented by Marianne Thyssen on the proposal for a Council regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, European Parliament, Committee on Economic and Monetary Affairs, 8 October 2012, 2012/0242 (CNS).

2.2.2 “Pooled sovereignty, divided accountability”⁴⁸

The lack of detail in the initial Commission legislative proposal prompted a reaction from the ECA in February 2013, as the informal trilogues between the European Parliament, the Council and the Commission were getting under way. In his statement, the President of the ECA considered more specifically that “the examination of the operational efficiency of the management of the ECB in respect of its supervisory tasks encompasses the audit of sound financial management as applied to other bodies held accountable to the European Parliament and Council under the provisions of Article 287 TFEU.”⁴⁹ One month later, the IMF noted that the limited accountability of the ECB’s new supervisory tasks represented a particular challenge. The recommendations of the IMF’s experts included the provision of periodic reviews by external experts of the ECB’s performance and practices with regard to the SSM function.⁵⁰ In early 2013, the accountability regime provided for the SSM became a matter of shared concern for all the SAIs. The SAI Contact Committee called for sufficient audit coverage concerning the prudential supervision of credit institutions falling under the scope of the SSM.⁵¹ The Algemene Rekenkamer was more closely involved in the debate. The Netherlands Court raised the question of the emergence of an audit gap in accountability with regard to the application of the SSM Regulation.

Under the SSM Regulation, the ECB has an exclusive competence to carry out all of the prudential tasks referred to in Article 4(1) of SSM Regulation. The choice made by the EU legislator in favour a decentralised framework for the implementation of some supervisory tasks conferred on the ECB results in a possible split of the banking supervision responsibilities at the local level. While the ECB exerts direct supervision over (at least) the important credit institutions, the NCA may carry out supervisory tasks over the other credit institutions. According to the Netherlands Court, the direct exercise of supervisory tasks by the ECB over Dutch credit institutions causes the audit gap. The Algemene Rekenkamer does not have the competence to audit the ECB. This supervisory role falls to the ECA, which has limited powers of audit over the ECB. The quality of banking supervision of Dutch credit institutions is thus no more guaranteed.⁵² The interpretation by the Algemene Rekenkamer is somewhat restrictive: it excludes the audit permitted under EU law in terms of the supervisory tasks not conferred on the ECB and the assistance functions performed by national banking supervisors.⁵³ However, in its first report on the supervision of credit institutions in the Netherlands, the Court points out some difficulties that it faced when auditing the supervisory tasks of the DNB. Methodologies and Risk analysis models followed by the DNB are based on those

⁴⁸ Peterson (1997).

⁴⁹ Caldeira (2013).

⁵⁰ International Monetary Fund (2013), point 16.

⁵¹ Contact Committee of the Supreme Audit Institutions of the European Union (2013).

⁵² Algemene Rekenkamer (2015). A copy of this letter was sent to the ECA.

⁵³ In its audit of the supervision of banks in the Netherlands by the DNB, the Algemene Rekenkamer concluded that the DNB organised its supervision well. This audit provides the Court of Audit with the opportunity to ask DNB for a guarantee that it would retain access to information on the supervision of medium-sized and small banks. See Algemene Rekenkamer (2017).

applied by the ECB. A better evaluation of the quality of the banking supervision could require the Court to obtain additional information from the ECB. The SSM Regulation does not regulate this issue. The limited nature of the audit powers that the ECA can exercise over the ECB and the lack of framework for exchange of information between the national SAI and the ECB represent a step backwards in those Member States where the SAIs had extensive audit powers. In May 2014 the ECA, the Algemene Rekenkamer and the German Bundesrechnungshof undertook a thorough analysis of the SAIs' remit and powers in the area of banking supervision.⁵⁴ In autumn 2014, a task force chaired jointly by the Netherlands and Germany was set up within the SAI Contact Committee to continue this study and prepare for a collaborative audit on banking supervision.⁵⁵

The *Landscape review of EU accountability and public audit arrangements* adopted by the ECA in September 2014 concurred with the criticism levelled by the SAIs at the accountability issue in the supervision field: "there are no provisions in place for the assessment by auditors of the supervisory system as a whole."⁵⁶ The audit of the prudential supervisory tasks exercised by the ECB that the ECA carried out in 2015-2016 provided the Court with an opportunity to test the limits of its remit in practice. Prior to this audit, the ECA had audited the ECB (and its predecessor the European Monetary Institute) on 18 occasions. The noticeably brief reports⁵⁷ did not give rise to any particular discussions between the two institutions: the ECB accepted most of the recommendations made by the ECA and even sometimes used them to justify decisions that had been criticised by Members of the European Parliament.⁵⁸ The European Parliament showed very little interest⁵⁹ in the audits performed on the ECB. The situation was completely different in November 2016, with the publication of the SSM special audit report. The ECA criticised "*an important obstacle in all areas of our intended audit – namely, the emergence of disagreement with the ECB over the exact terms of our mandate and right to access documents. Arguing that they lay outside our remit, the ECB was not willing to share a number of documents that we needed to complete our work. As a result we were only partly able to assess*

⁵⁴ *ibid.*, p. 3.

⁵⁵ Contact Committee of the Supreme Audit Institutions of the European Union (2016), p. 16. As part of this work, the ECA held a seminar in Brussels on 14 October 2014 entitled "Accounting for Europe – issues in accountability and audit structures in the EU", attended by representatives of the ECA, the national SAIs and the European Parliament.

⁵⁶ European Court of Auditors (2014), p. 57.

⁵⁷ The audit reports adopted between 1994 and 2006 were an average of five pages long. They offered a very general overview of the operational efficiency of the ECB in all areas of activity and projects. From 2007 onwards, the ECA changed its approach and focused its attention on specific areas: the audits were carried out in more depth and the length of the reports increased, reaching an average of 15 pages. By way of comparison, the special report adopted by the ECA on the SSM in November 2016 is 136 pages long!

⁵⁸ This was particularly the case for the renovation of the Grossmarkthalle to house the offices of the ECB. See, for example: Draghi, Mario, Letter to Mr. Rareș-Lucian Niculescu, Frankfurt, 13 November 2012, L/MD/12/731; Letter to Mr Mario Borghesio, Frankfurt am Main, 18 November 2013, L/MD/13/666. In these cases, the ECB made reference not to the audit reports drawn up by the ECB on the basis of Article 27(6) of the Statute but on the ECA's Special Report No 2/2007 concerning *the institutions' expenditure on buildings* (OJ C 148, 2.7.2007).

⁵⁹ Only two audits were mentioned in the introductory recitals to the European Parliament reports on the ECB's annual reports.

*whether the ECB is managing the SSM efficiently in the areas of governance, off-site supervision and on-site inspections.*⁶⁰

In light of the planned review of the SSM Regulation,⁶¹ the conclusions of the ECA audit provided significant support for the SAIs' call for a revision of Article 20(7) of the regulation, or even a revision of Article 27(2) of the ESCB Statute.⁶² In its reply to the ECA, annexed to the report, the ECB expresses its disagreement with the ECA as to the interpretation of the scope of its mandate and the Court's criticism that the Bank provided very little of the information requested; on the contrary, it considers that it cooperated fully with the ECA.⁶³ The sensitivity of the subject, together with the opening of discussions on the review of the SSM Regulation, led the EU's two co-legislators to join the debate. In February 2017, the Ecofin Council preferred to remain cautious: it reiterated the need to "ensur[e] the highest standards in terms of accountability and transparency of the SSM"⁶⁴ and welcomed the Commission's intention to address this subject during the work to review the regulation.⁶⁵ The complementarity of ECA audits and parliamentary supervision prompted a more critical stance from the European Parliament. In its resolution of 15 February 2017 on the Banking Union, Parliament expressed its concern that "owing to limitations imposed by the ECB on the ECA's access to documents, important areas are left unaudited" and "urge[d] the ECB to fully cooperate with the ECA to enable it to exercise its mandate and thereby enhance accountability".⁶⁶ In late August the ECB denied this criticism about the alleged lack of cooperation and emphasised its commitment "to cooperating fully with the ECA within the existing legal framework [our emphasis], while paying due respect to the confidentiality of supervision information. [...]"⁶⁷

3 The ECA's mandate in relation to the ECB

As an EU institution,⁶⁸ the ECA is obliged to act within the limits of the powers conferred on it in the Treaties.⁶⁹ It must exercise its powers with due regard for the

⁶⁰ European Court of Auditors (2016), p. 9. See especially recommendations 4 and 5 (p. 81).

⁶¹ Article 32 of SSM Regulation.

⁶² Contact Committee of the Supreme Audit Institutions of the European Union (2016), p. 16. As stated, the Task Force on the European Banking Union "encourages the European Commission to propose a strengthening of the ECA's mandate concerning the audit of the ECB's single supervisory mechanism, including clarifying the scope of Art. 20(7) SSM Regulation, and/or changing Art. 20(7) SSM Regulation and Art. 27(2) of the ESCB Statute, if necessary."

⁶³ *ibid.*, p. 123. The position expressed by the ECB in its reply to the ECA's recommendations was reiterated by Danièle Nouy (2017), Chair of the Supervisory Board, in the response sent to Eurogroup President Jeroen Dijsselbloem.

⁶⁴ The wording used by the Council is precisely the same as that used by the ECB in its opinion on the legislative proposal COM(2012) 511 final.

⁶⁵ The possibility of reviewing the SSM accountability regime is explicitly provided by Article 32 of Regulation (EU) No 1024/2013. The Council's support did not add anything new to the substance.

⁶⁶ European Parliament (2017), pt 23.

⁶⁷ European Central Bank (2017), point 4.2.

⁶⁸ Article 13(1) TEU.

⁶⁹ Article 13(2) TEU.

powers of other institutions.⁷⁰ The separation of powers under the Treaties does not mean that each institution should act in isolation; on the contrary, it requires them to practise mutual sincere cooperation.⁷¹ However independent it may be, no EU institution is entirely separate from the Union and exempt from every rule of EU law, as noted by the Court of Justice with regard to the ECB in its OLAF judgment.⁷²

Under Article 287 TFEU, the ECA examines the accounts of all revenue and expenditure of the Union and those of all bodies, offices or agencies set up by the Union in so far as the relevant constituent instrument does not preclude such examination. In addition to this financial audit, the ECA is responsible for examining the legality and regularity of revenue and expenditure and ensuring the sound financial management of the EU institutions, bodies and agencies covered by its mandate. The ECA's supervisory powers extend to all public or private bodies, offices or agencies at Union or Member State level which manage revenue or expenditure on behalf of the Union or are in receipt of payments from the EU budget.⁷³ Specific provisions in the Treaties lay down the ECA's mandate with regard to the "banking" institutions, namely the EIB and the ECB. Both are funded independently – they do not claim any payments from the EU budget. The EIB has capital subscribed by the Member States⁷⁴ and the ECB has capital subscribed by the NCBs of the EU Member States.⁷⁵ The tasks of auditing the banking activities of the EIB, verifying its accounts and operations and making sure its books are kept in a proper manner come under the remit of an independent body, the Audit Committee.⁷⁶ But since it manages EU revenue and expenditure, the EIB is subject to supervision by the ECA for these management activities;⁷⁷ the ECA's right to access the (banking) information held by the EIB in connection with these activities is governed by an agreement between the Court, the Bank and the Commission.⁷⁸ Given that the EIB and the ECB both enjoy similar budgetary autonomy, it may have seemed logical for the ECB to be excluded from the scope of the ECA's supervisory remit. The draft ESCB Statute drawn up by the Committee of Governors only provides for financial supervision by external auditors. At the request of the United Kingdom,⁷⁹ the ECA's mandate was extended to include the ECB, but in limited

⁷⁰ Judgment of the Court of 22 May 1990, *European Parliament v Council of the European Communities*, Case C-70/88. ECR 1990, p. I-2041.

⁷¹ Article 13(2) TEU.

⁷² Judgment of the Court of 10 July 2003, *Commission v European Central Bank*, Case C-11/00 [OLAF case], [ECLI:EU:2003:395](#), pt 135.

⁷³ Article 287(3) TFEU.

⁷⁴ Article 4 of Protocol (No 5) on the Statute of the European Investment Bank.

⁷⁵ Article 28(2) ESCB Statute.

⁷⁶ The EIB also makes use of external audit firms. See Mégret, Waelbroeck, Louis et al. (1979), p. 43.

⁷⁷ Bieber (2015), p. 1331.

⁷⁸ Article 287(3)(b) TFEU. Requested by the EIB in the negotiations for the Treaty of Amsterdam, this subparagraph is designed to limit the scope of the ECA's right of access to information. In the absence of such an agreement, the ECA has the right to access the information it needs for the performance of its audit tasks. See Inghelram (2000), pp. 141-142.

⁷⁹ Jan Inghelram (op. cit., p. 132) offers a misinterpretation of the analysis provided by Jim Cloos et al. (negotiators of the Maastricht Treaty for Luxembourg). These authors mention a British note dated 20 February 1990 which the UK sent to its partners concerning the ECA's powers. Nowhere do they mention the question of the ECB's mandate. However, Jan Inghelram attributes the idea of a reduced mandate for the ECB to the United Kingdom. See Cloos, Reinesch and Weyland (1994), p. 439. This misinterpretation is repeated in: Baez Seara and Lambrinoc-Schanz (2016), p. 178.

terms to respect the latter's independence. Under Article 27 of the ESCB Statute, the verification of accounts, which includes examining that operations have been conducted and books kept in a proper manner, is the responsibility of external auditors and not of the ECA. These auditors are approved by the Council, acting on a recommendation from the ECB.⁸⁰ The ECA's audit powers do not include the verification of accounts; according to Article 27(2), it may only examine "the operational efficiency of the management of the ECB".⁸¹

3.1 Scope of Article 27(2) of the ESCB Statute

Article 27(2) of the ESCB Statute restricts the ECA's mandate to an examination of the operational efficiency of the management of the *ECB*. It applies exclusively to the ECB (and not the ESCB) and thereby prevents the ECA from extending its powers to entities that are legally distinct from the ECB but associated with the performance of tasks under the remit of the ECB.

Moreover, Article 27(2) provides for an audit of operational efficiency of the *management* of the ECB, without defining or restricting the notion of management and the fields of action to which this applies. Accordingly, the ECA could continue exerting its auditing powers in fields where new tasks were conferred upon the ECB pursuant to EU law (Article 126(6)) or international law (ESM Treaty), as long as management is required. The default of any specific definition of the *management* means also that the form taken by the management is irrelevant to the scope of the ECA's mandate. One should regret the leeway given to the ECA. However, this counterbalances the ECB's operational independence: the management procedures to be employed by the ECB for the performance of its tasks are not laid down in the Treaties but are left entirely to the Bank's discretion. The ECB is free to organise its operation in such a way that it can carry out its tasks and conduct appropriate activities: the Governing Council is responsible for determining the ECB's internal organisation,⁸² while the Executive Board is responsible for the current business of the ECB.⁸³

The audit to be performed by the ECA should examine the operational *efficiency* of the ECB's management. This term 'efficiency' is not defined in the Treaties or the Statute, and the way it is translated in the various linguistic versions does not shed

⁸⁰ The Council's approval is given in the form of a decision. See for example Council Decision of 21 June 2013 amending Decision 98/481/EC approving the external auditors of the European Central Bank (2013/324/EU) (OJ L 175, 27 June 2013).

⁸¹ Article 27(2) ESCB Statute. This concept, which is not found anywhere else in EU law, is unclear and has therefore elicited much criticism. See especially: Kroppenstedt (2016), p. 177; Vesel (2017), p. 347.

⁸² Article 12(3) ESCB Statute.

⁸³ Article 11(6) ESCB Statute.

light on its meaning or scope.⁸⁴ Since the term applies to the ECA's mandate, defining it involves referring to the legal and methodological framework that governs the Court. The principles, concepts and procedures that underpin the ECA's powers of audit are laid down in Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union (Financial Regulation)⁸⁵. The Financial Regulation lays down guidelines for the presentation and audit of the accounts of the EU and of bodies and agencies created by it, as well as those of Euratom; the ECB is excluded from the scope of the Financial Regulation, except where otherwise provided for in the Regulation.⁸⁶ Article 30 on sound financial management defines what the concept of efficiency refers to:⁸⁷ it concerns “the best relationship between resources employed and results achieved”. It differs from the principle of economy, which requires that “the resources used by the institution in the pursuit of its activities shall be made available in due time, in appropriate quantity and quality and at the best price”, as well as from the principle of effectiveness, which concerns “the attainment of the specific objectives set and the achievement of the intended results”. These three definitions are copied word for word in the ECA's internal methodological documentation.⁸⁸ EU law mainly replicates standards adopted by the International Organization of Supreme Audit Institutions (INTOSAI). According to INTOSAI standards, the principle of “efficiency” means “getting the most from the available resources. It is concerned with the relationship between resources employed and outputs delivered in terms of quantity, quality and timing.”⁸⁹

The specific mention of *efficiency* in Article 27(2) of the ESCB Statute sheds light on the scope of the ECA's mandate. It places the ECA's audit in the category of performance audits, thereby confirming the exclusion of financial compliance audits implied by Article 27(1). INTOSAI defines the performance audit as “an independent examination of the efficiency and effectiveness of government undertakings, programs or organizations, with due regard to economy, and the aim of leading to improvements.”⁹⁰ However, unlike financial audit, performance audit is not governed

⁸⁴ The term “efficiency” (or “efficient”) is used four other times in the English version of the TFEU: Recital of the Preamble to the TEU (“efficient functioning”); Art. 194(1) on energy policy (“energy efficiency”), Art. 210(1) on development cooperation policy (“[...] complementarity and efficiency of [the] action [of the EU and the Member States]”) and Art. 214(6) on humanitarian aid (“[...] efficiency and complementarity of Union and national aid measures”). The French, Italian and German versions of the Treaty translate “efficiency” respectively by “efficience”, “efficienza” and “Effizienz” for Article 194 of the Treaty and Article 27 of the ESCB Statute. But “efficiency” is translated by “eficacia” in Spanish and “eficácia” in Portuguese in Article 27 and not in Article 194. Finally, only the German version of the EU Treaty associates the concept of efficiency (“Effizienz”) with that of democracy when referring to the functioning of the EU institutions; in the other languages, the term used is “efficacy”.

⁸⁵ OJ L 298, 26 October 2012.

⁸⁶ Recital 3 and Art. 2(2)(b) of the financial regulation.

⁸⁷ To avoid any criticism as to the risk of an anachronistic interpretation, it should be noted that during the negotiations for the Maastricht Treaty, the applicable financial regulation was based on just two principles: “economy” and “sound financial management”. The definition of the principle of sound financial management based on the threefold notion of “economy-efficiency-effectiveness” only appears in the 2002 revised version of the financial regulation. But the principles mentioned above are not new to public auditors: they are recognised as founding principles of the audits carried out by SAIs under the INTOSAI Lima Declaration adopted in 1977. See INTOSAI, *The Lima Declaration*. ISSAI 1 [INTOSAI-P 1*], 1977.

⁸⁸ See for instance European Court of Auditors (2011a), p. 6; European Court of Auditors (2015), p. 7.

⁸⁹ INTOSAI (2015), p. 2.

⁹⁰ INTOSAI (2004), p. 11.

by fixed standards and by formalized opinions. It is more flexible in its choice of the subjects, the audit objects, methods and opinions. Made on a non-recurring basis, the performance audit is “by nature wide-ranging and open to judgments and interpretations. [...] it is not a checklist-based form of auditing.”⁹¹ Based on standards and guidelines adopted by INTOSAI, the definition of performance audit by the ECA refers to “an independent, objective and reliable examination of whether undertakings, systems, operations, programmes, activities or organisations are operating in accordance with the principles of economy, efficiency and effectiveness, and whether there is room for improvement.”⁹²

The fact that the ECA’s mandate mentions explicitly only the objective of efficiency entails an important restriction for the Court: it excludes any audit that examines the ECB’s management in terms of the principles of economy and effectiveness. Accordingly, the ECA shall not examine and deliver an opinion about the resources of the ECB, their appropriate quantity and their availability in due time. The same applies for the attainment of its objectives by the ECB.

This restriction is in line with the independence principle laid down in Article 130 TFUE and Article 7 of the ESCB Statute. According to these two provisions, the ECA, like any other EU institution, must not seek to influence the members of the ECB’s decision-making bodies in the performance of their tasks. In practice, the Court may not express any judgment on the political expediency of organisational measures or the relevance of substantive measures. Although performance audits may conclude that there are shortcomings, they may go no further than making recommendations. In the OLAF case, referring to the investigative powers of the anti-fraud office, the Court of Justice confirmed that OLAF should not be “capable in practice of preventing [the ECB] from carrying out its particular tasks”.⁹³ In its report on the systems and procedures established by the ECB for managing its Business Areas’ activities, the Court indicates to this end that “the audit did neither evaluate the results of the ECB as a whole nor the BAs’ activities”.⁹⁴ It is these aspects linked with the practical operation of the institution that are emphasised by the qualifier “operational” associated with the aim of “efficiency” in the English, Spanish and Portuguese versions of the Treaties. Restricting the audit to “operational efficiency” excludes “an effectiveness-based examination of the entity’s decisions and policies”.⁹⁵ We would also suggest that the explicitly “operational” nature of the audit

⁹¹ *ibid.*

⁹² European Court of Auditors (2015), p. 7.

⁹³ Judgment of the Court of 10 July 2003, *Commission of the European Communities v European Central Bank*, Case C-11/00, ECR 2003, I-07147, pt 128; see also Judgment of the Court of 10 July 2003, *Commission of the European Communities v European Investment Bank*, C-15/00, ECR 2003, I-07281, pt 106.

⁹⁴ Report of the ECA on the audit of the operational efficiency of the management of the European Central Bank for the 2008 financial year: the systems and procedures established by the ECB for managing its Business Areas’ activities together with the replies of the European Central Bank (OJ C 159, 18 June 2010), pt 7; European Court of Auditors (2015), p. 11.

⁹⁵ Baez Seara and Lambrinoc-Schanz (2016), p. 181.

emphasises the fact that it differs from the ECA's general audit powers in the area of "financial management".⁹⁶

The ECA's audit must therefore be seen as an expert contribution aimed at the continuous improvement of the ECB's internal operation, via the identification of any shortcomings. In practice, the audit performed by the ECA examines (i) the appropriateness of internal organisational measures with respect to the aims and tasks attributed by the Treaties, (ii) the relevance of management procedures and (iii) the effective operation of the ECB with regard to internal rules and procedures. An analysis of the audit reports concerning the operational efficiency of the management of the EMI and the ECB reveals the unrestricted nature of the fields of action covered by the ECA: these include budgetary management, internal audit systems, project management and monitoring, decision implementation process, efficiency of human resources policy, risk management procedures and systems, and environmental management.

3.2 Applicability of Article 27(2) of the Statute to the supervisory tasks of the ECB

Article 20(7) of the SSM Regulation specifically provides that the ECA shall also take into account the supervisory tasks conferred on the ECB when it examines the operational efficiency of the management of the Bank under Article 27(2) of the Statute. This is surprising when compared with our interpretation of the scope of Article 27(2) of the ESCB Statute. Either Article 20(7) is merely descriptive⁹⁷ and serves no purpose other than to remove any ambiguity as to the general scope of Article 27(2), or it fills a silence in the Treaties and enshrines the ECA's competence to exercise its powers of audit in this new field of action for the ECB. According to this second interpretation, Article 27(2) would apply only to the areas for which the ECB has been given missions and tasks under primary law; for tasks conferred to it under secondary law, the legislator would be free to define the scope of the ECA's mandate. It is the latter interpretation that is supported by the ECA and the national SAIs when they call on the European Parliament, Council, the European Council and the Commission "to consider a strengthening of the ECA's mandate concerning the audit of the ECB's single supervisory mechanism, including clarifying the scope of Article 20(7) SSM Regulation, and/or changing Article 20(7) SSM Regulation and Article 27(2) of the ESCB Statute, if necessary [...]".⁹⁸ We dispute this.

The only purpose of Article 127(6) TFEU, on which the SSM Regulation is based, is to assign additional tasks to the ECB. It cannot be considered as a special review

⁹⁶ Article 287(2) TFEU. For a short summary of the main differences between the performance audit and the financial audit, see European Court of Auditors (2015), p. 10. In addition, it is interesting to observe that operational management is closely related to financial management in the Netherlands. Pursuant to Art. 21 (2) of the Government Account Act of 2001, the term "operational management" include in any event financial management, material management, and the records held for management purposes."

⁹⁷ See Kroppenstedt (2016), p. 176, footnote 9: also suggested by Zilioli (2016), p. 165.

⁹⁸ Contact Committee of the SAIs of the European Union (2015).

clause applicable to economic and monetary policy:⁹⁹ it does not authorise conferring new competences upon the EU or amending the scope of other primary law provisions applicable to the ECB. However, Article 127(6) authorises the European legislator to fill the voids in the Treaty concerning the exact substance of new tasks, which may be assigned to the ECB. In the case in point, as demonstrated above in point 3.1, Article 27 of the ESCB Statute is clearly and precisely worded: paragraph 1 lays down the competence of external auditors to examine the accounts of the ECB and confers on them full power to do so; paragraph 2 gives the Court responsibility for auditing the management of the ECB. In both cases, no reservations are made as to the fields of action concerned by the audits. Any change introduced by a regulation adopted under Article 127(6) will therefore contradict Article 27(2) of the ESCB Statute. The situation is completely different when it comes to relations between the ECB and political authorities (the Eurogroup and the national parliaments). EU primary law gives few details on this matter: draft legislative acts originating from the ECB shall be forwarded to the national parliaments by the Council; this latter shall forward the common reasoned opinion adopted by the national parliaments or opinions to the ECB¹⁰⁰; the ECB may be invited to take part in the Eurogroup.¹⁰¹ This gives the European legislator leeway to clarify the reporting obligations.

In this context, why did the legislator feel that it was necessary to introduce Article 20(7)? We would suggest that the aim of this superfluous clarification was to settle a legal debate that was beginning to emerge among the SAIs and to clear up what was seen as a “grey area”.¹⁰² Incidentally, the clarification also strengthens the coherence of the text, as seen in the reiteration of the external auditors’ mandate in Article 29 of the SSM Regulation on “Budget and annual accounts”. These repetitions ultimately enable two pitfalls to be avoided: excluding from the scope of the ECA’s supervision an area of activity that has become essential, namely prudential supervision of credit institutions; and excluding the application of a more thorough audit regime to the ECB for its performance of the tasks conferred on it by the SSM Regulation, as called for by the SAIs.

3.3 Calls for a more intrusive audit mandate

The financial crisis and subsequent sovereign debt crisis obliged the ECB to make use of all the flexibility within the Treaties to an unprecedented extent. It was also

⁹⁹ See Art. 126(14) and Art. 129(3) TFEU; Art. 41 of the Statute; and Art. 10(6) of the Statute, removed by the Treaty of Lisbon.

¹⁰⁰ Articles 2 and 3 of Protocol (No 1) on the role of national parliaments in the European Union.

¹⁰¹ Article 1 of Protocol (No 14) on the Euro group.

¹⁰² See Caldeira (2012). This speech was made less than 10 days after the publication of the Commission proposal on the new supervisory powers of the ECB, and concerns about possible audit gaps were already being expressed.

given new tasks under¹⁰³ and outside¹⁰⁴ the scope of EU law. These developments raised concerns, especially from the ECB itself. As explained by Mario Draghi in May 2017, “The ECB has been acutely aware that, as its monetary policy has become more far-reaching and it has taken on a wider range of powers, it cannot justify its actions solely in terms of outcomes. We have needed a higher degree of transparency and accountability so that citizens can understand how we make our decisions and subject them to greater scrutiny”.¹⁰⁵ This concern explains the ECB’s decision to publish the accounts of the monetary policy meetings of the Governing Council. It also sheds light on the ECB’s willingness to support any strengthening of accountability mechanisms for the performance of its new prudential supervision tasks.¹⁰⁶ This concern was shared by the European legislator – recital 55 of the SSM Regulation calls for an appropriate development of the ECB’s powers and its accountability regime: “Any shift of supervisory powers from the Member State to the Union level should be balanced by appropriate transparency and accountability requirements.” The question is whether this objective is achieved by the SSM Regulation. Are the accountability requirements sufficient to guarantee the ECB’s legitimacy with respect to the adoption of decisions that could be sensitive from a political perspective, such as the withdrawal of a banking licence from a major European credit institution? Notwithstanding the separation between monetary and prudential supervision,¹⁰⁷ what effect might such a decision have on the ECB’s reputation in the area of monetary policy? From this perspective, would an overly restrictive interpretation of the ECA’s mandate over the ECB not become a source of weakness for the Frankfurt-based institution? As the saying goes, the road to hell is paved with good intentions.

We have seen that the ECA’s mandate over the ECB is defined in clear, unambiguous terms that leave no doubt as to its scope. When it comes to the mandates of national SAIs, the EU has no authority to impose an extension of their audit powers over local supervisory authorities. To back out of this corner, Yves Mersch, a Member of the ECB Executive Board, has suggested revisiting the principle of independence applicable to the ECB.¹⁰⁸ His argument can be summed up by the following syllogism: the independence regime is an exception to the

¹⁰³ In the field of macro-prudential supervision, via its responsibility to provide the secretariat of the European Systemic Risk Board (Council Regulation (EU) No 1096/2010 of 17 November 2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board. (OJ L 331, 15 December 2010)); in the field of micro-prudential supervision (SSM Regulation, especially Art. 4 and 5); and finally in the field of economic policy, in its capacity as an expert (Regulation (EU) No 472/2013 of the European Parliament and of the Council on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability. (OJ L 140, 27 May 2013)).

¹⁰⁴ On the negotiations for the financial assistance programme, see for example: Eurogroup. Statement, Brussels, 27 June 2012; on the implementation of the ESM Treaty: Decision of the Representatives of the Governments of the Member States of the European Union of 20 June 2011, Brussels, 24 June 2011, 12114/11 ECOFIN 462; Article 13(1), (3) and (7); Article 14(6); Article 18(2) ESM Treaty.

¹⁰⁵ Draghi (2017).

¹⁰⁶ Opinion of the ECB of 27 November 2012 on a proposal for a Council regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions and a proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) (CON/2012/96) (OJ C 30, 1 February 2013), pt 1.4.

¹⁰⁷ Art. 25 SSM Regulation.

¹⁰⁸ Mersch (2017).

general rules of public administration, which can be justified by the specific nature of monetary policy; as an exception, this regime must be interpreted strictly. The ECB's other fields of action reflect its own objectives and can justify independence regimes that differ from those applicable in the monetary field. The ECB's accountability regime is the flip side of its independence regime. The ECB can therefore be bound by accountability obligations that vary depending on its fields of action and requirements in terms of independence. "[A]s the ECB as a supervisor enjoys a different kind of independence than the ECB as monetary authority, there is, in practice, a differentiated application of the concept of the "audit of the operational efficiency of the management of the ECB", meaning that it is possible for the ECB to have different obligations vis-à-vis ECA."¹⁰⁹

Yves Mersch's argument is precise, rigorous and appealing. However, we do not adhere to his analysis of the ECB's independence regime. This regime, set out in Article 130 TFEU, is designed to guarantee its beneficiaries (the ECB, national central banks and the respective members of their decision-making bodies) the free and responsible exercise of powers and to enable them to perform the tasks and duties that the Treaties and their Statute confer on them. This independence is referred to as "functional", since it serves the exercise of these powers and the performance of these tasks and duties. No distinction is made by Article 130 TFEU or by the Court of Justice in its OLAF judgment as to which powers, tasks and duties are protected; the only condition is that they must be enshrined in the Treaties (e.g. Articles 127 to 133, 139 to 144) and the ESCB Statute. Conversely, independence is not guaranteed for any powers, tasks and duties conferred on the ECB and the NCBs by another legal basis (e.g. international agreement). However, the effectiveness of the independence regime would be weakened if the European legislator or the Member States were permitted to confer new functions on the ECB or the NCBs that would jeopardise their ability to comply with their obligations under EU primary law. The performance of any additional functions other than those provided under primary law is only permitted for the NCBs on the condition that these functions do not "interfere with the objectives and tasks of the ESCB".¹¹⁰ Things are less clear when it comes to the ECB. This should come as no surprise, since it appears unlikely that the drafters of the Treaty envisaged that the ECB would be assigned any tasks or duties other than those already laid down in Title VIII Economic and monetary policy of the Part Three of the treaty on the functioning of the EU.¹¹¹ The Court of Justice has intervened on this matter on two occasions. In its OLAF judgment, it ruled that EU legislation which imposes obligations on the ECB is valid as long as it does not "undermine its ability to perform independently the

¹⁰⁹ *ibid.* This view was already expressed four years ago by Yves Mersch in an interview with the monthly *ECA Journal*. See Carotti (2013). It is also shared by Barnier (2012).

¹¹⁰ Article 14(4) of the ESCB Statute.

¹¹¹ In this respect the legislator's obligation to consult the ECB is restricted to proposed acts in the Bank's field of competence – thereby excluding consultation on acts proposed outside this field, even if they apply to the ECB. Typically, the proposal for a Council Regulation (EC, Euratom) establishing a European Fraud Investigation Office was not submitted to the ECB.

specific tasks conferred on it by the EC Treaty”.¹¹² This interpretation is confirmed in the Pringle judgment for obligations imposed under international law.¹¹³

It remains to be determined whether or not the supervisory tasks performed by the ECB can be considered as conferred by primary law. According to Yves Mersch, the conclusion is unambiguous: specific prudential supervision missions are conferred on the ECB by a Council regulation. As they are based on secondary law, these new tasks are not covered by Article 130 TFEU.¹¹⁴ This interpretation should be rejected. Article 127(6) is an enabling clause not a revision clause. It recognises the principle of EU competence in the area of prudential supervision and the performance of this supervision by the ECB. In this respect, the Council does not have the authority to confer a competence in this area on the EU¹¹⁵ or to determine which EU institution, body or agency may be assigned this competence. However, it is up to the Council to activate this provision, to provide details of the ECB’s specific tasks and to instruct that they be implemented. These might be secretarial tasks, such as in the case of the ESRB, or more substantive micro-prudential supervisory tasks, such as in the case of the SSM Regulation. It should also be noted that, during the negotiations on the Maastricht Treaty, the Committee of Governors added prudential supervisory powers to the core tasks of the ESCB. It was only under pressure from France and Germany, in particular, that these powers were relegated to the very end of Article 127. The choice of an enabling clause indicates that the negotiators had difficulty reaching agreement on a more detailed provision.¹¹⁶ It is therefore up to the Council to define the exact nature of the ECB’s powers in this field in due course. So the Treaty confers tasks on the ECB, but the performance of these tasks is postponed until the Council exercises its regulatory power. As explained by the legal service of the Council in an opinion issued on 9 October 2012, “while the Council may set *modalities* [our emphasis] for the operation of those specific supervisory tasks, including on certain aspects related to the internal organization of work within the Bank, at the time of conferring them on the ECB under Article 127(6) TFEU, those modalities cannot go as far as to modify the decision making bodies and procedures as set by the Treaties [...]”.¹¹⁷

But if Article 130 TFEU applies to the ECB when it exercises these tasks of prudential supervision, what purpose is served by Article 19 on independence in the SSM Regulation? The fact that the general independence regime applies to tasks conferred by primary law does not indicate that this regime is appropriate for all the ECB’s tasks.¹¹⁸ When it comes to the Supervisory Board, Article 19 addresses two concerns: it guarantees that the Supervisory Board, set up within the ECB and

¹¹² Judgment of the Court of Justice, *OLAF*, pt 137. See also: Adalid (2012), pp. 103 ff; Zilioli and Selmayr (2006), pp. 17-28.

¹¹³ Judgment of the Court of Justice, *Pringle*, pt 158. As stated by the Court, “those tasks do not alter the essential character of the powers conferred on those institutions by the EU and FEU Treaties”.

¹¹⁴ See Mersch (2017).

¹¹⁵ Under Article 127(6) TFEU and Article 25(2) of the Statute, the field of application of competence is restricted to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.

¹¹⁶ Louis (1995b), p. 92; also Smits (1997), p. 356; and Smits (2005), pp. 200-202.

¹¹⁷ “Leaked legal opinion on Eurozone banking union”, *Financial Times*, 18 October 2012.

¹¹⁸ Adalid (2012), p. 204.

mainly composed of members from the euro area Member States, does not put the interests of the euro area ahead of the interests of the Union as a whole (and therefore the potential interests of Member States not in the euro area); and it gives the members of the Supervisory Board a degree of personal independence similar to that enjoyed by members of the ECB's decision-making bodies, given their major responsibilities in the preparation and implementation of the ECB's prudential decisions.

Applying the independence regime in Article 130 TFEU to the ECB's prudential supervision tasks rules out the introduction of an audit system other than that provided under Article 27(2) of the ESCB Statute. On the other hand, as we have explained, nothing prevents the adoption of specific arrangements for accountability to political authorities, the Eurogroup and the European Parliament, even if this creates an asymmetry between technical supervision and political supervision.

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Linking ECB transparency and European Union accountability

By Deirdre Curtin¹

1 Introduction

We have heard three rich presentations on different aspects of the topic of this panel.

Sean Hagan's presentation was general and related to the issue of transparency and accountability of central banks, from a more international perspective.

Alexander Türk took us firmly to Europe and to the specifics of judicial protection in the European Union especially in relation to the justiciability of soft announcements and press releases by the ECB.

Finally, Frédéric Allemand turned our attention specifically to the banking union and the Single Supervisory Mechanism in particular and the role – or otherwise – of audit institutions in holding actors to account.

2 The specificity of the ECB

What all three presentations have in common, perhaps unintentionally, is that they in different ways highlight the specificity of the ECB compared to other central banks. Part of the specificity of the ECB is that EU constitutional law has a strong role to play also in terms of ongoing practices. In this sense over time the position of the ECB is 'normalised' similar to other EU institutions.

Prior to the euro, the topics of constitutional law and monetary policy rarely overlapped. Money was regulated on the national level through ordinary legislative processes. The institutional position of independent central banks was primarily the result of the dynamics between monetary policy and economic/fiscal policy makers. Conflicts over monetary policy rarely ended up in a court, constitutional or otherwise. In the Union it could not be more different. This has also to do with the explicit choice that was made in the Treaty of Maastricht: *'In Law We Trust'*.²

The ECB may well be the most independent central bank in the world but it is embedded structurally in EU constitutional law. This is not something new, it has been there since its very creation.

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² See further Van der Sluis (2017), p. 209.

For European monetary integration the use of constitutional law was an attractive option because it meant that the Member States would be in control of the negotiation process. It also enabled a very independent central bank and at the same time kept the Member States in control of the future of the euro.³

The euro is a constitutional currency. Even after the euro-crisis, in which many of the rules have been re-interpreted or reformed, the legal foundations of the euro are a key factor in its functioning.⁴

Plans for further reforms of the euro are usually structured according to what can be done without changing the Treaties and what requires amendments. The idea that euro-crisis law has shown that 'everything is possible' under EU law reveals serious misunderstandings of the processes of change during the crisis.⁵

The ECB is however not unlike other central banks in many advanced economies where they have become very powerful and have acquired a host of highly political powers. The difference is that there is no economic counterpart at the supranational level unlike at the national political level (in Europe at any rate). The ECB certainly does not live in fear of what the European Parliament (not to mind national parliaments) can do to it.⁶ Some – unkindly – refer to the role of the European Parliament as a 'fig-leaf'.⁷ Yet there has clearly also been progress in the quality of the accountability relationship over time, as Yves Mersch pointed out in his keynote lecture. It can be doubted whether the same can be said for the national level where the ECB itself considers it owes no accountability to national parliaments.⁸

In the last presentation by Allemand, we see a potential inter-institutional dimension among old and new actors, across different governance levels. The different types of accountability forums, including audit institutions, are not only at the European level but also at the national level and there is – or should be – an interface through public reporting with political accountability. It may still be weak, there are certainly significant gaps, but the voice of significant others is growing as a matter of practice as well as of law.

I think Allemand's presentation on SSM and the public audit gap is important. His proposal seems to lie in the direction of national reforms to the mandates of national audit bodies and this can be considered quite uncertain and difficult to harmonise. The issue of a public audit deficit touches however the tip of the iceberg in terms of transparency and accountability of the banking union.⁹ There are many novel aspects that need further research and elaboration. For example, does the sharing of information about financial institutions and banks between a variety of actors, including the ECB, create a closed system of inter-institutional accountability

³ *ibid.*, pp. 209-210.

⁴ *ibid.*, p. 120.

⁵ *ibid.*, p. 209.

⁶ Curtin (2017), p. 43.

⁷ Van der Sluis (2017), p. 160.

⁸ See further, Curtin (2017), p. 30.

⁹ See for instance on the difficulties encountered by the European Court of Auditors in obtaining data from the SSM, Curtin (2017), pp. 35-36.

between 'expert' institutions charged with different mandates? If so, this is problematic from the point of view of transparency and public accountability.

How does this sharing of information fit within a more public and political system of accountability in the EU legal and political order? This is a crucial question prompted by Allemand's presentation.

In any event we are facing a less linear and more fragmented financial governance system within the Union. There are a host of new questions on the relationship between transparency, the limits of the need for confidentiality and outside accountability mechanisms.¹⁰ I do not think this involves shaping a 'new' legal order as the title of this conference suggests but rather of fleshing out the legal order we have and which anyway develops incrementally, in fits and starts.

3 The Union legal order

The Union legal order, like its Community predecessor, has always been a dynamic one that is iteratively fleshed out as new cases are brought before the Courts by an ever wider host of actors through a variety of procedural means.

In fact, the very issue discussed by Türk on legal liability for *soft* press releases and soft announcements may well be touched upon by the CJEU in Luxembourg in some months from now. There is a case pending before the Grand Chamber which is in a very different area of European law and in which no observations were submitted by the ECB.¹¹ The case concerns the reviewability of soft law recommendations to Member States by the Commission. As there has always been a uniform test for reviewability under Article 263 TFEU, regardless of the act's form, the case may also have consequences for the reviewability of atypical acts: communications, notices, press releases, etc. Although formally non-binding, such acts may have some legal effects, in particular they may influence the interpretation of law by national courts.¹² Perhaps, the judgment by Grand Chamber will shed some light on the reviewability – within the annulment procedure under Article 263 TFEU – of *soft* press releases by the ECB that embody their decisions influencing markets, governments and millions of EU citizens. The issue for now seems rather complicated. As accurately pointed out by Türk, the Court has hitherto confirmed in its *Gauweiler* judgment¹³ the reviewability of ECB press releases within validity references from national courts under Article 267 TFEU only. Article 267 TFEU does not contain the same admissibility criteria as Article 263 TFEU. Time will tell whether the Court sees the chance to formulate a uniform or dualistic regime of legal accountability for ECB's press releases.

¹⁰ See further, Curtin (2017), pp. 43-44.

¹¹ Case C-16/16 P, *Commission v Belgium*, pending.

¹² See the judgment issued in the first instance and arguments raised by Belgium: Case T-721/14, ECLI:EU:T:2015:829, *Belgium v Commission*, paras. 42-43.

¹³ C-62/14, *Gauweiler*, ECLI:EU:C:2015:400.

Aware of these problems, Türk has undertaken a very important challenge – how to make a more coherent test for deciding whether *an atypical act* such as the ECB’s press release which formally has no binding force under Article 288 TFEU is reviewable under Article 263 TFEU and Article 267 alike. Türk believes such a test should live up to today’s challenges and respond to increased powers of the ECB. Raising the question on legal capacity of the Court to hold the ECB accountable is justified. Be that as it may, the ECB is an institutional winner of the euro area crisis because of its newly assigned and assumed powers.¹⁴ The need for heightened legal accountability of ECB seems to be emphasized by the German Federal Constitutional Court that made in July 2017 a new preliminary reference on the validity of Expanded Assets Purchase Program.¹⁵ For the rest, the test will always depend on the actual facts in specific cases and this is the case for the ECB too.

Türk’s presentation raises for me two wider questions that I can do no more than flag here. First, he refers only to press releases, for understandable reasons. But the range of abnormal sources and institutional actions in the *EU sovereign debt crisis* which are relevant to the topic of this panel on transparency and accountability is much broader.¹⁶ The issue is not only one of complexity but also of accessibility. Even those sovereign debt sources that are publicly available are very difficult to find and comprehend.

My colleague Clare Kilpatrick put it like this after an extensive study: “it is very difficult for even a specialized lawyer or national court to reconstruct the legal map of bailout measures so as to properly frame questions of constitutionality or fundamental rights compliance. It is nigh on impossible for an EU citizen to find the legal sources having a major impact on his/her life.”¹⁷

Second, judicial review, to a great extent, is a substitute for the lack of political representativeness, participation, transparency – or generally speaking – political accountability of the ECB. All of these principles are enshrined in Articles 11 TEU and 15 TFEU and apply to all institutions, including the ECB. However, in case of the ECB, the trade-off seems to be geared more towards the ECB’s independence rather than the said principles. This independence is seen as guaranteeing the efficiency of the ECB’s decision-making. So output legitimacy is prioritized over input legitimacy. Judicial review is an important substitute for the lack of input legitimacy but also an imperfect one. The adaptation of reviewability test under Article 263 TFEU to today’s challenges is just a first step. An even broader issue is whether a judicial body possesses adequate expertise to assess the adequacy, necessity and proportionality of, in particular, monetary policy measures. Judges, admitting their inaptitude to second guess uncertain consequences of policy measure, would prescribe light touch legality review, like they did in *Gauweiler*.¹⁸ Even a more intense review of the

¹⁴ Curtin (2017), pp. 29-30.

¹⁵ German Federal Constitutional Court, Case 2 BvR 859/15, 2 BvR 980/16, 2 BvR 2006/15, 2 BvR 1651/15 (order of 18 July 2017). See the press release in [English](#).

¹⁶ See further, Kilpatrick (2015).

¹⁷ *ibid.*, p. 18.

¹⁸ Case C-62/14, *Gauweiler*. See also Case C-62/14 (opinion of AG Cruz Villalón), *Gauweiler*, ECLI:EU:C:2015:7, para. 111.

ECB's acts by the Court would imply a partial shifting of responsibility for monetary policy from one technocratic and unaccountable institution to another, although the courts may lack sufficient (economic) expertise.

This is not to say that the quest for the judicial review of ECB measures should be abandoned. We should be aware however of the imperfections of courts. As a consequence, while enhancing the legal accountability of the ECB is important we should not forget about arguably more important questions of primary means of input legitimacy: democratisation of ECB decision-making, its transparency and public accountability. On the other hand, the quest for more political accountability of ECB raises even more difficulties than the quest for its legal accountability. We still do not know how to accommodate both accountability and efficiency of ECB's decision-making.

The debate on that should be intensified as the process of the ECB's normalisation seems to be entering the next phase. As already mentioned, the ECB has been specific in a sense that it has had no economic counterpart at the supranational level unlike at the national political level. However, Yves Mersch already referred to the relaunch this Autumn, in particular after the German election has taken place, of an institutional debate on the euro area, including novelties such as an EU Finance Minister and the (remote) possibility of a Eurozone Assembly.¹⁹ An important issue is whether all 27 Member States will agree to deeper integration for the euro area. If they do not, will efforts be made, as we saw in the recent past for ESM and other international Treaties *inter se*, to create new institutions outside the EU Treaties? This would involve potentially a real breach with the 'single institutional framework' that somehow up until now has been more or less maintained.

4 Conclusion

Does ECB transparency as it is interpreted by the ECB in 2017 suggest 'a new paradigm of accountability' as it has been internally described by the ECB itself?²⁰ I'm not convinced. Others, including the Irish parliamentary enquiry into the banking crisis are also not.²¹ They describe the lack of transparency coupled with an overly defensive attitude of the ECB and its (former) Presidents and Governing Council as the major 'cause' of the democratic deficit from which the ECB is considered to suffer.²²

I conclude with a further reflection on the title of today's conference. It is 'Shaping a legal order for Europe; a tale of crises and opportunities'. For me the essential question is: opportunities *for who* and *on whose behalf*?

¹⁹ See Juncker, State of the Union, 2017. See also proposals by Hennette et al. (2017).

²⁰ Zilioli (2016), p. 132.

²¹ See the (Irish) Joint Committee of Inquiry into the Banking Crisis, [Final Report](#), Vol. 1, January 2016, 356 (accessed 13 July 2016).

²² Curtin (2017), p. 30.

The audience matters now more than ever. That audience is composed not only of monetary policy makers, audit institutions, courts, parliamentary committees both within the EP and at national level but also *the citizens* of all the Member States of the EU, euro area and non-euro area.

The broader challenge for the EU 27 is to find a new way of engaging the publics across the Union as moves are made to go further and deeper especially for the euro area. The specific challenge for the ECB is *voluntarily* and proactively, in the absence of Treaty level amendment, to cut down its own vast discretion to what really genuinely needs to be kept secret given the financial stakes involved.²³

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Panel 2

Judicial review in a central bank context
– focus on fundamental rights

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**Judicial review and institutional balance
in European law**

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Justiciability of central banks' decisions and the imperative to respect fundamental rights

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Since the financial crisis which started in 2007, central banks have taken difficult decisions, involving the adoption of unconventional instruments, in order to provide markets and individual credit institutions with the liquidity necessary to bridge the gap until the democratic process, by nature slow, could be concluded and measures taken by governments and parliaments. These decisions were welcomed at the time, but have since been judged critically.

Also, during the financial crisis the expertise and reputation of central banks earned them new tasks. The ECB became competent to advise the Troika on the drafting and monitoring of the Memoranda of Understanding on which the financial assistance programmes in the euro area are based, and for the prudential supervision of significant banks in the euro area. Several national central banks had the banking supervisory function reassigned to them² and have indeed received other roles, for example, in banking resolution.³ Finally, the importance of preserving financial stability has acquired a significance hitherto unknown; this has also provoked discussion on the contributory role of central banks to financial stability.⁴

These developments have focused renewed attention on certain issues that are very fundamental to democracies, in particular the adequacy of democratic controls on

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² For example, the prudential supervision competences, which until then had been a task of the Bank of England, were assigned as of 1 December 2001 to the Financial Services Authority (FSA), newly established by the [Financial Services and Markets Act 2000](#). On 1 April 2013 these competences were then transferred back to the Bank of England, namely the Prudential Regulation Authority. The [Financial Services Act 2012](#) (Part 2) abolished the FSA.

³ The ECB has issued many opinions on the allocation of new resolution tasks on national central banks. See, for example: Opinion of the European Central Bank of 1 July 2015 on recovery and resolution in the financial market (CON/2015/22); Opinion of the European Central Bank of 21 January 2015 on the role of Národná banka Slovenska in the resolution in the financial market (CON/2015/3); Opinion of the European Central Bank of 2 May 2014 on the resolution of crises in the financial markets (CON/2014/31); and the Opinion of the European Central Bank of 2 September 2015 on bank resolution CON/2015/31.

⁴ The big political question is the following: is price stability an instrument for financial stability, as the Bank of England and the Bank of Canada seem to put it, or can financial stability only be pursued and supported when it serves to achieve price stability, as the Treaty on the Functioning of the European Union says? (Cunningham and Friedrich argue: "The use of monetary policy to mitigate financial stability risks appears to be an additional tool for central banks." See Cunningham and Friedrich (2016), p. 17, available at <http://www.bankofcanada.ca/wp-content/uploads/2016/07/sdp2016-15.pdf>. The Bank of England Monetary Policy Committee (MPC) states, in [Monetary policy trade-offs and forward guidance](#), that: "price stability is a precondition for ensuring that resources are allocated efficiently across the economy. Price stability can also contribute to financial stability, for example by removing distortions caused by shifts in inflation expectations over time." See the box entitled "The objectives of monetary policy" in Bank of England (2013). Since this issue is dealt with in different ways in the different statutes, the way in which central banks approach it is necessarily different.

independent institutions and the maintenance of the constitutionally established balance of powers. Central banks have been in the spotlight and, for the first time, legal challenges to monetary policy decisions have been brought. As a result, also the courts have been paying increasing attention to the activities of central banks.⁵

To set the scene for the discussion on “Judicial review in a central bank context – focus on fundamental rights”, I would like to address three issues. First, what is the relationship between the courts and the central banks; second, whether there are different levels of intensity of judicial scrutiny of central bank activities and, if so, on the basis of which parameters; and finally, what is the importance given by the courts, and especially the Court of Justice of the European Union, to the respect of fundamental rights by Union institutions, and especially the ECB.

1 The relationship between courts and central banks

Before looking at the relationship between courts and central banks, we need to answer the question: where does a central bank “fit” in the institutional balance of powers? Does a central bank belong in the traditional separation of powers that is broadly still considered to be the basis for the democratic concept of the State? Modern central banks have been made independent from the political power, including the legislator, by law or, like in the case of the ECB, by a norm of constitutional level. Clearly the central bank is neither part of the judiciary, nor of the parliament. Can the central bank be considered to be part of the executive, when the executive is prohibited from giving instructions to it? Or is the central bank part of a different branch of power – its independence distancing it from the executive?

I would argue that, in a world which recognises the scope for multilayered governance, based on decentralised power, the traditional concept of three separate State powers can no longer be applied to analyse the existing democratic structures. With this perspective, the central bank, in the same way as the executive and the judiciary, is tasked with the achievement of a specialised objective, serving the State and for the good of the citizens, on the basis of the law (or the constitution) adopted by the parliament, which represents the people. The question whether or not the central bank is part of the executive is in any case not so relevant when applied to the European Union, where the concept of the three State powers fits with some difficulty.⁶

Judicial control over the actions of the institutions through which the State wields power is an essential element of the rule of law and is imposed for the benefit of the State and of the citizens. It is a form of indirect accountability, since accountability is the “interaction between the holder of power (the ‘accountable body’) and the authority to which account is owed.”⁷ Here the court is not the authority to which

⁵ “It is important to have in place adequate mechanisms to ‘guard the guardians’ of monetary and financial stability.” See Goodhart and Lastra (2017), p. 19.

⁶ Lenaerts (1991), p. 13 and the doctrine referred to in footnote 7.

⁷ Zilioli (2003) p. 100, and Zilioli (2016), p. 131.

account is owed, rather, it is through the court's examination of legality that the institution becomes accountable for its actions to the citizens. The court is an instrument of the State: in exercising judicial control, it performs the mandate conferred on it by the constitution (or, in a Union context with regard to the Court of Justice of the European Union, the Treaties).

Because of the need to respect the distribution of powers decided by the drafters of the constitution, in other words, the institutional balance, it follows that judicial control over the actions of the other powers of the State is limited to a so-called legality control, i.e. checking the compatibility of the actions with the law, which does not extend to an evaluation of the merits of the decision. Indeed, the role of the courts in assessing the actions of other branches of government is a delicate one.

The French and common law traditions see this role in a different way. While Montesquieu considers that the role of a judge is to declare the law (*les juges ... ne sont que la bouche qui prononce les paroles de la loi, des êtres inanimés qui n'en peuvent modérer ni la force ni la rigueur*)⁸, Locke believes judges to be guarantors of the fundamental freedoms that arise from natural law. For him, those who govern have received power in trust from the peoples, and the judges must ensure that they cannot abuse this power. This latter approach seems to be the one of German constitutional law: the well-known "eternity clause" enshrined in the German *Grundgesetz* means that some rights cannot be modified, and the task of the *Bundesverfassungsgericht* is to ensure that these rights are preserved, even against the will of the majority.⁹

This approach has sometimes been criticised in the doctrine and in the public debate as being the interference of the judges in the political sphere: decisions of the judiciary might annul political decisions not because they infringe the clear letter of the law, but on the basis of what, in the interpretation of the judges, is an infringement of the law. Since the constitutional principles that the court interprets are very general, the scope for interpretation (and law creation) can be quite broad. Hence the concerns that the judges' interpretation on matters of substance encroaches on a competence that the drafters of the constitution (or the Treaties) did

⁸ Montesquieu (1748), *De l'esprit des lois*.

⁹ The eternity clause (*Ewigkeitsklausel*) in Article 79(3) of the Basic Law of the Federal Republic of Germany establishes that certain fundamental principles of Germany's democracy cannot ever be changed. The Federal Constitutional Court ensures that Parliament does not infringe the general principles laid down in the Basic Law. However, since the general principles are indeed very general, the question is whether, in its interpretation, the court is merely applying the law or in fact creating the law.

not assign to the court¹⁰ and that the latter could unsettle the delicate institutional balance between the branches of government.¹¹

Thus there is a need for judicial restraint when the court deals with decisions of the other branches of government. This general principle applies to the ECB as well, no matter whether it is part of the executive or a separate branch of government. Indeed, the reason for judicial restraint is the fact that the drafters of the Treaties granted a separate mandate, for the public good, to the independent institution ECB.

The principle of judicial restraint finds application in all jurisdictions. This principle is all the more important when it is a question of monetary policy decisions taken by central banks.

In the **United States**, judicial restraint has been embodied in a jurisprudential principle – the “Chevron deference” –¹² according to which the courts are required to defer to government agencies’ interpretations of statutes that mandate the agency to take action, unless such interpretations are unreasonable.¹³ Within the above limits, while banking supervision,¹⁴ payment systems¹⁵ and financial stability related decisions¹⁶ can be subject to the assessment of the court, monetary policy decisions are completely excluded from judicial control.¹⁷

¹⁰ The well-known expression *le gouvernement des juges* stigmatises precisely the practice of US courts of declaring the unconstitutionality of the law through their interpretation of the Constitution, which is considered to be an interference in the other two branches of government. See Lambert (1921; 2005).

¹¹ The risk that judicial control over the policies of other branches of government oversteps the delicate institutional balance is not merely a theoretical one. Recently, for example, this criticism was uttered by judge Lübbe-Wolff in her dissenting opinion to the BVerfG judgment of referral to the Court of Justice in the [Gauweiler](#) case, where she said: “what the plaintiffs petition the Federal Constitutional Court to order goes, in my view, beyond the limits of judicial competence under the principles of democracy and separation of powers. The demarcation of these limits is open to debate.... Under the principles of democracy and separation of powers, decisions by judges at whom the citizens cannot, either directly or indirectly, come back by exercising their right to vote are justifiable only as decisions according to legal rules”. See Lübbe-Wolff (2014), paragraph 3 and following of the dissenting opinion. See also the Opinion of Advocate General Cruz Villalón, paragraph 111, in [Gauweiler](#): “The Courts, when reviewing the ECB’s activity, must therefore avoid the risk of supplanting the Bank, by venturing into a highly technical terrain in which it is necessary to have an expertise and experience which, according to the Treaties, devolves solely upon the ECB. Therefore, the intensity of judicial review of the ECB’s activity, its mandatory nature aside, must be characterised by a considerable degree of caution.”

¹² *Chevron U.S.A., Inc. v Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

¹³ It should be mentioned that President Trump, with the proposed Financial Choice Act, is seeking to repeal the Chevron jurisprudence (Title III of the draft act). If adopted, although this is unlikely, it would pave the way for a change in the balance of powers of the State.

¹⁴ See for example 12 U.S.C. §§ 1817(k); 1818(i); 1818(h); 1848; 5 U.S.C. § 704, all of which provide for the jurisdiction of the courts.

¹⁵ 5 U.S.C. § 704; 12 U.S.C. § 1818(i).

¹⁶ For example, the designation of a non-bank financial institution as subject to supervision by the Financial Stability Oversight Council is clearly reviewable. 12 U.S.C. § 5323. See *Metlife, Inc. v Fin. Stability Oversight Council*, 2016 U.S. Dist. LEXIS 68366 (D.D.C. 2016). (This judgment has put in doubt the *Chevron* deference; the case has been remanded).

¹⁷ “It would be an unthinkable burden upon any banking system if its open market sales and discount rates were to be subject to judicial review. Indeed, the correction of discount rates by judicial decree seems almost grotesque, when we remember that conditions in the money market often change from hour to hour, and the disease would ordinarily be over long before a judicial diagnosis could be made.” *Raichle v Federal Reserve Bank of New York*, 34 F.2d 910 (2d Cir. 1929).

Similar principles apply in the **United Kingdom**. There, the statutory immunity of the Bank of England¹⁸ allows its decisions to be judicially reviewed for illegality, irrationality and procedural impropriety,¹⁹ but it excludes that the court substitutes its decision for the one of the decision-making body and it also excludes liability for damages arising from negligence and breach of statutory duty of the Bank's officials. This immunity covers all Bank of England actions under its functional responsibility.²⁰ The justification given for granting immunity is the need to avoid defensive regulation; to allow the Bank to take into account multiple interests when adopting complex technical decisions;²¹ and to protect independent decision-making.

In the **European Union**, the Treaty on the Functioning of the European Union (the "Treaty") clearly states that the ECB is subject to judicial control. The Court, in assessing the legality of decisions of the Union institutions, has limited its judicial control to manifest errors of appraisal when it examines decisions in which the institution needs to conduct a complex economic assessment.²² This applies also to monetary policy decisions: rather than being immune from jurisdiction, as in the United States and to some extent the United Kingdom, these decisions are justiciable,²³ however the Court respects the discretionary powers and technical competence of the ECB within the monetary policy area.²⁴ It does not enter into the merits of the decision but checks manifest errors of appraisal, that all the necessary procedural steps have been completed to ensure that all interests and relevant

¹⁸ Banking Act 2009 Part 7 Section 244:

(1) *The Bank of England has immunity in its capacity as a monetary authority.*

(2) *In this section (a) a reference to the Bank of England is a reference to the Bank and anyone who acts or purports to act as a director, officer, servant or agent of the Bank, (b) "immunity" means immunity from liability in damages in respect of action or inaction, and (c) a reference to the Bank's capacity as a monetary authority includes a reference to functions exercised by the Bank for the purpose of or in connection with (i) acting as the central bank of the United Kingdom, or (ii) protecting or enhancing the stability of the financial systems of the United Kingdom.*

(3) *The immunity does not extend to action or inaction (a) in bad faith, or (b) in contravention of Section 6(1) of the Human Rights Act 1998.*

¹⁹ The scope of the judicial review is to review the lawfulness of a decision or action made by a public body; it is a challenge to the way the decision was reached. If a decision is assessed to be illegal, a quashing order will remit back to the decision-making body; the court will not substitute the decision with its own.

²⁰ It should be noted that the Bank of England has never been challenged in court for its monetary policy decisions.

²¹ Principle 2 of the (revised) *Basel Core Principles for Effective Banking Supervision* refers to the need to grant legal protection to the supervisors. See also Proctor (2002) and Athanassiou (2011).

²² Case C-136/77, *Racke v Mainz*, ECLI:EU:C:1978:116, paragraph 4; Case C-138/79, *Roquette Frères v Council*, ECLI:EU:C:1980:249, paragraph 25; Case C-26/76, *Metro v Commission*, ECLI:EU:C:1977:167, paragraph 50; Case C-151/80, *De Hoe v Commission*, ECLI:EU:C:1981:309, paragraph 9; Case C-161/97, *Kernkraftwerke Lippe-Ems v Commission*, ECLI:EU:C:1999:193, paragraph 97; and Case C-373/08, *Hoesch Metals and Alloys*, ECLI: EU:C:2010:68, paragraphs 61 and 68.

²³ Indeed, for the first time in history, a monetary policy decision found its way to the courts, through a referral to the Court of Justice by the German *Bundesverfassungsgericht* in the *Gauweiler* case, *op. cit.*

²⁴ One interesting question is whether the judicial review of central bank decisions should be undertaken by specialised judges. Goodhart and Lastra (2017), *op. cit.*, argue that "If judicial restraint in monetary matters is advocated on the basis of [limited] technical expertise and qualifications of the judges adjudicating such matters, the counter-argument to not 'being equipped' is to actually equip judges", and on this basis they advocate for a specialised Chamber for ECB matters, arguing that: "having dedicated specialised judges with expertise in financial and monetary matters when adjudicating cases related to the ECB would enhance the legal framework of ECB accountability in light of the significantly expanded mandate of the ECB". Also US Supreme Court Judge Stephen Breyer has argued that it is not possible to understand and evaluate what agencies do without some understanding of their regulatory policies (see Caplan (2017)).

aspects have been properly taken into account, and the respect of the proportionality principle. Concerning ECB supervisory decisions, these can be challenged before the Court but, in contrast to other jurisdictions, there is no statutory exemption from liability.²⁵ I would argue, however, that since general principles of law common to the Member States are a source of law recognised by the Court, and since the exclusion, or at least limitation, of the liability of supervisors can be found in all Member States, it could be expected that the Court will conclude that the ECB's liability for supervisory decisions cannot be unlimited, and this for the same reasons of public order underlying the introduction of such limitations in national legislation.

A different approach to judicial restraint towards decisions of Union institutions²⁶ was expressed by the German *Bundesverfassungsgericht* (BVerfG) in the final *Gauweiler* decision of 2016.²⁷ The BVerfG regrets that the Court of Justice did not reassess the factual evidence in detail, as it considers that it is the duty of the competent court (in this case the Court of Justice) to conduct a strict judicial review of the acts (in this case) of the central bank. Moreover, an insufficient intensity of judicial review “would enable the EU institutions to autonomously decide upon the scope of the competences that the States have conferred on them.”

The BVerfG went even further, with quite a novel statement. Specifically in relation to an independent central bank, the BVerfG considers that since the independence of the central bank from the political power is an exception to the principle of democracy, it is necessary, first, to construe the mandate given to the ECB by the legislator in a restrictive way and, second, for there to be a more intense judicial control on the compliance with the mandate.²⁸

While one can concede the first statement,²⁹ on the second, that there should be a more intense judicial control over the ECB's fulfilment of its mandate in order to compensate for the independence granted to it by the legislator, I beg to disagree.

²⁵ In its Opinion CON/2012/96, the ECB drew attention to this issue; however no limitation of liability was introduced in Council Regulation (EU) No 1024/2013 on the Single Supervisory Mechanism (recital 61 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)). See also D'Ambrosio (2015); Athanassiou, op. cit., footnote 17; and Almhofer (2016).

²⁶ Towards national institutions, the BVerfG has always exercised judicial restraint. This has been justified with the fact that parliament is the expression of the democratic representation and, therefore, has a “prerogative of evaluation” (*Einschätzungsspielraum*) (see the overview in BVerfGE 50, 290 (333) and that the government has a similar prerogative for decisions of considerable importance, in particular if they are based on an evaluation of political events (BVerfGE 62, 1 (50); 77, 170 (214 et seq.)). Since no case has ever been brought against the independent Bundesbank, it is not clear whether the concerns that the BVerfG expresses in relation to the independence of the ECB it would apply also to the Bundesbank.

²⁷ [Gauweiler](#), paragraph 182.

²⁸ *ibid.*, paragraph 187.

²⁹ The first statement is based on the general principle according to which exceptions need to be applied restrictively and it also coincides with the concept of conferred competences. The Court of Justice also agrees with this point, as it has interpreted in an extensive way the provision which most clearly limits the mandate and the powers of the ECB – Article 123. Advocate General Cruz Villalón has stated that the prohibition of monetary financing “assumes the status of a fundamental rule of the constitutional framework that governs the economic and monetary union, exceptions to which must be interpreted restrictively”. See [Gauweiler](#), paragraph 219.

Thus, the BVerfG would unilaterally substitute its judicial control on the merits for the same political control that the drafters of the Treaty decided to prohibit to enable the ECB to pursue its statutory objectives. There is a risk that taking the initiative to “offset” the allegedly missing democratic control by its own assessment of the merits would fall outside of the BVerfG’s competences.

I believe here that the BVerfG mixed up two very different issues: the independence of specialised institutions from the political power to ensure that they can better fulfil their mandate; and the issue of the judicial restraint that courts need to exercise when considering the actions of institutions belonging to other branches of government – independent or not from the political power.

Indeed, the reason why judicial control of the actions of the institutions is limited to the control of legality has nothing to do with the independence that some of them have from the political power. The self-restraint which is inherent to this limited control – the control of legality – reflects the need to respect and pay tribute to the will of the drafters of the Treaties, who granted to each institution the respective exclusive competences, including the power to make policy choices within these competences. This is in fact the highest expression of the constitutional control of the institutional balance established by the Treaties that the Court is in charge of performing.³⁰

To conclude, these different approaches to the intensity of judicial review by the different jurisdictions reflect the difficulty of striking a balance between the need to preserve, within its exclusive competences, the discretion of the institution, and the need to ensure respect for the constitutional law. This question has a very strong bearing on the issue of the balance of powers and interinstitutional relations: judicial activism could upset this balance yet with no corresponding improvement in terms of political accountability as courts are not democratically accountable.

It is interesting to note, focusing now on the relationship between central banks and courts, that there are some parallelisms. Both have been made independent to protect them from the “tyranny of the majority”, thereby enabling them to comply with their specialised mandate. For both of them, independence is a tool for the benefit of the citizens, and the fact that the citizens cannot control their activities requires a strict respect of their mandate as spelled out in the law.

For the central bank this means that it is to maintain price stability and focus on its core competences. Moreover, it must not take initiatives outside of the conferred powers (this was confirmed by the *Olaf* case).³¹ For the Court this means that it verifies the legality of the actions of the other branches of government and of the central bank, without entering into the merits of policy decisions, which are part of the discretion the drafters of the Treaties granted exclusively to these institutions.

³⁰ Zilioli, “La Corte, giudice costituzionale delle competenze attribuite alle istituzioni dell’Unione: il caso della Banca Centrale europea”, in Lenaerts, K., *Un parcours européen : de la Cour de justice des Communautés européennes à la Cour de justice de l’Union européenne*, Liber Amicorum in honour of Antonio Tizzano, Giappichelli, 2018.

³¹ Case C/11/00, *Commission v ECB*, ECLI:EU:C:2003:395, [Olaf](#). See also Beukers, T. (2013), p. 1618.

As these are two specialised independent institutions, I would argue that it is possible to imagine here not a hierarchical relationship, even though the actions of the ECB are subject to judicial control,³² but a speciality relationship in which each institution needs to respect the peculiarity and the exclusive competence of the other in fulfilling its own mandate: for the Court, the obligation is to respect the discretionary powers that the Treaty has granted exclusively to the ECB, exercising judicial restraint; for the ECB, to give execution to its judgments .

2 The parameters for the varying levels of judicial scrutiny

A central bank adopts a wide range of decisions³³ relating to monetary policy, banking supervision, financial stability, contracts and procurement, personnel issues and so forth. While the purpose of judicial restraint is to respect and protect the grant of discretionary powers and the monetary policy-making functions, and the institutional balance established by the Treaties, the exercise of restraint would not be appropriate for some central bank decisions which are purely the technical implementation of regulations or that have an executive nature. In view of the different type of decisions that a central bank can adopt, the second point I would like to consider is whether there can be different levels of intensity of judicial scrutiny of the different central bank actions and decisions and, if so, what are the parameters on which the variation of such intensity depends.

Traditionally, in administrative law, a distinction exists between full jurisdiction on the merits, or unlimited jurisdiction, and jurisdiction limited to control of legality. In the case of unlimited jurisdiction, courts are not only entitled to annul the decision taken by an administrative entity (or institution) entrusted with a certain task, but also have the power to replace the appraisal of the facts and the assessment conducted by the administration with their own appraisal and assessment. In the case of legality control, the court restricts itself to verifying that the administration has followed the necessary procedures and fulfilled the requirements, accepting the limits deriving from the principle of separation of powers.³⁴

Full jurisdiction and control of legality are two extremes of a continuum. Indeed, within the control of legality, the case-law of the Court distinguishes between “comprehensive judicial review”, where the Court, besides assessing the legality of the procedure, also appraises the facts, and “limited review”, which applies to the cases where the acts which have been challenged imply either a complex economic

³² In a Union based on the rule of law, even an independent institution is subject to the scrutiny of the courts and needs to adhere to its judgments. Judicial review results in a judgment that the ECB needs to implement; it is not a dialogue or discussion for the ECB to consider.

³³ In particular since the allocation of new tasks to central banks following the crisis.

³⁴ The Treaty on the Functioning of the European Union builds on a distinction between “unlimited jurisdiction” (Article 261) and control of legality (Article 263). Article 261 refers specifically to penalties: under its “unlimited jurisdiction” the Court can fully review the appraisal of facts conducted by the administration, its assessment, and replace the latter with its own, i.e. reduce or increase the fine or periodic penalty payment imposed. On the other hand, the rule for judicial review of the acts of the institutions is contained in Article 263, which provides for the control of legality.

assessment, a technical assessment, or the exercise of discretion.³⁵ In the first, the Court assesses both the facts and their appraisal by the relevant authority, with the appraisal of the facts being the most subjective and discretionary part of the assessment left to the administration. In the second, the Court focuses solely on the correctness of the reasoning underlying a “complex economic assessment,”³⁶ here the Court cannot substitute itself for such a technical and complex assessment, as this would be tantamount to replacing the administration in making a choice, rather than reviewing the soundness of the reason underlying the choice in question.³⁷

Reverting to the first part of our question, namely whether there can be different levels of intensity of judicial scrutiny of the different central bank actions and decisions, the answer is yes: the Court will apply different standards of review to the different decisions of the ECB.

This brings me to the second part of our question: what are the parameters on which the variation of such intensity depends? The intensity of the review depends on three aspects: first, the capacity in which the Court is evaluating a certain issue, i.e. whether it is acting as constitutional court or as administrative court;³⁸ second, the scope for discretion granted by the Treaties or secondary legislation to the institution for adopting its decisions³⁹ in view of the complexity and technical nature of the assessment involved; and finally, whether the protection of fundamental rights is at stake.⁴⁰

If we now apply these parameters to the ECB, we conclude that there are different standards for the intensity of the judicial review, depending on the topic.

In monetary policy the ECB acts in its policy-making capacity: the Court of Justice (in the *Gauweiler* case) exercised a limited review, recognising that the ECB was fully competent to take those decisions and had properly analysed the matter before

³⁵ See also Van Cleynenbreugel (2014); Laguna de Paz (2012); and Nazzini (2015).

³⁶ According to the Court, in cases involving complex economic and technical assessments, judicial review is “limited” to verifying whether: (i) the relevant procedural rules have been complied with; (ii) there is a comprehensive statement of reasons; (iii) there was any error of law; (iv) the facts are accurate, reliable and consistent; (v) the evidence put forward contains all the relevant data that must be taken into consideration to assess a complex situation; and (vi) whether there has been any manifest error of assessment of those facts or any misuse of powers or, on the contrary, they are capable of sustaining the conclusions drawn from it. The crucial element for the judicial review conducted by the Court is the duty to state reasons, in accordance with Article 296 of the Treaty on the Functioning of the European Union. This jurisprudence has been developed in the context of the judicial review of the Commission’s exercise of the discretion conferred on it in the competition field. The Court has stated that it cannot substitute its assessment of the Community interest for that of the Commission, but focuses on whether the contested decision is based on materially incorrect facts, or is vitiated by an error of law, manifest error of appraisal or misuse of powers.

³⁷ The question of finding a middle way has been considered by the doctrine. Goldmann, in [Adjudicating Economics? Central Bank Independence and the Appropriate Standard of Judicial Review](#), p. 280, advocates for review/scrutiny on the basis of rationality checks which fall somewhere in-between judicial review and full discretion, arguing that rationality checks provide a middle way that falls short of full review but provides more than a procedural review: “Judges should not overstep the limits of their competence in order to enforce the limits of other actors’ competence. Otherwise, they might cause consequences they neither know nor want.”

³⁸ On the various judicial functions of the ECB, see Vesterdorf (2006).

³⁹ Bailey (2004), at p. 1339.

⁴⁰ See Section 3.

taking them. The Court of Justice stated that, being a complex economic matter, it was not possible for it to substitute its assessment for that of the ECB.

By contrast, with regard to individual decisions, for example in cases involving personnel, the Court's review extends to appraising the facts, as the scope for discretion is much more limited: the ECB is acting there as an employer and not a legislator and it needs to abide by the employment rules. Here the Court carries out a comprehensive judicial review.

In ECB decisions imposing sanctions, full jurisdiction applies, as established in Council Regulation (EC) No 2532/98.⁴¹

The most interesting question today relates to the intensity of judicial review in the supervisory field. Will supervisory decisions be subject to a comprehensive judicial review or to a limited review?⁴²

In my opinion, there cannot be a univocal answer. The intensity of the judicial review does not depend of the topic, but on the scope of the discretion granted by the legislator for taking the challenged decision and the complexity of the subject matter. In supervision this varies: while in some decisions the ECB is simply implementing the law and therefore the Court's review will be more intensive, in other decisions the ECB has been granted quite a wide supervisory discretion, and there the Court may recognise that the decision implies a complex technical assessment. In the latter cases, the Court may thus want to exercise some self-restraint in respect of any appraisal of the facts.

In this way, by adapting the intensity of the judicial review to the scope of the discretion granted, the Court will respect independent policy choices while ensuring the appropriate judicial scrutiny that the democratic legal order requires.

3 Judicial review of the respect of fundamental rights in the actions and decisions of Union institutions

Already in the 1970s, much before the formalisation of fundamental rights in Union law,⁴³ the Court was the guarantor of the respect of fundamental rights in the actions of the Community institutions. With the inclusion of the Charter of Fundamental

⁴¹ Council Regulation (EC) No 2532/98 of 23 November 1998 concerning the powers of the European Central Bank to impose sanctions (OJ L 318, 27.11.1998, p. 4).

⁴² To date there has only been one Court judgment on supervisory matters: the judgment of the General Court of 16 May 2017 in Case T-122/15, *Landeskreditbank v ECB*, ECLI:EU:T:2017:337. However, since it deals with the interpretation of a point of law, it does not give any guidance with reference to this question. See also Witte (2017).

⁴³ The Charter of Fundamental Rights was first solemnly proclaimed in Nice on 7 December 2000 (OJ C 364/1) and thereafter inserted in the Lisbon Treaty, according to which it has the same value of the Treaties (Article 6 of the Treaty on European Union). Even earlier, however, starting with its judgment of 12 November 1969, C-29/69, *Erich Stauder*, the Court considered itself competent to verify that Community law and national implementing rules comply with fundamental rights (ECLI:EU:C:1969:57). In its judgment of 11 January 1977, C-4/73, *J. Nold, Kohlen- und Baustoffgroß-handlung*, paragraph 13, the Court made clear that the rights protected in the Community included international treaties on human rights and the constitutional traditions of the Member States (ECLI:EU:C:1974:51).

Rights in the Treaty on European Union, the importance of the respect of such rights by the institutions and by the Member States when implementing Union law has been given more visibility. The Court itself, when defining, within the Treaties, the cornerstones of the legal construction of the Union, has given high priority to the protection of fundamental rights.⁴⁴

During the financial crisis, the pressure to take decisions quickly to protect the public good of financial stability, overruling the private rights at stake, has opened a discussion on whether, in a crisis, fundamental rights deserve the same level of protection, and whether the dichotomy between Union law, in which fundamental rights are protected, and other law where they are not, is sustainable.⁴⁵

The Court has clarified that the respect of fundamental rights in the actions of the institutions, and of the ECB, is justiciable, and that it attaches great importance to their role in ensuring the respect of fundamental rights in the Union. In its *Ledra* decision,⁴⁶ the Court clarified that the institutions, including the ECB, have to respect the Charter of Fundamental Rights even when facing a crisis, and bear in mind the consequences in terms of their liability. This is why, even when policy decisions are taken, towards which the Court would normally exercise restraint, the alleged breach of a fundamental right will be considered in depth by the Court.

With this important contribution, which goes in the same direction as decisions adopted by the European Court of Human Rights,⁴⁷ the Court has made clear that in all its actions, whether in fulfilling its primary objective of maintaining price stability or in performing other tasks that Union law has assigned to it, the ECB needs to ensure that fundamental rights have been properly considered and balanced in the decisions it takes. This applies even when acting under pressure in an emergency situation and even when the ECB is acting outside of the Union legal framework – such cases will be subject to judicial control. The Court has thereby ensured that the fundamental rights are alive and protected in the Union legal system through the actions of the institutions.

4 Conclusions

The analysis has shown that the courts (and the Court of Justice of the European Union in particular), even when dealing with a highly specialised and independent institution such as a central bank, through the varying intensity of judicial control ensure the protection of the cornerstone principles of their constitutional framework, especially fundamental rights, while respecting the horizontal allocation of

⁴⁴ Opinion of the Court (Full Court) 18 December 2014, Case 2/13.

⁴⁵ Barnard spoke of a “twin-track approach” in [The Charter, the Court – and the Crisis](#) (Barnard (2013)).

⁴⁶ Judgment of 20 September 2016, *Ledra Advertising*, paragraph 67 (ECLI:EU:2016:701). This case was brought against the Commission and the ECB with regard to the damage arising from the application of the measures agreed in the Memorandum of Understanding, in application of the Treaty Establishing the European Stability Mechanism, between Cyprus, the Commission and the IMF.

⁴⁷ See the contribution of Pauliine Koskelo, entitled “Relevance of fundamental rights for central bank policy and decision-making”, in this book.

competences and the institutional balance established by the same constitution, or the Treaties.

The next panel includes distinguished specialists on these issues, who are very well placed to further develop the analysis.

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Judicial review and institutional balance with regard to European monetary policy

By Juliane Kokott and Christoph Sobotta¹

1 Introduction

Institutional balance is a well-known topic in the context of judicial review. The European Union courts have addressed it with regard to the relationship between the Parliament, the Council and the Commission,² but it is less clear how institutional balance applies to the role of the European Central Bank (ECB) and the Eurosystem.

This paper will aim to avoid the technicalities of judicial review, but discuss the core elements with particular focus on issues that are relevant for the relationship between the ECB, the Eurosystem and the Court of Justice of the European Union. Obviously, the main guidance in this regard is to be found in the *Gauweiler* case,³ but this case does not exhaust the topic of institutional balance and judicial review with regard to European monetary policy.

The term institutional balance speaks to our imagination. The picture that comes to mind is a mobile, that is, a freely moving sculpture hanging from the ceiling, always returning to a fragile equilibrium. Obviously, the equilibrium between the institutions is significantly less fluid and certainly less picturesque. However, similar to a mobile the Treaties create a complex set of forces that are mutually influencing each other while, at the same time, interacting with external events.

Unfortunately, as a legal term, the concept of institutional balance does not add much beyond this appeal to our imagination. It underlines that we should be careful not to disturb the balance, but doesn't really help us to determine the constituent elements of the actual balance. To find out more we need to study the provisions that define the relationship between the different institutions.

The obvious candidates in this regard are the powers of the different institutions, but also rules on their interactions, such as obligations to consult or to inform. The jurisprudence of the Courts provides us with many examples of disputes over such issues. As regards the ECB a very early case on the powers of OLAF, the European

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² Cf. Judgment of 22 May 1990, *Parliament v Council*, C-70/88, EU:C:1990:217, para 21; judgment of 23 March 2004, *France v Commission*, C-233/02, EU:C:2004:173, para 40; and judgment of 16 July 2015, *Commission v Council*, C-425/13, EU:C:2015:483 paras 60 ff.

³ Judgment of 16 June 2015, *Gauweiler and Others*, C-62/14, EU:C:2015:400.

Union anti-fraud office, to investigate in the ECB should be highlighted.⁴ And of course one of the subjects of the Gauweiler case was the powers of the Eurosystem in the area of monetary policy. This issue will briefly be addressed in section 2.

But another element of Gauweiler is much more interesting because it demonstrates how the institutional balance between the Union courts and specialised Union institutions works within the context of judicial review, namely the standard of judicial scrutiny regarding the substance of the measures under review. This will be the main focus of this paper, to be found in section 3.

2 Institutional powers

The Court has highlighted that the observance of the institutional balance means that each of the institutions must exercise its powers with due regard for the powers of the other institutions.⁵ Obviously, the balance between the institutions can be affected if institutions act beyond their own powers and intervene in areas of competence that are reserved for other institutions. Therefore Article 13(2) TEU provides that each institution shall act within the limits of the powers conferred on it in the Treaties. This is the horizontal complement to the vertical principle of conferral of powers set out in Article 5(2) TEU. It reminds us that the Union can only act within the limits of the competences conferred upon it by the Member States in the Treaties. This provision serves to protect the powers of the Member States. As a consequence, any measure adopted by a European Union institution must be based on a specific competence, directly or indirectly derived from the Treaties.

In accordance with settled case-law, the choice of the legal basis of a European Union act must rest on objective factors amenable to judicial review. These factors include the aim and content of that measure.⁶ If examination of a measure reveals that it pursues two aims or that it has two components and if one of those aims or components is identifiable as the main one, whereas the other is merely incidental, the measure must be founded on a single legal basis, namely that required by the main or predominant aim or component.⁷

This is how the Court in Gauweiler addressed the boundaries between monetary policy, the competence of the Eurosystem, and economic policy, a competence mainly held by the Member States and coordinated primarily by other institutions of the Union. The Court looked into the objectives of the measure and the instruments employed.⁸ And analogous to focus on the main or predominant aim or component, the Court of Justice was not distracted by indirect effects, in particular on economic

⁴ Judgment of 10 July 2003, [Commission v ECB](#), C-11/00, EU:C:2003:395.

⁵ Judgment of 22 May 1990, [Parliament v Council](#), C-70/88, EU:C:1990:217, para 22; and judgment of 28 July 2016, [Council v Commission](#), C-660/13, EU:C:2016:616, para 32.

⁶ Judgment of 11 June 1991, [Commission v Council](#), C-300/89, EU:C:1991:244; judgment of 6 November 2008, [Parliament v Council](#), C-155/07, EU:C:2008:605, para 34; judgment of 14 June 2016, [Parliament v Council](#), C-263/14, EU:C:2016:435, para 43.

⁷ Judgment of 4 October 1991, [Parliament v Council](#), C-70/88, EU:C:1991:373, para 17; and judgment of 6 November 2008, [Parliament v Council](#), C-155/07, EU:C:2008:605, para 34.

⁸ Judgment of 16 June 2015, [Gauweiler and Others](#), C-62/14, EU:C:2015:400, para 46.

policy objectives. Such indirect effects do not exclude a qualification as monetary policy.⁹

3 Standard of review

3.1 Potential disputes

Once it has been established that a measure comes within the scope of monetary policy, there may still be a dispute over its legality. To exemplify this we will look into the concept of price stability and the debate over the level of interest for bank deposits.

3.1.1 The concept of price stability

According to Article 127 TFEU the main substantial objective of the Eurosystem is to maintain price stability. A subsidiary aim is to support the general economic policies in the Union.

Primary law only gives us a definition of price stability in respect of the convergence criteria for accession to the monetary union. It is not absolute, but relative in nature. The price stability criterion is met if the performance of the Member State in question does not exceed by more than 1½ percentage points that of, at most, the three best performing Member States.¹⁰ But the concept of “best performance” is not entirely clear, in particular if we consider that Member States could experience deflation. Moreover, for the purposes of a monetary policy for the euro area as a whole the understanding cannot exclusively rely on the performance of specific Member States.

From the perspective of a layperson price stability could be understood as meaning zero percent inflation. But this would put us very close to deflation where monetary policy may no longer be effective. In addition, there appears to be a risk of errors when measuring inflation. And, finally, it is unlikely that the rates of inflation are identical in all economies of the euro area. Therefore an average inflation of zero percent would imply harmful deflation in some areas.

For these reasons the Governing Council of the ECB aims to maintain consumer price inflation rates below, but close to, 2% over the medium term, for the euro area as a whole.¹¹ This inflation target, more or less, seems to be the current consensus among central banks of the developed world.

⁹ *ibid.*, paras 51, 52 and 59.

¹⁰ Article 140(1) TFEU and Article 1 of the Protocol on the Convergence Criteria.

¹¹ European Central Bank (2003).

Conversely, in the light of experiences during the financial crisis, US economists are currently debating whether an even higher rate of inflation should be adopted as the objective of price stability.¹² Others are concerned about asset price inflation, in particular the risk of so-called bubbles.¹³

And finally, it should be noted that it is not excluded to take the definition of price stability out of the hands of the independent central bank and leave it with a government that is subject to democratic supervision. This is the path chosen by the United Kingdom where the Treasury defines price stability.¹⁴

In view of these diverging positions, the question arises whether in the EU system the Court of Justice should decide this issue by interpreting the term “price stability”?¹⁵

3.1.2 Low interest rates

Another possible dispute over monetary policy is exemplified by the current public debate in Germany. The ECB is criticised for the effects that current interest rates have on savings. It is claimed that depositors are “expropriated” by low interest rates resulting from monetary policy.¹⁶ It could also be argued that the low interest rates harm the traditional business model of banks because the possible margin between the interest on savings that is paid to depositors and the interest on credit that they charge debtors is very small.¹⁷

With regard to savings the critics allude to the protection of property while the freedom of banks to conduct a business could be affected by the limited margins. The EU Charter of Fundamental Rights guarantees both. Does that mean that depositors and banks can expect to be protected against ECB policy by the Court of Justice?

3.2 Review of complex appraisals

Though judicial control of monetary policy is very new to the Union judiciary, well-established jurisprudence on issues of a similar nature can provide guidance. In particular, the Court recognises that the Commission has a margin of discretion with regard to complex economic appraisals, for example in the area of competition law. The necessary assessments are often not only characterised by technical or

¹² See, for example, Baker et al. (2017).

¹³ On the ECB strategy in this regard see Trichet (2005) and Smaghi (2009).

¹⁴ See section 12 of the Bank of England Act 1998.

¹⁵ Implied by Palm (2016), paras 45 and 46; Schütz (2001), pp. 298 et seq.

¹⁶ Sinn (2017).

¹⁷ Bank for International Settlements (2015), p. 111.

scientific complexity, but also by uncertainty. Therefore they require a prognosis of future developments. In such cases judicial review is limited to manifest errors.¹⁸

This jurisprudence is not only an example of judicial self-restraint, but is also a practical expression of institutional balance. It is based on the consideration that Union courts cannot substitute their own view on complex assessments for that of the institutions on which alone the Treaties have conferred that task.¹⁹ These other institutions possess better technical and scientific expertise within the fields of their competence than courts of law. In addition, they usually enjoy a stronger democratic legitimacy than the courts because they are directly or indirectly responsible to an elected parliament.²⁰

Although substantial review therefore is limited, the European Union courts will need to establish whether the evidence relied on is factually accurate, reliable and consistent, but also whether that evidence contains all the information which must be taken into account in order to assess a complex situation and whether it is capable of substantiating the conclusions drawn from it. Moreover, the courts will verify the respect of procedural requirements and in particular of the duty to give reasons.²¹

3.3 Application to monetary policy measures

In *Gauweiler*, the Court applied this jurisprudence to monetary policy measures of the Eurosystem, more specifically to outright monetary transactions.²²

It can be assumed that this was primarily based on the specific expertise of the Eurosystem with regard to monetary policy. Conversely, the Eurosystem cannot claim particularly strong democratic legitimacy due to the fact that the Treaties guarantee its independence from direct democratic supervision. However, the Members of the Governing Council of the ECB enjoy democratic legitimacy because of their appointment, either – in case of the members of the Executive Board of the ECB – by the European Council or – in case of the Governors of the Eurosystem national central banks – by the Member States. Moreover, the Member States have democratically decided to assign the task of independently conducting monetary policy to the Eurosystem and not to courts of law.

¹⁸ Judgment of 15 February 2005, *Commission v Tetra Laval*, C-12/03 P, EU:C:2005:87, para 39; judgment of 8 December 2011, *Chalkor v Commission*, C-386/10 P, EU:C:2011:815, para 54; and judgment of 10 July 2014, *Telefónica and Telefónica de España v Commission*, C-295/12 P, EU:C:2014:2062, para 54.

¹⁹ Judgment of 15 October 2009, *Enviro Tech (Europe)*, C-425/08, EU:C:2009:635, para 47; and judgment of 21 July 2011, *Etimine*, C-15/10, EU:C:2011:504, para 60.

²⁰ Kokott/Sobotta (2017), p. 169.

²¹ Judgment of 21 November 1991, *Technische Universität München*, C-269/90, EU:C:1991:438, para 14; judgment of 15 February 2005, *Commission v Tetra Laval*, C-12/03 P, EU:C:2005:87, para 39; judgment of 6 November 2008, *Netherlands v Commission*, C-405/07 P, EU:C:2008:613, para 56; judgment of 8 December 2011, *Chalkor v Commission*, C-386/10 P, EU:C:2011:815, para 54; and judgment of 10 July 2014, *Telefónica and Telefónica de España v Commission*, C-295/12 P, EU:C:2014:2062, para 54.

²² Judgment of 16 June 2015, *Gauweiler and Others*, C-62/14, EU:C:2015:400, para 68.

As a consequence of Gauweiler it seems quite safe to assume that the Court would allow the Eurosystem broad discretion with regard to the setting of interest rates because this is a typical measure of monetary policy based on a complex appraisal.

The specification of price stability by setting an inflation target is, on the other hand, a much more sensitive issue. This concept is central to the mission of the Eurosystem. Can we grant an independent specialised body a margin of discretion to define its own mission?

At first glance, the jurisprudence on complex economic appraisals appears to support discretion. One area where this jurisprudence began is competition law. The first cases concerned the Commission's assessment whether certain agreements restrained competition or not. It should not surprise us that the Court considered that this assessment requires discretion.²³

The concept of "restriction of competition" is very similar in nature to the concept of "price stability". Both require complex assessments in the area of economics, implying a prognosis of future developments and they are the foundation of the mission conveyed on the institution responsible for this policy area. As a consequence these early cases support the expectation that the Court would refrain from an exhaustive and closely circumscribed interpretation of "price stability" and consider it a matter of complex economic appraisal subject to limited substantial review.

Such an approach would reflect the entanglement between the concept of price stability and monetary policy. The setting of an inflation target is at the same time a specification of the concept and a measure of monetary policy that will influence market expectations. The press release on outright monetary transactions that was the object of the Gauweiler case demonstrates that such announcements can be extremely effective. Strict judicial scrutiny of the concept of price stability could deter the Eurosystem from employing this instrument. After all, there is no obligation to communicate an inflation target. The US Federal Reserve waited until 2012 to do so.²⁴

Additionally, even if the Court provided a precise definition of price stability, it would be difficult if not impossible to verify whether the monetary policy of the Eurosystem really aimed at implementing the legally determined inflation target or at some other objective.

In spite of these considerations, it is far from obvious that the Court would extend the jurisprudence on limited substantial review to the concept of price stability. In more recent jurisprudence on competition law, the Court stresses effective judicial protection and therefore insists on reviewing the legal classification²⁵ or

²³ Judgment of 11 July 1985, [Remia and Others v Commission](#), 42/84, EU:C:1985:327, para 34; judgment of 17 November 1987, [British American Tobacco and Reynolds Industries v Commission](#), 142/84 and 156/84, EU:C:1987:490, para 62; and judgment of 28 May 1998, [John Deere v Commission](#), C-7/95 P, EU:C:1998:256, para 35.

²⁴ Board of Governors of the Federal Reserve System (2012).

²⁵ Judgment of 11 September 2014, [CB v Commission](#), C-67/13 P, EU:C:2014:2204, para 46.

interpretation²⁶ of information identified by the Commission. This could be understood as drawing a distinction between legal concepts, such as “restriction of competition” or “price stability”, that are subject to strict judicial review, and the appraisal of economic facts with regard to these concepts where only manifest errors would be sanctioned.

It should also be noted that the Court has refused to limit judicial review in cases of serious interference with the fundamental rights of a large number of people.²⁷ Although the specification of the concept of price stability does not directly interfere with fundamental rights it is central to the structure of the monetary union and therefore affects the economic dimensions of fundamental rights of everybody in the EU.

Therefore, the Court could review the concept of price stability more strictly than other measures of monetary policy. In particular, it cannot be excluded that there is an upper limit for inflation targets where the Court would intervene. In any event, other factors such as the circumstances of the specific case, the general economic situation, the practice of other central banks and the perception of the Eurosystem’s policies at the time could also have an impact on the level of scrutiny that the Court applies.

3.4 Compensatory scrutiny

As regards these other factors, in particular the remaining vectors of judicial review relating to complex appraisals should not be underestimated. The institution’s compliance with obligations to examine carefully and impartially all the relevant elements of the situation in question and to give an adequate statement of reasons²⁸ could have a spill-over effect on substantial review. If the Eurosystem provides a coherent and convincing reasoning for its position and demonstrates a comprehensive appraisal of the relevant elements, a strict substantial review appears less likely. At the same time, compliance with these obligations would promote the debate of monetary policy. This could help to compensate the absence of direct democratic supervision.

4 Conclusion

We have seen that institutional balance is not only an objective of judicial review, but also deeply embedded in the actual review process. With regard to monetary policy, the foundations have been laid in the Gauweiler case, but there is still much scope for further developments. The next opportunity lies in the recent reference of the

²⁶ Judgment of 8 December 2011, [Chalkor v Commission](#), C-386/10 P, EU:C:2011:815, para 54; and judgment of 6 November 2012, [Otis and Others](#), C-199/11, EU:C:2012:684, para 59.

²⁷ Judgment of 8 April 2014, [Digital Rights Ireland and Others](#), C-293/12 and C-594/12, EU:C:2014:238, paras 47 and 48; and judgment of 6 October 2015, [Schrems](#), C-362/14, EU:C:2015:650, para 78.

²⁸ Judgment of 21 November 1991, [Technische Universität München](#), C-269/90, EU:C:1991:438, para 14; and judgment of 16 June 2015, [Gauweiler and Others](#), C-62/14, EU:C:2015:400, para 69.

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²⁹ German Federal Constitutional Court, Order of the Second Senate of 18 July 2017 – [2 BvR 859/15](#), [2 BvR 980/16](#), [2 BvR 2006/15](#), [2 BvR 1651/15](#) (ECLI:DE:BVerfG:2017:rs20170718.2bvr085915), pending as Case C-493/17 – Weiss and Others.

Varying standards of judicial scrutiny over central bank actions

By Matthias Lehmann¹

Central banks fulfil crucial macroeconomic functions. Extensive judicial review could hamper the decisiveness and efficacy of their actions. At the same time, central banks – like all other organs of the state – need to be subject to the rule of law. This contribution is an attempt to reconcile these seemingly contradictory propositions. The principle of central bank independence proves to be inconsequential for this discussion, as it does not exclude judicial control. The question is not whether such control is necessary, but rather what the appropriate degree is.

In this respect, the contribution proposes a system of differentiated scrutiny. It introduces varying standards of review for different types of measures (e.g. monetary policy, bank supervision or bank restructuring). It then goes on to refine the grounds of review for monetary policy measures. The suggestion is that judicial oversight, if properly exercised, does not stymie the activity of central banks, but rather encourages them to correctly perform their economic functions.

Central bankers appearing before judges are certainly an unusual sight. Moreover, such appearance is also undesirable. Intuition tells us that central bankers should be answerable to judges for their professional activities only when they have done something patently illegal or even criminal. Why is this so? The reason lies in institutional balance and efficiency. The main function of the central bank, according to modern understanding, is to set the parameters of monetary policy.² They could not accomplish this task if their actions were subject to constant second-guessing and reversal by other authorities. To fulfil their mandate, central banks need a degree of flexibility and autonomy. This is not only true with regard to politicians, but with regard to courts as well.

Yet a central bank is a body of the state and, as such, it has to obey the law. It follows that its actions must be subject to judicial review, for a legal rule which cannot be enforced by courts is a paper tiger. One could simply not countenance, for instance, that a central bank appropriates new powers it is not endowed by statute.

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² See Bernanke (2010), pp. 2 et seq.; Pollard (2003), p. 19. The functions of central banks have changed over time. At the beginning, they also included commercial banking services and the provision of government finance in times of crises, before they became more focused on price stability as the typical goal of modern monetary policy, see Capie, Goodhart, and Schnadt (2012), pp. 4-5, 8; Goodhart (1988).

Hence there is a tension between central banking and the rule of law. The powers of central bankers and courts must be delineated in such a way as to allow efficient and flexible monetary policy while at the same time ensuring the respect of legal limits. Finding this balance is the challenge that this contribution has to master.

The first part will examine the impact of central bank independence and accountability on judicial review. The second part will set out different standards of scrutiny for various types of central bank actions. The third part will flesh out the grounds for review in one specific area, i.e. monetary policy.

1 Independence, accountability, and judicial review

In most current discussions about the legal status of central banks, the two terms that frequently come up are ‘independence’ and ‘accountability’. These are the two basic tenets of central banks’ legal regime. Before we can discern their importance for the question of judicial review, we must clarify their meaning.

1.1 An independent monetary authority and its relation to the courts

Many central banks around the world take pride in being called ‘independent’. The word is however not without ambiguity. Milton Friedman denounces as “trivial” the common interpretation according to which monetary policy is delegated, for reasons of expedience, to a specialised agency of the state.³ What independence truly aims at, in his opinion, is to establish the central bank as a fourth branch of government, in addition to the legislature, executive, and judiciary. From this, he concludes that it would be hard to reconcile the idea of central bank independence with the liberal belief in the rule of law.⁴

In legal terms, independence is much more complex than this conception suggests. Countries in which the central bank is called “independent” have quite varying rules. Details matter.

Take the European Central Bank (ECB). It enjoys functional, personal, financial, and regulatory independence.⁵ What is more, its status is guaranteed by the Treaty on the Functioning of the European Union (TFEU), and consequentially can only be amended by unanimous agreement and subject to ratification by the Member States.⁶ The TFEU also contains an explicit prohibition against political interference: It enjoins other Union bodies, Member States and national banks from seeking to

³ Friedman (1962), p. 225.

⁴ *ibid.*, p. 227.

⁵ For these different aspects, see Brentford (1998), pp. 88-100.

⁶ Art 48(6) Treaty on European Union. See also Zilioli and Selmayr (2000), p. 629.

influence the decision-making of the ECB, and bars ECB members from seeking or taking any instructions from them.⁷

Contrast this with the status of the Bank of England. Part of the mandate of its Monetary Policy Committee is “supporting the economic policy of Her Majesty’s Government, including its objectives for growth and employment”.⁸ True, this obligation is subject to the objective of price stability, but the Treasury can specify its meaning. There are also connections at the personal level between members of the Committee and the government.⁹ The peculiar arrangement of the Bank of England is called “operational independence”.¹⁰ The Bank of Japan has a similar status.¹¹

Looking to the United States, one can see again a very different picture. The “independence” of the Board of Governors of the Federal Reserve and its Federal Open Market Committee is mainly the result of a political consensus.¹² It is buttressed by two legal rules. The first rule is that the Fed is financially autonomous because it does not receive its funding through the congressional budgetary process, but through interest and fees.¹³ The second rule concerns personal autonomy, which results from the rather long terms of appointment for the members of the Board of Governors (staggered fourteen years, with the chairman being elected for four years),¹⁴ and the fact that elected officials and members of the administration are not allowed to serve as board members. Nevertheless, the Board must produce an extensive biannual report to Congress, and its chairman and other officials are often asked to give testimony. These factors explain why the Board does not claim to be independent from government but instead uses the expression “independence within government” to describe its role.¹⁵

This short survey demonstrates that countries fashion central bank independence very differently.¹⁶ In addition, *legal* independence does not necessarily amount to *de facto* independence.¹⁷ It is therefore not correct to claim, as Friedman did, that central bank independence aims at establishing a fourth branch of government.

⁷ Article 130 TFEU. See also Article 7 of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank. In the view of the ECJ, this prohibition “is intended to shield the ESCB and its decision-making bodies from external influences which would be likely to interfere with the performance of the tasks”, Case C-62/14, *Gauweiler and Others v Deutscher Bundestag*, ECLI:EU:C:2015:400, para. 40.

⁸ Article 11(b) of the Bank of England Act 1998.

⁹ The Chancellor of the Exchequer appoints four members and needs to be consulted for the appointment of another two by the Governor of the Bank, see Article 13(2) of the Bank of England Act 1998.

¹⁰ Hall (2008), p. 129.

¹¹ Bernanke (2010), p. 9.

¹² It was an Accord struck in 1951 between the Treasury and the Federal Reserve that has laid the foundation of modern monetary policy independence, see Meltzer (2010), p. 708.

¹³ See Board of Governors of the Federal Reserve, “[What does it mean that the Federal Reserve is ‘independent within the government’?](#)”, (last accessed 20 September 2017); Goodfriend (2012), p. 6.

¹⁴ Banaian, Laney and Willett (1986), p. 204-205; Pollard (2003), p. 16.

¹⁵ See Board of Governors of the Federal Reserve, “[What does it mean that the Federal Reserve is ‘independent within the government’?](#)”, (last accessed 20 September 2017).

¹⁶ See Banaian, Laney and Willett (1986), p. 202 et seq. For an index of central bank independence, see Alesina and Summers (1993), p. 154.

¹⁷ Cukierman (1992), pp. 43-44; Taylor (2016), pp. 96-97.

Despite their divergences, all rules on independence have a common function: They shield the exercise of monetary policy from political influence, whether in total or only on the operational level.¹⁸ The usual justification given is economic, and runs along the following lines: Monetary policy is most effective if it is long-term oriented because it works with significant time lags.¹⁹ Politicians, however, are prone to short-term thinking, mainly due to the influence of the election cycle. The result is a time-inconsistency problem: Politicians have a tendency to go easy on the inflation target if it helps to stimulate the economy at a time suitable for them. Empirical evidence shows that this has negative effects in the long run.²⁰ Hence it is recommended to take monetary policy away from politicians and put it in the hands of an “independent” central bank.²¹

This case for central bank independence is not undisputed, with Milton Friedman in particular arguing against an autonomous monetary authority.²² Also, the shield imposed between politicians and monetary policy is a relatively recent development, having started after World War II.²³ More important for our purposes is that the rationale for central bank independence does not apply to oversight by courts. Judges typically do not have a political agenda, or if they have they cannot rely on it in legal arguments, and they are not at risk of succumbing to short-termism. Hence there is little danger that they will interfere with monetary policy out of ignorance or egoistic motives. This does not exclude that judicial review may hinder the efficiency of central banks. They may indeed be hamstrung by restrictive legal interpretations, yet this danger is of an entirely different nature than that of an appropriation of monetary policy functions by politicians. The arguments against political and judicial interference are not the same. Independence is first and foremost a shield against the political power, not against the control by the judiciary and the enforcement of the rule of law.

1.2 Sovereign immunity of central banks?

Despite the clean theoretical break between central bank independence and judicial review, some legal systems mix the two issues. In the US, the Board of Governors of

¹⁸ See Bernanke (2010), pp. 2 et seq.; Crowe and Meade (2007), pp. 70 et seq.; Thatcher and Stone Sweet (2002), pp. 12 et seq.

¹⁹ Bernanke (2010), p. 2.

²⁰ The so-called Phillips' curve establishes a historical inverse relationship between rates of unemployment and corresponding rates of inflation that result within an economy. For a discussion of its importance for an independent central bank, see Sawyer (2010).

²¹ See Rogoff (1985) (arguing that the appointment of a central banker predisposed toward a low and stable inflation rate would solve the time-inconsistency problem); Banaian, Laney and Willett (1986), p. 205-206 (providing empirical evidence of a correlation between central bank independence and low inflation); Fischer (1995) (reviewing theoretical arguments for central bank independence). There may be additional reasons why politicians are not ideal for taking policy decisions, such as their susceptibility to interest groups or side-payments, see Alesina and Tabellini (2007).

²² Friedman (1962) (“Money is too important to be left to the central bankers.”). Alesina and Summers (1993) find no measurable effect of central bank independence on economic factors other than price stability such as growth, unemployment or real interest rates. Goodfriend (2012) goes further and argues that wide operational and financial independence of monetary policy may even be detrimental for macroeconomic and financial stability.

²³ See the Accord between the Fed and the Treasury cited above footnote 11.

the Federal Reserve is considered to be immune from court control. It cannot be sued, even in matters that are entirely unconnected to its special economic mandate.

A good illustration is the case *Research Triangle v Board of Governors of the Federal Reserve*. A non-profit organisation conducting a survey for the Fed claimed compensation for unforeseen costs during the contract's performance. The claim was dismissed on the district court and the appeals level for lack of jurisdiction on the ground that the Fed had legal personality separate from that of its constituent member banks and enjoyed sovereign immunity, which had not been waived.²⁴ This view may be correct under US law,²⁵ yet it seems exaggerated from an outsider's perspective. There is no reason why a contractor should not be able to sue the central bank with regard to the fulfilment of contractual obligations. In particular, one fails to see how ordinary contract litigation could endanger the Board's independence or prevent it from exercising its functions properly.

Given the general nature of sovereign immunity, it is likely that US courts will also apply it to public law cases. By excluding all judicial review against the Fed's decisions, they effectively give it a blank cheque. Control can only be exercised politically by Congress and the government.

The situation in Europe differs significantly from that of the US. Under the treaty law, it is clear that the European Central Bank (ECB) is subject to judicial oversight.²⁶ That is not called into question by the fact that the bank enjoys legal personality separate from that of the Union and a special constitutional status. Even those authors who compare the ECB to a "new Community" stress that it is subject to the "full control of the ECJ".²⁷ Thus, independence does not exclude judicial review.

1.3 Accountability, transparency, and judicial review

While it would be an error to consider central bank independence as an obstacle to court review, it would as well be wrong to suggest that accountability warrants such review. Accountability is the principle that one has to give an explanation for one's action and will be held responsible for them.²⁸ At first blush, one could think that this principle would mean that the central bank must be accountable to the courts. Yet accountability has a different addressee. This becomes exceedingly clear when looking at the corollary of accountability, which is transparency. For a central bank to be transparent, the policy and the aims underlying its actions must be open and clear

²⁴ *Research Triangle v Board of Governors of the Federal Reserve*, United States District Court, M.D. North Carolina, 962 F.Supp. 61, confirmed by 132 F.3d 985 (4th Cir. 1997).

²⁵ But see *Texas State v United States*, 432 F.3d 1370 (Court of Appeals for the Federal Circuit 2005), in which the court upheld its jurisdiction to review a policy that allowed the Fed to keep interests in earnings from bank's deposits. However, the judgment attributed the policy to the US government and not to the Fed, and therefore does not squarely contradict the decision in *Research Triangle*.

²⁶ Articles 263, 265 Treaty on the Functioning of the European Union (TFEU). See also Case C-11/00, *Commission v ECB*, ECLI:EU:C:2003:395, para. 135.

²⁷ Zilioli and Selmayr (2007), p. 359.

²⁸ See de Haan, Amtenbrink, and Eiffinger (1999), pp. 171-73.

to the *general public* or elected officials.²⁹ At the basis of the demand for accountability and transparency is democracy.³⁰ In a democratic state, ultimate power shall lie with the people and not with a small group of central bankers. Thus the beneficiaries of accountability are not judges, but the government, the parliament or the public.³¹

Judicial review works differently. Judges in most states, just like central bankers, are unelected and therefore also lack democratic legitimacy. If central bankers were accountable to judges, it would just mean replacing one group of unelected officials with another. True, courts function as guardians of democracy by making sure that the will of the people as expressed through the law is respected. Yet their task goes much further: They have to defend the rule of law, including fundamental rights and liberties, which are not dependant on the will of the majority. This special function results in very different consequences of judicial review when compared with accountability and transparency. While it suffices under the latter for central bankers to simply *explain* their actions to the public, judges control whether these actions *abide* by the law. If the courts were to find that a central bank measure falls short of this standard, they can annul and reverse it, something that members of parliament or the public could not do.

The distinction between accountability and transparency on the one hand and the need for judicial review on the other is essential. If one fails to draw a clear line between the two, one might fall into the trap of calling for *strict* judicial control of all central bank measures on the basis of democracy. This would be wrong: The bank is obliged to disclose all of its motives and actions to the public, but whether they can be fully reviewed by a court is an entirely different matter. For finding the proper balance between the judiciary and central bank, the principles of accountability and transparency are not helpful.

2 The adaptation of judicial review to different types of central bank measures

Some limits to judicial oversight are necessary. The main reason is the specialisation of the central bank in economic matters.³² A number of central bank decisions require macroeconomic knowledge and expertise, which courts do not have. Even if a judge, by a happy coincidence, disposes of both, he is not supposed to use them because he was appointed for his legal and not for his economic skills. Monetary decisions are to be taken by central bankers, not lawyers. A judge should therefore never substitute his own economic assessment for that of the monetary authority.

²⁹ Mester (2016), p. 44; Tucker (2014), p. 11.

³⁰ See, e.g., Eijffinger and Hoerberichts (2001).

³¹ de Haan, Amtenbrink, and Eiffinger (1999), pp. 154-55; Bernanke (2010), pp. 1-2. For example, the ECB must report at least biannually to the Council on the progress made by the Member States that do not have the euro as a currency in fulfilling their obligations regarding the achievement of economic and monetary union, see Article 140(1) TFEU. On the reporting duties of the Fed, see above 1.1.

³² Cf. Zilioli and Selmayr (2007), p. 358 (describing the ECB as an “independent specialised organisation of Community law”).

Not all central bank measures are alike in this respect. Some require more economic expertise and therefore call for more restricted control than others. Therefore, the question is not whether courts can review central bank measures as such, but which *type* and to what *degree*.

2.1 Monetary policy

The archetypical acts over which courts should exercise only limited review are monetary policy decisions. There are several reasons for this.

The first is the complexity of the assessments and forecasts that the central bank has to make.³³ Another reason is the instantaneous nature of its decisions. The particular situation in which it decides to raise interest rates or inject liquidity into the market cannot be replicated by a court. Central bankers also need credibility to exercise their mission because their task is to a large extent psychological.³⁴ This credibility would be seriously impaired if their actions were subject to *ex post* reversal in court. An additional obstacle is the irreversibility of monetary action. It would be hard if not impossible to unwind the economic consequences, e.g., of a rise of interest given the countless transactions and investment decisions based on them.

These points are important but in the end not fundamentally different from the characteristics of other specialised administrative agencies that also must credibly decide complex matters in a short timeframe and with irreversible consequences, such as the police, health and safety authorities or financial supervisors. The central bank, however, has a distinctive feature that sets it apart. Crucially, its monetary mandate implies some space reserved for its exclusive decision-making. The very term “*monetary policy*” in this context is revealing. It shows that monetary decisions are not merely technical and complex, but require a careful balancing of pros and cons and ultimately consist of a value judgment.³⁵ In that sense, monetary policy is very different from, say, the task of the competition authority, whose actions are narrowly circumscribed by the law.³⁶ It is much closer to fiscal or economic policy.³⁷ The creation of the central bank means that a part of policy-making has been outsourced from the day-to-day work of the government and parliament and

³³ Cf. Case C-62/14, *Gauweiler and Others v Deutscher Bundestag*, para. 68.

³⁴ See Blinder (2000), pp. 15-16 (providing empirical evidence that credibility is even more important than central bank independence); Rochon and Rossi (2015) (discussing theoretical bases of central bank credibility).

³⁵ Blinder (1997) (arguing that policy decisions by the Fed also require a value judgment). See also Banaian, Laney and Willett (1986), p. 199-200 (highlighting that the central bank must emphasize some policy goals at the expense of others); Tucker (2014), 35 (stressing that the central bank must make choices between firms and sectors).

³⁶ There is a debate among economists whether monetary policy should also follow rules, see e.g. Barro and Gordon (1983); Kydland and Prescott (1977); Taylor (2013). However, this discussion is about rules set by the central bank itself and not externally. It is therefore not relevant for the legal analysis carried out here.

³⁷ Lamandini, Ramos and Solana (2016), p. 18. On the distinction between monetary and economic policy, see below in the text.

transferred to the central bank.³⁸ Monetary policy measures thus cannot be subject to the same judicial control as decisions of administrative authorities, but only to a lower standard of review. The grounds for such review will be set out later (see part 3).

An obvious question is how far the category of 'monetary policy' is to be drawn. Take the ECJ decision in *Pringle*,³⁹ in which the claimant alleged, inter alia, that the establishment of the European Stability Mechanism (ESM) would encroach on the ECB's exclusive competence for monetary policy. The ECJ disagreed, ruling that the ESM's power to grant financial assistance is part of economic and not monetary policy.⁴⁰ This result, which is correct, can be buttressed by the criteria developed above: neither is the granting of financial assistance non-repeatable nor irrevocable, nor does it require a special sort of credibility. Most importantly, granting financial assistance is not related to a central bank's exclusive policy space, but can be done by other bodies or organs of the state.

A difficult question is whether the monetary policy category also encompasses new and innovative measures such as quantitative easing (QE). Again, one may resort to the description made: The adoption of QE is an instantaneous, not repeatable decision, the consequences of which are hard to unwind, and which requires for its success the credibility of the decision-making authority. Moreover, adopting these measures requires precisely the kind of weighing of macroeconomic pros and cons for which central bankers are appointed. In spite of its unconventional nature and its possible fiscal side-effects, QE should therefore be considered as part of monetary policy.⁴¹ The same applies to the Outright Monetary Transactions (OMT) programme of the ECB, which despite its differences with QE can be compared in the sense that it is also a novel type of monetary policy measure. The ECJ was right to qualify the announcement of the OMT programme as covered by the ECB's mandate.⁴²

2.2 Banking supervision

Supervising financial institutions is entirely different from monetary policy. It does not involve any of the policy decisions that must be taken for instance in the fixing of interest rates. Instead, bank supervision is a purely administrative and legalistic task. This elucidates why in many states it is delegated to a completely different authority than the central bank.⁴³ Actions such as the granting or withdrawal of a bank licence, the change of management or the requiring of additional capital can interfere with rights, including human rights.⁴⁴ They strongly call for judicial control of their legality.

³⁸ Such transfer is compatible with the principle of democracy as long as the final decision about which parts of the policy are transferred to the central bank and for how long remains in the hand of people's representatives, see Tucker (2016), p. 11.

³⁹ Case C-370/12, *Pringle v Government of Ireland and Others*, ECLI:EU:C:2012:756.

⁴⁰ Case C-370/12, *Pringle v Government of Ireland and Others*, paras. 55-60.

⁴¹ Bernanke (2010), p. 7.

⁴² Case C-62/14, *Gauweiler and Others v Deutscher Bundestag*, para. 56.

⁴³ See the table provided by Goodhart and Schoenmaker (2003), p. 353.

⁴⁴ See Lamandini, Ramos and Solana (2017), p. 216 et seq.

At the same time, such control does not hinder the efficiency of supervisory measures, as they are neither non-repeatable nor irrevocable.

When acting as bank supervisors, central banks should therefore be subject to a similar level of scrutiny as other administrative authorities. The latter often enjoy a large measure of discretion, for instance in the United States.⁴⁵ Central banks as supervisors of credit institutions should be granted the same margin of appreciation and discretion, but not more. Indeed, that seems to be the internationally accepted judicial practice. The Spanish Constitutional Court and Supreme Court have strictly scrutinised the imposition of sanctions by the Banco de España.⁴⁶ Likewise, German courts have no qualms in submitting the decisions of the Federal Financial Supervisory Authority (BaFin) to full judicial review.⁴⁷ The result should not be different where the supervisory powers are exercised by a central bank. When the Bank of England was sued for its alleged failure to oversee BCCI – the first claim against the Bank after 300 years into its existence –, the House of Lords did not even bother to ponder on the limits of its judicial powers, but simply assumed it could control the bank's actions.⁴⁸ It would certainly have decided differently had the dispute concerned a monetary policy measure.

A fundamental objection against the distinction drawn here between monetary policy and supervisory measures, and indeed against any type of differentiated review, is that it would permit to elude court control. A central bank can achieve the same policy goals by different means: If it wishes to tighten monetary supply, it can choose between raising interest rates or increasing capital requirements of banks. The first is a monetary policy decision and subject to limited judicial control, while the second is a supervisory measure that can be more strictly reviewed by the courts. In practice, however, a central bank can hardly evade court control. If it chose to exercise monetary policy via the raising of capital standards, it would become subject to stricter and not less court control. The opposite, supervising banks via monetary policy measures, is difficult to do. Hence, the room for eluding courts is scarce.

Still it is surprising that a bank may be subject to different standards of judicial control based on how it pursues the same policy goal. Ultimately, this is the consequence of the central bank having different tools with varying legal regimes at its disposal, which is due to the aggregation of new tasks and the corresponding transformation into a 'multi-purpose institution'.⁴⁹ To overcome this situation, one need not apply the same standard of scrutiny across the board, i.e. increase judicial

⁴⁵ *Chevron U.S.A. v Natural Resources Defense Council*, 467 U.S. 837 (1984); see also *National Cable & Telecommunications Association v Brand X Internet Services*, 545 U.S. 967 (2005). But see *King v Burwell* 135 S.Ct. 2480 (2015).

⁴⁶ See Spanish Constitutional Court (*Tribunal Constitucional*), judgment of 8 February 1999, ATC 25/1999; Spanish Supreme Court (*Tribunal Supremo*), judgment of 7 October 1997, STS 5921/1997, ECLI: ES:TS:1997:5921.

⁴⁷ See, e.g. Federal Administrative Court (*Bundesverwaltungsgericht*), judgment of 22 September 2004, 6 C 29/03, BVerwGE 122, 59; judgment of 27 February 2008, 6 C 11/07, 6 C 12/07, 6 C 11/07 (6 C 12/07), BVerwGE 130, 262; judgment of 22 April 2009, 8 C 2/09, BVerwGE 133, 358.

⁴⁸ From the various judgments in *Three Rivers District Council and others v Governor and Company of the Bank of England*, see House of Lords, judgment of 18 May 2000, [2000] UKHL 33, and judgment of 22 March 2001, [2004] UKHL 48.

⁴⁹ Taylor (2016), 97. See also Tucker (2016), who speaks of "multiple-mission agencies".

review of monetary policy measures or reduce judicial control over supervisory measures. The former would disturb the exercise of core central bank functions, whereas the latter would loosen the grip of the rule of law. The only way to exclude differentiated standards would be a strict institutional separation between core monetary functions and other tasks, but this would run counter the current trend of extending central banks' powers to ever more areas.

2.3 Bank resolution

At the most basic level, restructuring or resolving an ailing credit institution is merely a prolongation and consequence of supervising its activities. Also, bank recovery and resolution have many legal implications: They touch upon fundamental rights, such as property rights or the right to exercise a profession, the protection of which requires strict judicial scrutiny. While it is true that recovery and resolution measures often have to be undertaken with a sense of urgency, the same can also be said with regard to many other administrative actions, such as health and safety measures. This in and of itself does not justify the same limited judicial control that applies to monetary policy decisions.

The task of restructuring and winding-up credit institutions and financial firms is usually fulfilled by a specialised body and not by the central bank. The latter may be involved in this process as a bank supervisor. But it may also be interested in its function as a guardian of monetary stability, given that recovery and resolution measures can have implications on the financial system and the economy as a whole. This connection to the monetary policy mandate should be taken into consideration when reviewing central bank actions in the area of restructuring and resolution. Where they are preoccupied not with an individual institution, but rather with macroeconomic implications, a lighter form of review is appropriate.

A good illustration is the ECJ decision in *Ledra Advertising*, in which the ECB was sued alongside the Commission for its participation in the negotiation of a macro-adjustment programme for Cyprus that ultimately led to the recapitalisation and resolution of the country's two largest banks.⁵⁰ The General Court had dismissed the suit on the grounds that the programme did not originate with the Commission or the ECB.⁵¹ But the form of involvement was not the point, as all actions of EU bodies must comply with the rule of law. The ECJ therefore was right in reversing the judgment on appeal.⁵² It held that the adjustment measures were justified "given their objective of ensuring the stability of the banking system in the euro area, and having regard to the imminent risk of financial losses" for bank depositors.⁵³ This ruling has been criticized by some authors who plead for more

⁵⁰ Joined Cases C-8/15 P to C-10/15 P, *Ledra Advertising Ltd and Others v European Commission and ECB*, ECLI:EU:C:2016:701.

⁵¹ Case T-289/13, *Ledra Advertising Ltd v European Commission and ECB*, ECLI:EU:T:2014:981, paras. 43-55. On the decision, see Karatzia (2015).

⁵² Joined Cases C-8/15 P to C-10/15 P, *Ledra Advertising Ltd and Others v European Commission and ECB*, paras. 55-61.

⁵³ *ibid.*, para. 74.

stringent judicial scrutiny.⁵⁴ However, the thrust of the programme was not about the restructuring of two credit institutions but concerned the granting of liquidity to a state in return for fundamental reforms. There were significant macroeconomic interests at stake, such as the survival of the Euro, the distribution of losses between Member States and the creation of moral hazard. The weighing of these pros and cons is primarily a political task, and the ECB was involved in the agreement precisely in its capacity as a monetary policy actor. The Court of Justice's reluctance to submit the agreement to a strict standard of review was therefore well founded.

2.4 Other areas

Judicial oversight exercised over other measures which have not yet been mentioned varies along the spectrum of strict to limited review. This spectrum should not be understood as being strictly compartmentalised, but rather as a continuum. The level of scrutiny will be determined by the closeness of the measure to one or the other ends of the continuum.

Take for example the central bank functioning as a lender of the last resort. If one distinguishes this task at all from monetary policy,⁵⁵ it is at least very closely linked to it.⁵⁶ Where the central bank acts as lender of last resort, its actions should therefore be subject to limited judicial scrutiny.

Another area in which courts should exercise restraint is financial stability. In many legal systems, central banks are explicitly tasked to fend off or reduce systemic risk.⁵⁷ Even where this is not the case, it is argued that their mandate nevertheless requires them to do so because the successful transmission of monetary policy to the economy depends on a functioning banking sector.⁵⁸ This intimate connection to monetary policy must influence the standard of judicial review.

An illustration is the categorisation of a financial institution as systemically important. The General Court has upheld the ECB's refusal to characterise a credit institution as "less significant" and transfer its direct supervision to the authorities of a Member State.⁵⁹ In this regard, it exercised strict review. This contrasts with the United States District Court's reversal of a decision by the Financial Stability Oversight Council (FSOC) subjecting an insurance company to enhanced regulation and supervision under the Dodd-Frank Act.⁶⁰ Even though the US court had to apply a comparatively light standard of review, controlling only whether the administrative act was "arbitrary

⁵⁴ Nettesheim (2016); Dermine (2017).

⁵⁵ See Tucker (2014), who is in favour of such a distinction.

⁵⁶ See Lamandini, Ramos and Solana (2016), p. 22.

⁵⁷ For a cross-country comparison, see Han (2016). For an in-depth discussion of the situation under EU law, see Lamandini, Ramos and Solana (2016), p. 19-20.

⁵⁸ Schnabel (2016), p. 49. See also Cunningham and Friedrich (2016); Padoa-Schioppa (2003); Schinasi (2003).

⁵⁹ Case T-122/15, *Landeskreditbank Baden-Württemberg – Förderbank v ECB*, ECLI:EU:T:2017:337.

⁶⁰ *MetLife v Financial Stability Oversight Council*, 177 F.Supp.3d 219 (D.D.C. 2016).

and capricious”,⁶¹ it annulled the FSOC decision for having failed to adhere to its own standards and to carry out a cost-benefit-analysis. The judgment surprised many observers, who have urged for an alternative approach.⁶² The uneasiness stems from the fact that the categorisation of an institution as significant concerns the safety and stability of the financial system, a task first and foremost conferred on the FSOC, in which the Fed is strongly represented. It therefore makes sense to employ a light standard of judicial review. A similarly alleviated review may be appropriate for a decision over the systemic significance of financial market infrastructures, such as central counterparties (CCPs).

There are many areas in which central banks should be subject to strict review. When they enter into contracts or where they commit torts, for example, they do not merit any lighter standard of scrutiny than other actors. The same is true in the area of public law, e.g. where their selection of a certain provider is assessed for compliance with competition or procurement law. These actions do not have any connection with monetary policy, nor do they serve to prevent an imminent threat or danger.

3 Standard of review for monetary policy measures

In the previous section, it has been argued that monetary policy should be subject to a limited form of judicial scrutiny. But what exactly does this mean? What precise legal limitations are placed on central bank actions in this particular sphere, and how can courts review them?

3.1 Mandate

Firstly, a court can look at whether the central bank has the competence to take a certain measure. This is necessary to prevent central bankers from exceeding their mandate. Obviously, it does not suffice that a measure is branded by its author as being part of “monetary policy”. These are not magic words that, when uttered, justify any action and shield it from judicial review. A court must be able to verify whether the central bank is vested with the power to take the particular measure. For this reason, the General Court was right in controlling the power of the ECB to promulgate a policy framework that contained certain requirements for CCP location.⁶³ Implicit to this control is the court’s power of ‘characterisation’: it must have the right to categorise whether the action is a part of monetary policy or not.⁶⁴

⁶¹ Section 113(h) Dodd-Frank Act (Wall Street Reform and Consumer Protection Act), 12 U.S.C. § 5323(h).

⁶² Note (2017), pp. 1197, 1201 et seq.; Dokic (2017); Norchi (2017).

⁶³ General Court, Case T-496/11, *UK v ECB*, ECLI:EU:T:2015:133, paras. 85 et seq.

⁶⁴ Very clear with regard to the OMT programme ECJ, Case C-62/14, *Gauweiler and Others v Deutscher Bundestag*, para. 40, (stating that “the ESCB must act within the limits of the powers conferred upon it by primary law and it cannot therefore validly adopt and implement a programme which is outside the area assigned to monetary policy by primary law”).

Though these points seem sufficiently clear from a theoretical viewpoint, some qualification is necessary. As a matter of practice, there is no static definition of ‘monetary policy measures’. Rather, the concept is dynamic: What today constitutes such a measure may tomorrow be replaced by new tools. These new tools, such as QE, will first be introduced by the central bank itself. Reacting in new and unconventional ways is also part of its monetary mandate. Courts should respect this in order to keep the central bank flexible in adapting its measures to new challenges. The term “monetary policy” should therefore be understood as an open concept. That does not mean that judges must accept anything that the central bank markets under this name, but they should grant it some leeway in introducing new measures. The ECJ showed this kind of openness when allowing the ECB’s OMT programme to go forward despite its new and unconventional character.⁶⁵

3.2 Human rights and other substantive rules (e.g. the prohibition of monetary financing)

Another limitation drawn to central bank actions are human rights, or – as they are called in the EU – ‘fundamental’ rights. As they bind every exercise of state power, there can be no doubt that monetary policy measures must abide by them. Courts must be able to review the compliance of central bank measures with human rights. In this area the central bank does not have any exemption from judicial oversight.

On the other side, court decisions annulling or revoking monetary policy measures are virtually non-existent. This is because these measures can hardly conflict with human rights due to the fact that they operate on a macroeconomic level. When being seized of an action against them, courts usually take into consideration that such measures are a careful balancing act between many different public and private rights.

A good example is the decision of the European Court of Human Rights in the *Mamatras* case. Seized with an action against the bail-in of Greek bond-holders, the judges ruled that reactions to the financial crisis are part of social policy and that state authorities are better placed than an international court to achieve the goals of their choice.⁶⁶ This rationale applies, *a fortiori*, to monetary policy measures. Central banks must be free to decide which policy is best suited to achieve objectives such as price stability or a high level of employment. The execution of their mandate should not be hampered by legal actions of individuals. One must thus be wary when new rights are proposed, such as an individual right to the maintenance of money’s purchasing power or price stability.⁶⁷ Such a legal right would limit the central bank’s

⁶⁵ Case C-62/14, *Gauweiler and Others v Deutscher Bundestag*.

⁶⁶ European Court of Human Rights (ECHR), judgment of 21 July 2016, *aff. Mamatras et autres c. Grèce*, requêtes nos 63066/14, 64297/14 et 66106/14, p. 26, paras. 88 and 89.

⁶⁷ Herrmann (2010), pp. 331 et seq.; Schmidt (2013), p. 1504 (against a “targeted” reduction of money’s purchase power). The German Federal Constitutional Court, not known to take the issue of price stability lightly, has ruled that the fundamental right to property only protects the institutional foundation (i.e. the existence) and the individual attribution of money, but not its value, judgment of 31 March 1998, 2 BvR 1877/97 and 2 BvR 50/98, BVerfGE 97, 350, para. 87.

ability to adopt certain policy measures, e.g. those of the Keynesian type, which lead to inflation but may serve as a stimulus to the overall economy. These policies may make sense from an economic perspective and should not be excluded upfront because of legalistic arguments. The assessment of which policy is suited best to attain the macroeconomic policy goals should ultimately be taken by central bankers, not by judges.

Monetary policy measures must comply with the prohibition of discrimination, and this should be reviewed strictly.⁶⁸ The prohibition may be violated e.g. by the distribution of so-called ‘helicopter money’, which has been discussed as a hypothetical example by Milton Friedman and whose application in the real world has recently become the subject of debate.⁶⁹ Such a measure would change the purchase power of citizens *relatively* to each other. It would therefore violate the prohibition of discrimination as well as the protection of property.

It is self-understood that in taking monetary policy measures, the central bank must obey legal rules that are specifically addressed to it. An example is the prohibition of monetary financing enshrined in Article 123 TFEU.⁷⁰ The European Central Bank or the central banks of the Member States have no prerogative in this regard, and the courts have the power and the duty to strictly review compliance of their measures with the prohibition. It may not be easy to say whether the OMT programme violates EU primary law, but this is not a problem of the degree of review, but rather of the proper construction of the law. There can be no doubt that the latter is ultimately a task of the judiciary and not a prerogative of the central bank. The ECJ in *Gauweiler* has interpreted Article 123 TFEU in a way that carefully balances the purpose of the prohibition of monetary state finance against the effectiveness of monetary policy.⁷¹ It will soon have the chance to rule again on that matter in the context of the Public Sector Purchase Programme (PSPP).⁷²

3.3 Procedural requirements

Several procedural rules regulate the making of monetary policy. For instance, monetary policy action would be unlawful if it were induced by corruption or self-interest.⁷³ It can be discussed whether central bankers are allowed to disclose monetary policy measures to a restricted group of insiders before their official

⁶⁸ As done by the ECHR, judgment of 21 July 2016, *aff. Mamas et autres c. Grèce*, requêtes nos 63066/14, 64297/14 et 66106/14, p. 36, para. 130.

⁶⁹ Friedman (2005), pp. 4 et seq. For the recent discussion see Bernanke (2016); Buiter (2014); Reichlin, Turner, and Woodford (2013).

⁷⁰ The conformity with Article 123 TFEU must be distinguished from the question of ‘proportionality’ and has been treated by the ECJ separately, see Case C-62/14, *Gauweiler and Others v Deutscher Bundestag*, paras. 66 et seq. This has been ignored by the German Federal Constitutional Court in its reference for a preliminary dated 18 July 2017, para. 79.

⁷¹ Case C-62/14, *Gauweiler and Others v Deutscher Bundestag*, paras. 93-127.

⁷² See the reference for a preliminary ruling by the German Federal Constitutional Court dated 18 July 2017.

⁷³ Unfortunately, these cases are anything but theoretical, as illustrated by the recent allegations against the governor of the Banca d’Italia, see Reuters, “[Italy backs central bank chief in corruption investigation](#)”, 28 October 2015, (last accessed 20 September 2017).

adoption⁷⁴ and whether their family members may act on such information for private profit.⁷⁵ These questions are legal questions and have to be decided by courts; central bank representatives cannot invoke a monetary policy related prerogative in their regard.

There are other procedural requirements that the central bank must respect. Among them is the requirement that it must act on the basis of comprehensive information and give reasons for its decisions.⁷⁶ If monetary policy actions were not accompanied with reasons at least explaining the relation to the mandate and the points taken into account, judicial review would be close to impossible. A more detailed reasoning is necessary for accountability vis-à-vis the public or the Parliament. Courts can verify whether the central bank fulfils its obligations in this respect, even though they do not review the reasons themselves.

3.4 Proportionality?

The rather long list of criteria that courts can control raises a question: What is meant by a 'lighter standard of review' that applies in monetary policy matters? In particular, which aspects of central bank's decisions are withdrawn from judicial review?

As a general rule, it can be said that determining the *appropriateness* of monetary policy measures falls within the exclusive competence of the central bankers. There are strong arguments as to why courts should not second-guess, for instance, the timing or quantum of increase in interests rates or the volume of securities purchased on the open market. These are questions that require specific macroeconomic expertise, which courts do not necessarily possess and are not meant to exercise.

What does the aforementioned statement imply with respect to ensuring proportionality in judicial control of monetary policy actions? Under what conditions can courts exercise oversight? One must be careful to distinguish between two types of proportionality review.

The first type applies in the context of fundamental rights control. There can be no doubt that courts can review proportionality when they exercise oversight with regard to fundamental rights.⁷⁷ But as has already been mentioned, monetary policy measures rarely enter into direct conflict with fundamental rights.⁷⁸

The second type of proportionality review relates to the general principle of proportionality enshrined in Article 5(1) and (4) of the Treaty on European Union. The

⁷⁴ See Reuters, "[ECB's Draghi defends private meetings after criticism of hedge-fund dinner](#)", (last accessed 20 September 2017).

⁷⁵ Reuters, "[Swiss central bank chief quits over wife's currency deal](#)", (last accessed 20 September 2017).

⁷⁶ See Case C-62/14, *Gauweiler and Others v Deutscher Bundestag*, para. 69.

⁷⁷ See e.g. ECHR, judgment of 21 July 2016, *aff. Mamatas et autres c. Grèce*, requêtes nos 63066/14, 64297/14 et 66106/14, p. 30, paras. 106 et seq. for the review of macroeconomic policy measures (restructuring of Greek debt).

⁷⁸ See above 3.2.

ECJ interprets this principle to mean that an act must be appropriate for attaining its goals and not go beyond what is necessary to achieve those objectives.⁷⁹ This standard should be applied very cautiously to monetary policy measures. A court should not control, for instance, whether the increase of the interest rate by 50 basis points is appropriate to achieve price stability and does not go beyond what is necessary to attain that goal. That is precisely a question for the central bankers to decide because it requires a policy decision which carefully balances the pros and cons of such a measure. The courts have generally no mandate to substitute the central bank's decision on this point with their own assessment. This does not mean that the central bank would not have to obey the general principle of proportionality, which binds all EU organs, including the ECB.⁸⁰ But it is a different question which standard of scrutiny courts should apply. This standard should be very light and lead to the annulment of a monetary policy measure only where the latter exceeds what is necessary to achieve its objective in such an obvious way that it can be said to lack a rational basis.

Superficially seen, this position seems to contradict the *Gauweiler* decision, in which the ECJ dedicated a lengthy passage to 'proportionality'.⁸¹ However, the court effectively put many different questions under this heading that are not directly related to proportionality and can more properly be characterised as 'procedural guarantees'. This includes in particular the obligation of the bank to carefully and impartially examine all the relevant elements of the situation in question and to give an adequate statement of the reasons for its decisions.⁸² While the court was strict in emphasising these procedural elements, it took a very light touch approach with regard to substantive proportionality.⁸³ The court controlled the reasoning of the ECB only for "manifest error of assessment"⁸⁴ and explicitly stated that "nothing more can be required of the ESCB apart from that it use its economic expertise and the necessary technical means at its disposal to carry out that analysis with all care and accuracy".⁸⁵ Overall, the ECJ has given the ECB broad discretion with regard to the substantive proportionality of its actions, which it justified by the technical nature of the choices to be made and the need to undertake forecasts and the complex assessments.⁸⁶ Crucially, the Court of Justice does not go into the details of the OMT programme, e.g. its volume or the timing, but only controls whether the ECB could "legitimately" take the view that a programme such as that announced in the press release is appropriate for the purpose of contributing to the European System of

⁷⁹ See the definition by the ECJ, Joined Cases C-453/03, C-11/04, C-12/04 and C-194/04, *ABNA and Others v Secretary of State for Health and Food Standards Agency*, ECLI:EU:C:2005:741, para. 68; Case C-558/07, *S.P.C.M. and Others v Secretary of State for the Environment*, ECLI:EU:C:2009:430, para. 41; Case C-58/08, *Vodafone and Others v Secretary of State for Business*, ECLI:EU:C:2010:321, para. 51.

⁸⁰ See Case C-62/14, *Gauweiler and Others v Deutscher Bundestag*, para. 66.

⁸¹ *ibid.*, paras. 66-92.

⁸² *ibid.*, para. 69.

⁸³ See also Lamandini, Ramos and Solana (2016), p. 17, who describe the ECJ's approach as "a slightly formalistic proportionality review".

⁸⁴ *ibid.*, para. 74.

⁸⁵ *ibid.*, para. 75.

⁸⁶ *ibid.*, para. 68.

Central Bank's objectives.⁸⁷ It is true that the judgment places special emphasis on the limitations of the OMT programme.⁸⁸ Yet that may be explained by the relative novelty of the type of action as well as by the fact that the ECB did not put any *ex ante* quantitative limitation on the transactions it would undertake. Ultimately, the Court of Justice was satisfied by the fact that the bank did not act arbitrarily and weighed up the interests at play, without the judges replicating that weighing themselves.⁸⁹

Though the reasoning of the *Gauweiler* decision is not free from ambiguities, it can be read as advocating a limited court control with regard to proportionality. Such judicial restraint is in line with the text of the TFEU, which gives the ECB the power to "define" the monetary policy of the Union.⁹⁰ There is no objective standard to determine which measures are necessary and proportional to attain macroeconomic goals such as the objective of price stability. Courts should not substitute their own opinion in this regard for that of the central bank. They should limit their control to "manifest errors of assessment", as the ECJ did. Only in this way can they prevent constant legal challenges of monetary policy actions on grounds of proportionality. To maintain institutional efficiency and balance, central bankers before the courts must remain the exception and not become the new normal.

4 Summary

Central banks cannot escape the rule of law. Their independence is primarily designed to shield them from political interference and does not stop courts from controlling their decisions. The standard of judicial scrutiny should, however, vary depending on the type of measure taken.

A limited standard of review should apply with regard to monetary policy decisions. A court can control whether these decisions fall within the central bank's mandate, whether they comply with human rights and other substantive rules, and whether procedural requirements are met, such as the prescription of acting in an unbiased fashion and on a full information basis. The court should not exercise strict review over the question whether monetary policy action is necessary or proportionate in relation to its objectives. Otherwise, it would effectively take over the economic function for which central bankers have been appointed.

Technical tasks like bank supervision measures should be subject to stricter scrutiny. Where a central bank supervises credit institutions and other financial firms, it does not fill a policy space, but acts as an administrative authority. Its powers are constrained by the applicable legal framework and the rights of the supervised entities. A court can exercise control to ensure the central bank does not cross these legal boundaries. As in the case with other public authorities, the court must defer to

⁸⁷ *ibid.*, para. 80.

⁸⁸ *ibid.*, paras. 85-86.

⁸⁹ *ibid.*, paras. 90-91.

⁹⁰ Article 127(2) first indent TFEU.

the central bank's administrative discretion and take account of the possibly limited information basis available to the authority *ex ante* when exercising its *ex post* review.

The standard of scrutiny for other measures lies somewhere in between those two extremes. The closer they are to the framing of monetary policy task, the more courts should exercise judicial restraint. Of course, this is not a hard and fast rule. But it may help in raising the courts' awareness that a central bank decision is not necessarily the same as that of an administrative agency, and therefore should not be treated in the same way. Where judges forget this point, they risk upending institutional efficiency and the balance of power.

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Relevance of fundamental rights for central bank policy and decision-making

By Pauliine Koskelo¹

1 Introduction

Whenever we discuss fundamental rights we are dealing with a topic of many complexities. In the present contribution, however, the main aim and ambition is to keep it simple and short. Without going into a high level of details, it is useful to begin by briefly setting out some of the basic notions and distinctions in the field of fundamental rights, before moving on to the more specific issues which have particular relevance in the domain of central bank activities.

2 Elements of context

2.1 Rule of law

Rule of law requires that all exercise of public authority must be based on law and remain within its confines. Rule of law implies that fundamental rights, as part of the binding legal order, do impose both constraints and demands on public decision-making in all areas. Indeed, respect for fundamental rights is one of the pillars in the very concept of rule of law. This being said, and leaving aside the non-derogable core rights such as the right to life and the prohibition of torture and other forms of inhuman or degrading treatment, fundamental rights are not absolute or of a clear-cut nature. Rather, the constraints and demands they impose involve legally structured and controlled balancing exercises.

2.2 Categories of fundamental rights

2.2.1 Civil and political rights – economic and social rights

There is an important distinction between civil rights and freedoms on the one hand and social and economic rights on the other hand. The former comprise the classic liberty rights, also enshrined as human rights, while the latter comprise the more recent kinds of welfare rights. This distinction goes to the sources of rights as well as

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their substance and enforcement. In many of the more modern legal instruments, both at the national and international level, both kinds of rights are included.

2.2.2 Sources of rights

Individuals derive rights from multiple sources. There are rights enshrined at the domestic constitutional level, rights enshrined at the international level, in particular through various Conventions adopted within the framework of the United Nations (UN), and rights enshrined at the European level.

Even between the European Union Member States, the domestic systems of fundamental rights vary considerably. Some constitutions contain fairly comprehensive sets of provisions on the rights of individuals, including not only civil and political rights but also social and economic rights, whereas other constitutions remain limited to enshrining, in more or less inclusive terms, rights in the more classic tradition of civil and political rights and freedoms. There are also differences in regard to the hierarchical status of human rights treaties in the domestic legal order, with some states affording them a status at a level equal to the domestic constitution, some affording them a status at an intermediary level (inferior to the domestic constitution but superior to ordinary domestic laws), and some affording them a status at the level of domestic legislation. Furthermore, the mechanisms available for enforcing the rights of individuals at the domestic level also vary a great deal. Similarly, the mechanisms of interaction between rights guaranteed at the domestic level and rights guaranteed at the international level are also variable.

Among the international instruments we can recall in particular the International Covenant on Civil and Political Rights (1966), the International Covenant on Economic, Social and Cultural Rights (1966), the International Convention on the Rights of the Child (1989) and the International Convention on the Rights of Persons with Disabilities (2006), all of which have been adopted by resolutions of the UN General Assembly. Furthermore, several multilateral instruments have been adopted within the framework of UN specialised agencies such as the International Labour Organisation (ILO).

At the European level, the two main sources of legal instruments in the field of fundamental rights are the various multilateral conventions adopted within the framework of the Council of Europe, comprising 47 Member States, and the treaties governing the European Union. As all EU Member States are also members of the Council of Europe, they are covered by both legal regimes in parallel.

Within the Council of Europe, the European Convention on Human Rights (i.e. the Convention for the Protection of Human Rights and Fundamental Freedoms), including several additional Protocols, enjoys particular prominence, largely on account of the particularly strong enforcement mechanism that is attached to it in the form of the European Court of Human Rights and the supervision of the Court's judgments by the Committee of Ministers of the Council of Europe. This Convention is dedicated to the classic domain of civil and political rights, even though the evolution of those rights through the process of interpretation over the decades has

expanded the conception of many of those rights in ways which encompass aspects of social, economic and cultural rights. Apart from the Human Rights Convention there are, however, several other legal instruments as well, such as the European Social Charter, which covers a range of social and economic rights and is associated with a supervision mechanism through the European Committee of Social Rights, and a whole range of specific conventions in particular fields of human rights protection.

At the level of the Union, it is well-known that fundamental rights under EU law (or previously Community law) developed gradually and were established as general principles of law through the case-law of the Court of Justice. In 1992, the Treaty on European Union expressly introduced a provision according to which the Union shall respect fundamental rights, as guaranteed by the European Convention on Human Rights and as they result from the constitutional traditions common to the Member States, as general principles of Community law (Article 6 TEU). Subsequently, the EU Charter of Fundamental Rights was adopted, first as a non-binding instrument and, through the revision by the Treaty of Lisbon in 2007 and with effect from 2009, as a legally binding part of EU primary law. Article 6(1) TEU now provides that the Union recognises the rights, freedoms and principles set out in the Charter, which shall have the same legal value as the Treaties.

In line with general developments in the field, the EU Charter of Fundamental Rights has a wider substantive scope than, for instance, the European Convention on Human Rights, in that the Charter comprises not only the classic civil and political rights and individual liberties but contains also a number of provisions relating to social and economic rights.

2.2.3 The legal status of rights

The legal status or standing of fundamental rights in each legal order raises a series of complex issues which cannot be addressed here in any depth or detail.

In so far as the domestic level is concerned, reference was already made (under 2.2.1 above) to the variations that exist in terms of the extent to which fundamental rights are enshrined at the level of the national constitutions, in terms of the hierarchical status of international human rights treaties in the domestic legal order and in terms of the domestic mechanisms of enforcement of individual rights. The European map in this field remains diverse.

At the European level, the picture is also multifaceted, in the sense that the real impact of the obligations undertaken by the states depends on the coercive strength of the international supervision mechanisms. In particular as regards the distinction between the classic civil rights and freedoms, as enshrined in the European Convention on Human Rights, and the economic and social rights enshrined in the European Social Charter, there are significant differences, which render the former more powerful than the latter. Complaints before the European Court of Human Rights may result in judgments finding violations of the Convention which are legally binding on the respondent state and which may, depending on the underlying

problem, require various corrective measures in legislation, in administrative or judicial practice, in organisational arrangements or the deployment of resources. The supervisory mechanism at the international level (through the Committee of Ministers of the Council of Europe) reinforces the binding effect of judgments whereby violations are established. By contrast, the European Social Charter is backed up by institutional arrangements which do not represent the same intensity of control; in this field, there is no judicial body competent to adjudicate with legally binding effects.

The EU Charter of Fundamental Rights contains provisions which encompass civil and political rights and freedoms as well as various economic and social rights. However, the Charter makes a distinction between “rights” and “principles” (Article 51), by providing that “rights must be respected” while “principles must be observed”. While the distinction is not spelled out in specific terms, it is intended to reflect the distinction between civil rights and freedoms on the one hand and economic and social rights on the other hand. The underlying thrust here is that whereas rights may be concretised and enforced not only through legislation but also through judicial processes when relied on before the courts, principles must be observed in the policy-making and legislative field, and thus produce their concrete effects more indirectly. As Article 52(5) of the Charter clarifies, “principles” may be implemented by legislative and executive acts in the exercise of the respective powers of Union and Member State authorities, but shall be judicially cognisable only in the interpretation of such acts and when the competent court rules on their legality.

This distinction is understandable in view of the fact that while the implementation of fundamental rights always requires a deployment of resources for the institutional structures of enforcement, economic and social rights, such as those concerning social security and health care, largely depend on the availability and deployment of resources in terms of their very substance. Therefore, the realisation of the latter type of rights remains closely linked with the exercise of legislative and budgetary powers.

2.3 Categories of state obligations arising from fundamental rights

The counterpart of individuals’ fundamental rights are the state obligations that arise from them, including of course similar obligations at the level of the EU institutions within their field of competence. These obligations are usually divided into the following main categories:

On the one hand there is a distinction between positive and negative obligations. Negative obligations refer to what the state is not allowed to do in order to respect the rights of individuals. Positive obligations in turn refer to what the state is required to do in order to ensure the rights of individuals are adequately protected, both in the vertical relationship between the individual and the state and in the horizontal relationship between individuals. The state’s positive obligations are primarily of a regulatory nature, but they encompass also duties at the level of implementation and enforcement.

On the other hand there is a distinction between substantive and procedural obligations. The state must fulfil its obligations, both positive and negative, in order to ensure respect for the substance of the various individual rights, but it must also put in place an effective procedural framework for the enforcement of those rights.

2.4 Types of measures affecting fundamental rights

Fundamental rights may be affected through a wide range of measures taken by the public authorities. If such measures interfere with individual rights without a legal basis, the unlawfulness will in itself be sufficient to constitute a breach. Under the rule of law, however, the action of public authorities needs a legal basis, which is why problems and issues in the context of fundamental rights often arise from deficiencies or alleged deficiencies at the legislative or regulatory level. Especially in this perspective, and with a view to the required or available remedial action, it is useful to distinguish between general measures and individual measures.

Legislative or other regulatory measures may affect the fundamental rights of groups of individuals either intentionally or as a consequence or side-effect – whether contemplated or not – of policies pursued for other reasons. Regardless of the background, such general measures can typically not as such be challenged by individuals before the courts, i.e. unless and until the general measure has given rise to an individual measure taken in application of the general measure.²

2.5 Types of remedies

The realisation of rights is ultimately seen in the remedies that are available for individuals in the event of a violation, or alleged violation, of their rights. The system of remedies is therefore essential. This in itself is an area of great complexity. Only some basic distinctions will be mentioned here.

Whether the individual has access to a judicial remedy or non-judicial avenues of redress is important, because judicial remedies give rise to legally binding rulings, whereas non-judicial findings usually are weaker in impact.

Above, reference was already made to the fact that remedies against general measures are usually not available for individuals, at least not in the form of judicial remedies. In most circumstances, general measures can only be contested indirectly, as and when they materialise in individual measures.

This being said, the case-law of the European Court of Human Rights does recognise that it is not always necessary for victim status to arise to wait until a

² At the level of EU law this approach is reflected in the provision governing legal standing in actions for annulment under Article 263(4) TFEU, according to which any natural or legal person may institute proceedings against an act addressed to that person or which is of direct and individual concern to them, and against a regulatory act which is of direct concern to them and does not entail implementing measures.

contested piece of legislation has actually been applied to the individual concerned. It may be enough that an individual can establish that he or she is a member of a class of people who risk being directly affected by such legislation.

We can also distinguish between individual and collective remedies, whereby the former are based on action brought by identified individuals or groups of individuals, and the latter contemplate action brought on behalf of collective interests. Judicial remedies are typically available as individual remedies, whereas, for instance, the European Social Charter only allows for collective remedies before the European Committee of Social Rights.

Finally, we must distinguish between remedies at the domestic level and remedies at the European level. While the European Convention on Human Rights provides, as a central element, for a right of individuals to bring complaints before the European Court against a Government for alleged violation of their rights under the Convention, it is a fundamental feature of that European remedy that is subsidiary. In other words, available domestic remedies must be exhausted first, and it is only if those have not succeeded that the applicant can turn to the European Court and have his or her complaint examined.

Under EU law, individuals must normally exercise remedies at the domestic level. The domestic authorities and courts are responsible for applying Union law, while the Court of Justice of the European Union is entrusted with the task of interpreting Union law, for which it has exclusive competence where any such question is pending before a national court of last instance, and of deciding on the validity of secondary Union law, for which it has exclusive jurisdiction where any such question is pending before a national court, through the mechanism of preliminary rulings. It is only in situations involving alleged violations through acts of the EU institutions or organs themselves that an individual may have a direct remedy available at Union level, by recourse to the General Court. While an individual has a very limited chance of challenging the validity of any general measures, a remedy may be available in damages, as we shall see more specifically below.

3 Remedies in a nutshell

The topic of our present theme refers to judicial review and thus directs our focus on judicial remedies. Consequently, on the basis of the brief general overview above, one can offer the following nutshell summary.

Judicial remedies in the field of fundamental rights are usually available as individual remedies, against individual measures, and on the grounds of alleged violations of civil rights or freedoms. Economic and social rights mainly receive protection through legislative measures, and available remedies are weaker.

Judicial remedies for alleged violations of civil rights and freedoms are usually domestic in terms of both object and procedure, although it may be necessary to obtain binding interpretative input on issues of EU law from the Court of Justice. Only

in the case of acts or omissions by the institutions or other organs of the EU may a remedy be available at EU level, although the hurdles are rather high.³

The European Court of Human Rights provides a mechanism through which individuals can trigger a posterior supervision of States' compliance with their Convention obligations, once available domestic remedies have been exhausted. The respondent party in these proceedings is always the State concerned.

As the EU itself is not (yet) party to the Convention⁴, its Members States, as parties to the ECHR, retain responsibility also for acts undertaken by them on the basis of their obligations under EU law. An exception, based on a "presumption of equivalent protection", applies, however, in situations where EU law allows for no margin of manoeuvre for the Member States and the supervisory mechanisms under EU law, notably through the preliminary rulings procedure, have been used.⁵

4 Relevance of fundamental rights in the light of available remedies and European case-law

4.1 Preliminary remarks

Central bank action primarily takes place at a macro level, whereas fundamental rights as individual rights are primarily exercised, and exercisable, at a micro level. Central bank policies operate largely through a complex process of "transmission", and the links between central bank policies and their effects on individuals are mostly indirect. Individuals will usually have no remedies against central banks as such. Thus, for instance, even if central bank policies and actions may result in adverse effects on asset values, there is hardly any prospect of individual remedies against the central bank on the grounds of such effects entailing a breach of individual property rights.

In the field of central bank activities, individuals may be directly affected in their fundamental rights in mainly two ways.

Firstly, such effects may arise in the context of measures required by situations of sovereign insolvency or the insolvency or financial rescue/reorganisation of financial institutions. In these circumstances, individuals may be affected in their capacity as investors/creditors, and the fundamental rights at issue are primarily the right to property and procedural rights.

³ For a recent account of compensatory remedies at EU level, see Poltorak, N. (2016) "Action for damages in the Case of Infringement of Fundamental Rights by the European Union", in: Bagińska, E. (ed.) *Damages for Violations of Human Rights. Ius Comparatum – Global Studies in Comparative Law*, Vol. 9. Springer Cham.

⁴ See Article 6(2) TEU and Opinion 2/13 of the CJEU.

⁵ See *Bosphorus Hava Yolları Turizm ve Ticaret Anonim Şirketi v Ireland* [GC], No 45036/98, ECtHR 2005-VI; *Michaud v France*, No 12323/11, ECtHR 2012; *Avotiņš v Latvia* [GC], No 17502/07, ECtHR 2016.

Secondly, individuals may be affected in their fundamental rights by various austerity measures adopted in the context of efforts to deal with financial crises. In these contexts, individuals may be affected in their capacity as recipients of social welfare benefits. The rights at issue may involve economic and social rights, regarding which available individual remedies are usually weaker than in the context of civil rights. Notably matters such as the level of statutory benefits that are made available to people are not easily open for individual challenge. Actual civil rights, notably property rights may, however, be at stake where acquired rights are removed or reduced.

Measures affecting individuals' fundamental rights are normally based, and must be based, on legislation. Thus, they are not directly matters of central competence. The policy links are generally indirect, as a matter of conditionality or otherwise.

4.2 Examples in the context of insolvency or financial rescue measures

4.2.1 Property rights: *Mamatras and Others v Greece* (ECHR 2016)

The case of *Mamatras and Others v Greece*⁶ arose from the Greek debt crisis. The 6,320 applicants in the case were individual holders of Greek government bonds who became subject to legislation adopted in 2012 to implement the so-called "haircut" mechanism, whereby their bonds were cancelled and replaced with new securities, entailing a capital loss of nearly 54%. The applicants, having exhausted domestic remedies, complained to the European Court of Human Rights alleging a violation of their right to property under Article 1 of Protocol 1 to the Convention.

In its judgment⁷, the Court found that Article 1 of Protocol 1 was applicable but that there had been no violation of that article. To recount only the gist of the reasoning, the Court observed that the nominal value of a bond was not the actual market value at the time of enactment by the State of the impugned legislation. The circumstances were such that the debtor state would not have been able to honour its obligations under the contractual clauses of the old bonds. (In other words, there was a situation of insolvency.) The Court also pointed out that investing in bonds could never be risk-free.⁸

The applicants further alleged that there had been a violation of Article 14 (prohibition of discrimination) in conjunction with Article 1 of Protocol 1. For Article 14 to be applicable, in conjunction with a substantive provision of the Convention, it is enough that the situation complained of falls within the ambit of the substantive provision, here Article 1 of Protocol 1. A measure can therefore, because of its discriminatory character, be in violation of Article 14 in conjunction with the

⁶ *Mamatras and Others v Greece*, No 63066/14, 64297/14, 66106/14, ECtHR judgment 21 July 2016.

⁷ The judgment is available in [French](#) only, press release in [English](#).

⁸ The Court also made reference to the judgment of the General Court of the EU in Case T-79/13, *Alessandro Accorinti and Others v European Central Bank*, ECLI:EU:T:2015:756.

substantive provision, even if the latter as such has not been breached. In *Mamatias and Others v Greece*, the applicants argued that there had been discriminatory treatment because they, as private individuals, had not been afforded more favourable treatment than institutional or professional investors. That line of argument did not, however, succeed either. Thus, the Court found no violation on the grounds of discrimination.

4.2.2 Property rights: *Ledra Advertising* (CJEU 2016)

The cases here referred to as *Ledra Advertising*⁹, decided on appeal from the General Court by CJEU judgment (GC) 20 September 2016) arose from the banking crisis in Cyprus. The applicants' bank deposits were subjected to a substantial reduction in their value as a result of bail-in measures. The applicants alleged that the bail-in constituted a flagrant breach of their right to property, guaranteed under Article 17 of the EU Charter of Fundamental Rights. They brought an action for damages against the Commission and the ECB (under Articles 268 and 340(2) and (3) TFEU), on the grounds of the allegedly decisive role of those institutions in the context of the adoption, under the ESM Treaty, of the relevant Memorandum of Understanding of 26 April 2013 and, therefore, in the bringing about of their financial loss.

The key findings of principle by the CJEU¹⁰ may be summarised as follows:

- The tasks allocated to the Commission by the ESM Treaty oblige it to ensure that the memoranda of understanding concluded by the ESM are consistent with EU law. The Commission, in its role as guardian of the Treaties, should refrain from signing a memorandum of understanding whose consistency with EU law it doubts.
- The Member States do not implement EU law in the context of the ESM Treaty, so that the Charter is not addressed to them in that context. As regards the EU institutions, the Charter is addressed to them, including when they act outside the EU legal framework.
- The fact that the acts of the ESM fall outside the EU legal order cannot prevent unlawful conduct linked to the adoption of a memorandum of understanding on behalf of the ESM from being raised against the Commission and the ECB in an action for compensation.

The CJEU thus examined the appellants' claims relating to compensation for the damage allegedly suffered as a result of, first, the inclusion by the Commission and

⁹ Joined Cases C-8/15 P *Ledra Advertising v Commission and ECB*, C-9/15 P *Eleftheriou and Others v Commission and ECB* and C-10/15 P *Theophilou v Commission and ECB*, ECLI:EU:C:2016:701 and in Joined Cases C-105/15 P *Mallis and Malli v Commission and ECB*, C-106/15 P *Tameio Pronoias Prosopikou Trapezis Kyprou v Commission and ECB*, C-107/15 P *Chatzithoma v Commission and ECB*, C-108/15 P *Chatziioannou v Commission and ECB* and C-109/15 P *Nikolaou v Commission and ECB*, ECLI:EU:C:2016:702.

¹⁰ Joined Cases C-8/15 P *Ledra Advertising v Commission and ECB*, C-9/15 P *Eleftheriou and Others v Commission and ECB* and C-10/15 P *Theophilou v Commission and ECB*.

the ECB of the disputed paragraphs in the Memorandum of Understanding and, secondly, the Commission's inaction in breach of the obligation to ensure, in the context of the adoption of the Memorandum, that the latter was in conformity with EU law. More specifically, the CJEU examined whether the Commission had contributed to a sufficiently serious breach of the appellants' right to property.

In this case, it was thus confirmed that the ECB, as an EU institution to which the Charter of Fundamental Rights is addressed, might be responsible for acting, in the exercise of its functions, in breach of the Charter in a way that could render it liable in damages under the TFEU. In the circumstances of the case, however, more focus was put on the particular obligations arising for the Commission, given its role as guardian of the Treaties.

Thus, the judgment in *Ledra Advertising* demonstrates that the EU Courts may be called upon to examine claims of this kind. This, however, does not yet say anything about the prospects of success for such claims. On their merits, the claims brought by the applicants in these cases failed.

In its assessment of the merits, the CJEU found that in view of the objective of ensuring the stability of the banking system in the euro area, and having regard to the imminent risk of financial losses to which depositors with the banks concerned would have been exposed if the latter had failed, the impugned measures did not constitute a disproportionate and intolerable interference impairing the very substance of the appellants' right to property. Consequently, the bail-in measures could not be regarded as unjustified restrictions on that right.

4.2.3 Procedural rights: *Adorisio and Others v the Netherlands* (ECHR 2015)

The case of *Adorisio and Others v the Netherlands* raised issues of procedural fairness in the context of proceedings that arose from the impending collapse of a financial institution in the Netherlands. The applicants brought complaints under Article 6 of the European Convention on Human Rights, which enshrines the right to fair trial, concerning accelerated proceedings for bond holders to challenge the lawfulness of the expropriation of the assets held in a banking and insurance conglomerate which had run into trouble as a result of the financial crisis of 2008. Here, the Government aimed to protect the domestic banking industry and customers' savings by nationalising the conglomerate.

The applicants complained that the period for appeal in order to contest the Government's measure, had been too short. They considered that there had been insufficient time to study a statement made by the Minister of Finance. The applicants also complained that access had only been given to incomplete versions of two reports concerning the bank and its assets.

In its decision, the European Court of Human Rights found the complaint manifestly ill-founded and declared it to be inadmissible.¹¹

As regards the time constraints imposed on the bondholders, the complaint implied that the brevity of the time-limit prevented them from properly developing their arguments and presenting their evidence. The Court, however, considered that the applicants had not been placed at an unfair disadvantage by those constraints. The Court took into account that the situation had been characterised by the need for a very speedy decision. The Court further took into account that the impugned proceedings could only concern the legality of the expropriation. Disputes on the potentially complicated issue of compensation could only arise once it was determined that the expropriation was not per se unlawful. Following the domestic court's finding that the expropriation was not unlawful, proceedings on compensation were to follow, and did follow, separately in the ordinary civil courts.

As regards their restricted access to financial reports concerning the bank and its assets, the Court concluded that such restrictive measures had been necessary under the circumstances. It accepted that the Government had restricted the access to documents in order to prevent the disclosure of information that might, if it were public, have harmed the financial interests of the conglomerate and of the State. The Court considered that, in the very exceptional circumstances of the case, the undoubted disadvantage under which the applicants found themselves was adequately counterbalanced by the judicial review carried out at the domestic level, including the court's own subsequent examination of the full report and its express finding that its release to the applicants only in redacted form was not prejudicial to their interests.

4.3 Examples in the context of “austerity measures”

Complaints relating to various “austerity measures” have in recent years given rise to a series of judgments and decisions by the European Court of Human Rights. An overview is available in a factsheet provided by the Court.¹²

Mostly these cases have arisen from alleged violations of the right to property (Article 1 of Protocol 1) taken alone or together with the prohibition of discrimination (Article 14).

Regarding the protection of property under Article 1 of Protocol 1, the following general features are worth noting in the light of the case-law of the European Court of Human Rights:

- The notion of property, or “possessions”, is a wide one. While the Article does not guarantee any right to obtain property and is limited to the protection of existing possessions, acquired rights in the field of social security may fall within

¹¹ *Adorisio and Others v the Netherlands*, No 4 7315/1317, ECtHR decision 17 March 2015.

¹² European Court of Human Rights, “Factsheet on Austerity measures”, July 2017.

the notion of property. The fact that a right may fall within the scope of the Article does not, however, mean that it enjoys protection against any restrictive measures.

- States enjoy a wide margin of discretion in matters relating to economic and social policies, i.e. in determining what is “in the public interest” in the regulation of matters such as the welfare system.
- Thus, even if the scope of property rights is wide, this does not mean that they are immutable.
- In the assessment of whether there has been a violation of the protection of property under the Convention, the main focus – provided that the impugned measure is not without a legal basis – typically falls on the question of proportionality. This entails an assessment of whether a fair balance has been struck between the competing interests at stake.
- Typically, the proportionality assessment boils down to whether an “excessive individual burden” has been imposed.

From the case-law, the following judgments can be mentioned:

- In the case of *Valkov and Others v Bulgaria*¹³, the complaints concerned a legislative measure whereby a statutory cap was imposed on retirement pensions, thus reducing benefits exceeding a specified maximum amount. The Court found that there was no violation of the right to property under Article 1 of Protocol 1, nor a violation of the non-discrimination clause of Article 14 in conjunction with Article 1 of Protocol 1.
- In the case of *Bélané Nagy v Hungary*¹⁴, the complaint concerned a withdrawal of a disability pension due to a change of conditions. The judgment contains a discussion of the scope of application of Article 1 of Protocol 1. The Court found that the Article was applicable and that there was a violation of Article 1 of Protocol 1.
- In the case of *Fabian v Hungary*¹⁵, the complaint concerned the suspension of pension disbursements for civil servants occupied in post-retirement employment in the private sector. The Court found that there had been no violation of the right to property Article 1 of Protocol 1, and no violation of the non-discrimination clause of Article 14 in conjunction with Article 1 of Protocol 1.

There are also a number of decisions where complaints concerning various austerity measures have been found manifestly ill-founded and have thus been declared inadmissible. Among these can be mentioned the following:

¹³ *Valkov and Others v Bulgaria*, No 2033/04, ECtHR judgment 25 October 2011.

¹⁴ *Bélané Nagy v Hungary*, No 8263/15, ECtHR judgment [GC] 13 December 2016.

¹⁵ *Fabian v Hungary*, No 78117/13, ECtHR judgment [GC] 6 September, 2015.

- *Koufaki and ADEDY v Greece*¹⁶, concerned reductions in public sector remunerations, benefits, pensions as part of measures taken because of the financial crisis.
- *Da Conceição Mateus and Santos Januário v Portugal*¹⁷, concerned reductions in public sector pensions because of the crisis.
- Most recently, *Mockienė v Lithuania*¹⁸, concerned reductions in welfare benefits during the crisis.

Conclusions

In the present context, fundamental rights do not operate as stringent straitjackets but rather as contextual balancing exercises. Thus, they impose on the policy-makers and decision-takers burdens of proper reflection and justification, and demands on the quality of argument, rather than any clear-cut constraints. Judicial review in these kinds of fields should remain just that, i.e. a matter of review. While judicial organs must exercise a supervision of measures applied by the governing bodies, they should not substitute themselves for those responsible for policy-making, nor – particularly in the context of the ECHR – disregard the principle of subsidiarity, according to which the primary responsibility for the application and implementation of the Convention should remain at the domestic level. This principle is, on the one hand, enshrined in the requirement for applicants to exhaust domestic remedies, which implies both a right and a duty for the Contracting States to address alleged human rights violations in accordance with their domestic arrangements before they can be raised before the European Court of Human Rights. It is also reflected in the doctrine of margin of appreciation, which affords to the Contracting States a measure of “leeway”, depending on the context, for their policy-making and the balancing exercises that arise in matters affecting human rights.

¹⁶ *Koufaki and ADEDY v Greece*, No 57665/12, ECtHR decision 7 May 2013.

¹⁷ *Da Conceição Mateus and Santos Januário v Portugal*, No 62235/12, ECtHR decision 8 October 2013.

¹⁸ *Mockienė v Lithuania*, No 75916/13, ECtHR decision 4 July 2017.

A few notes on judicial review of central banks' activity from the perspective of corporate law

By Marco Ventoruzzo¹

I would like to offer a few remarks, from the point of view of a scholar of corporate law and securities regulation, on the issue of judicial review of central banks' acts. The adoption of the Single Supervisory Mechanism ("SSM") and the Single Resolution Mechanism ("SRM") have significantly complicated this issue, giving it a new international and comparative dimension, but so far the problem has attracted primarily the attention of administrative and EU law experts, while scholars in my field – with a few significant exceptions (for example, Professor Brescia Morra) – have not extensively studied it. I believe, however, that their perspective can add some interesting insights, for at least a couple of reasons.

First, some traditional and at the same time specific institutes of corporate law (for example, fiduciary duty doctrines) might be useful in seeing in a different light the questions we are considering or, at a minimum, contribute to develop a useful and coherent conceptual and terminological framework to address them.

Second, somehow simplifying, corporate lawyers and to some extent securities regulation experts are probably inclined to consider the relationship between administrative authorities and private parties from the standpoint of the latter. Our technical toolbox is primarily one of private law, and a central issue in our discipline is the limits of contractual – or, more broadly, business – freedom versus mandatory rules in order to protect efficiently weak parties and limit negative externalities of corporate activity. Therefore, scholars in this area might be able to single out specific issues concerning the proper boundaries between the powers of the regulators and protection of private parties, both in the sense of protection of freedom of enterprise and of investors. While of course the proper conceptual framework to consider the relationship between regulators and private parties is the one of subordination to public powers and protection of regulated subjects (a typically administrative law issue), the viewpoint of scholars and practitioners more familiar with the inner workings of banks and corporations, together with familiarity with the problem of regulatory vs. market failures, are crucial for a complete understanding of the relationship among central banks, private intermediaries, and investors and clients in need of protection.

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I am however pointing out the perspective I come from to justify in advance a partial lack of sophistication with respect to issues that colleagues in the areas of administrative law and EU law have studied at the European and national levels more extensively and more profoundly.

Considering the limited space and time available, it is certainly not my goal to fulfil the ambitious agenda mentioned above, which should be intended as a program of research. I will rather throw on the table a few ideas and hypotheses, partially suggested by the contributions of the previous speakers.

To begin with, let me underline the obvious: virtually all legal systems, although to different degrees, show a certain reluctance to second-guess administrative actions, especially when the issue concerns the exercise of technical discretion. The French capture this idea with an effective expression: *juger l'administration c'est aussi administrer*. Of course, this hesitation is primarily grounded in one of the tenets of modern democracies, separation of powers.

In corporate law, we talk about the “business judgment rule” to refer to the degree of deference that courts should grant – and indeed do grant – to the directors of a corporation in pursuing its goals: the idea is not so radically different. The entrepreneurial spirits of directors would be chilled if decisions that, ex post, turn out to be damaging would be automatically sanctioned in hindsight, and assuming risks would be subject to too powerful disincentives. Of course, the rationale and values underpinning judicial deference in reviewing the decisions of corporate directors and of the public authorities are obviously very different and, in the second case, the power of the state must be curbed also to preserve individual freedoms. In both situations, however, judicial interference might undermine the effectiveness of activities that require quick decisions under limited information in uncertain and evolving scenarios.

Reluctance of the judiciary to second-guess administrative action is particularly justified when dealing with an agency whose independence is utterly essential for its effectiveness, such as a central bank; and whose mandate sometimes requires extremely fast action, for example, in relation to financial supervision or resolution of troubled banks.

Of course, this does not mean that a central bank is not subject to the rule of law, but that review standards should be flexible enough to consider the particular function – or, as I will mention in a minute, “functions” – of this peculiar Institution. Once again, allow me to use a parallel from private law. When contractual obligations are or can be defined in a precise and clear way, such as in a debtor-creditor relationship, performance can be relatively easily evaluated against the rules spelled out in the contract. When, on the other hand, the obligations of a party cannot be analytically listed and described ex ante, such as in an agency relationship (e.g. a trustee, or the director of a corporation), then courts must use more flexible and malleable standards, such as fiduciary duties. This essentially means judging the lawfulness of the activity of a fiduciary not with a sort of “check-the-box” approach, but rather in terms of coherence with its ultimate goals, such as pursuing the best interests of its principals and exercising due care, focusing more on the conduct and on the

deliberation process, rather than on the specific result. As imprecise and eccentric this comparison between fiduciary duties in private law and administrative powers might sound to a more formal jurist, I believe that the parallel is quite effective to describe the position of a central bank vis-à-vis judicial review, in light of the complex, undefinable and sometimes contradictory goals that are entrusted to it. In other words, the idea is the following: whenever it is impossible or inefficient to provide for a complete list of specific tasks of the relevant parties, be it in a private contract or in the definition of the institutional objectives of a public authority, and performance involves a highly technical activity combined with know-how, i.e. information and skills that judges do not have, judicial review must adopt “standards” rather than “rules” and defer more broadly to the discretion of the – so to speak – defendant. Of course, public powers also require a great deal of attention to be paid to the protection of fundamental rights of private parties subject to the authority, but the balance between these two partially conflicting needs does not necessarily call for more intrusive and extensive judicial review.

Having said that, on a more technical level let me also note that, when we talk about judicial review of central banks’ actions, we talk about several different things that we can visualize with a matrix.

There are at least four variables to consider that would bring some order to the area. These dimensions, which we might imagine as the columns of our matrix, are jurisdiction (in the sense of power to adjudicate), standing to sue, standards of review, and available remedies (injunctive relief, annulment of illegal acts, monetary damages, specific performance, etc.).

On the other hand, the rows of this hypothetical matrix would be the different functions and powers of a central bank and, in particular, monetary policy, supervisory functions over intermediaries and resolution powers. In addition to this substantive division of functions, we should also distinguish – more formally – the type of act through which the agency exercises its powers and functions: regulations, decisions, recommendations and opinions, guidelines etc., something that in fact leads to a 3D matrix.

While very general and broad principles for judicial review might be identified, I believe it is difficult to offer a comprehensive and solid practical explanation without examining each single different cell of the matrix I have briefly evoked. Even limiting ourselves just to the three major functions mentioned (monetary policy, SSM, and SRM), it should be clear that the intensity of judicial review cannot be identical for all three and that, for some activities, the ability of judges to second-guess central banks must be more limited than for others. Just to offer one example to support this claim, obviously enough the vital need to act swiftly vis-à-vis the crisis of a bank (the proverbial “week-end solution”), is largely incompatible with full judicial review and injunctory relief. A very different conclusion applies, however, to – for example – administrative sanctions imposed on the directors of a bank in a scenario that does not have similar pressing time constraints.

In this perspective, I totally agree with the paradigm illustrated by Professor Lehmann, according to which – and I take the liberty of simplifying – judicial scrutiny

can and should be more intense with respect to financial supervision and more restrained with respect to monetary policy; while resolutions powers should be subject to a middle-ground test. Needless to say, this is just a general rule of thumb, and within these three categories there might be specific functions and acts for which court control should be more intense and penetrating. The general picture, balancing individual freedoms and the needs of effective economic policy, is however clear enough and I think that Professor Lehmann's model nicely captures the essence of the issue.

We can briefly illustrate the different degree of deference courts should attribute to supervision and monetary policy by considering the standard of review. As we all know, a broad distinction concerns what might be defined legal deficiencies of an act – ultra vires, violation of a statute –, versus a review of the merits of an administrative decision that might be disproportionate, irrational, determine unjustified unequal treatment, etc. It is not surprising that the most insidious challenges to the role of the ECB for monetary policy – and I refer to *Gauweiler* – were essentially issues of ultra vires: it would be almost science-fiction imagining challenges to the merits of a monetary policy choice.

Another take away from our discussion concerns, of course, human rights. I believe that not more than fifteen years ago the notion that the protection of human rights might have had an important role in regulating the financial industry – consider, for example, its impact in insider trading with the *Grande Stevens and Others v Italy* case² and its progeny – would have sounded quite strange not only to laypeople, but also to many professional jurists. We have however now several cases and situations, discussed by Judge Koskelo, in which fundamental rights become more and more relevant as an outer limit to the discretion of EU institutions such as the ECB (and, for that matter, independent agencies) entrusted with financial regulation generally, and of the ECB specifically.

The 300-pound gorilla in the room is, however, possibly another one, one that I think deserves a lot of attention but that is very difficult to address. Judicial review of central bank decision-making presents many profoundly different traditions in the single Member States, from the macroscopic issue of whether specialized courts exist, to many profound differences in most of the elements I have cited before, from standing to remedies. The so-called movement of “Global Administrative Law” – represented here today by one of its founders and more active proponents, Professor Cassese – which aims at a broader international study of a traditionally very local field, has offered extremely valuable contributions to compare the different systems and isolate common core principles, but in many ways, this area is still in its youth. Administrative law in action, almost by definition, is still a field characterized by a strong national dimension. The European judicial system is, in this respect, essentially a system of administrative justice, influenced by the different traditions, but also very different from them.

² *Grande Stevens and Others v Italy*, Nos 18640/10, 18647/10, 18663/10, 18668/10 and 18698/10, ECtHR judgment 4 March 2014.

And here's the catch. Due to the existing matrix of different regulators and legal sources, the ECB is inevitably required to adopt regulations and decisions taking into account national law and NCBs' acts. Correspondingly, NCBs exercise their regulatory and decision-making powers based (also) on EU law and ECB activities. This is not only true in the case of common procedures but, at some level, also with other activities. Combining this new feature of the European System of Central Banks with not-entirely settled, and often inconsistent, provisions on jurisdiction (in the sense of power to adjudicate), a complex picture emerges. In fact, the Court of Justice of the European Union might sit in judgment over ECB acts taking into account national law; and national courts might be required to adjudicate NCBs acts based also on EU law (and I am not referring only to cases when a preliminary ruling might be required to the Court). Since, as mentioned, review standards vary among these courts, and might be more or less deferential to regulatory agencies, the consequence might be different treatments of substantively similar cases, and even conflicts with the right of defence protected under the EU Charter of Fundamental Rights and by Articles 6 and 13 of the European Convention on Human Rights.

There is one last point I want to raise. First, as everybody knows or can easily intuit, harmonizing judicial activity, in Europe, is incommensurably harder than harmonizing substantive rules, notwithstanding the preliminary reference procedure. This is true in private law and possibly even more so in administrative law. Consider, for example, private enforcement of prospectus liability. A directive on the substantive contents of a prospectus and on the substantive rules governing the drafting and approval of prospectuses for public offers was relatively easy to achieve, much harder was the discussion on the (private law) consequences of omissions of misstatements that damage investors. In fact, only vague and rather empty provisions were incorporated in European law in this respect, due to the profound differences still existing among Member States in terms of private enforcement. In other words, and with a catch phrase, it is easier to harmonize the "physiology" of business activities, rather than their "pathology." The law, however, lives primarily in court: it is in court that otherwise abstract rights and obligations come to life concretely and are able to affect the life of European citizens, influence their behaviours, and give them the sense that we live in a truly common European space, where similar cases are treated similarly. Without obviously discounting the importance of substantive rules, it is fair to say that the true challenge of building a harmonized legal space in Europe lays in developing comparable adjudication procedures and standards.

From this perspective, our reflection on judicial review of central banks' acts has an importance that transcends the technical and possibly dry analysis that is required

Panel 3
Brexit – Looking inwards



Brexit and the European financial and economic architecture

By Benoît Cœuré¹ and Peter Praet²

1 Introduction

After more than four decades of British membership of the European Union (EU) and the single European market, the United Kingdom and the EU27 Member States today naturally share close political, institutional, economic and financial ties. For instance, the EU is the United Kingdom's major trading partner, accounting for 43.5%³ of UK exports and 53.5%⁴ of imports of goods and services in recent years. Conversely, the United Kingdom accounts for 13% of euro area foreign demand⁵, while about 15%⁶ of extra-EU27 goods exports from the EU27 go to the United Kingdom. Trade data also show that the United Kingdom's value chain is closely integrated geographically with that of the rest of the EU: nearly half of the United Kingdom's intermediate imports and exports are from and to the EU27. And owing to London's role as a major international financial centre, the United Kingdom runs a significant trade surplus in financial services vis-à-vis the rest of the EU. Close trade links are also reflected in significant cross-border production capacities: euro area countries accounted for 45%⁷ of the foreign direct investment stock in the United Kingdom in 2015. Finally, labour mobility has also advanced noticeably. Today, EU nationals account for around 7%⁸ of the entire UK workforce (32.1 million in July 2017), while an estimated 1.2 million UK nationals⁹ were residing in another EU country before the referendum.

Of course, with such close ties, political, institutional and economic risks arising from the United Kingdom's withdrawal from the EU are abundant. So far, the euro area economy has demonstrated great resilience to the outcome of the UK referendum on EU membership. Although the result of the vote led to a pronounced bout of heightened risk aversion, the market reaction was short-lived, and asset prices largely recovered in the weeks thereafter, thanks in part to preparations by central

¹ Member of the Executive Board of the European Central Bank, Chairman of the Committee on Payments and Market Infrastructures.

² Member of the Executive Board of the European Central Bank.

³ As at the second quarter of 2017 (source: ONS).

⁴ As at the second quarter of 2017 (source: ONS).

⁵ Source: ECB staff calculations.

⁶ Source: ECB staff calculations.

⁷ Source: ONS.

⁸ Latest figure: 7.4% as at April-June 2017. Source: ONS dataset EMP06: Employment by country of birth and nationality.

⁹ Source: UN. Research from the ONS based on nationality rather than country of birth estimates the number of UK nationals in EU countries at around 900,000 pre-referendum.

banks and supervisors on both sides of the Channel and around the globe.¹⁰ But despite the resilience shown so far, a no-deal scenario or the absence of a satisfactory transitional arrangement at the end of March 2019 may have adverse consequences.

More generally, the consequences of Brexit will largely depend on the arrangements governing the United Kingdom's future relationship with the EU. For example, compared with the United States, the United Kingdom is not simply closer to the EU geographically, which matters for trade, but for decades it has shared with the EU a common institutional and regulatory framework. The United Kingdom's decision to leave the Single Market and the customs union is also likely to have an impact on existing trade and financial interlinkages. From a European perspective, it will therefore be important to prepare the regulatory framework for a situation where a large economy and significant financial market with close ties to the EU becomes a third country. Whatever form the new relationship with the United Kingdom takes, the guiding principle must be to strengthen the supervisory and regulatory architecture and preserve the integrity of the Single Market.

The European Central Bank (ECB) itself is not a party to the negotiations with the United Kingdom. These are first and foremost a political process. But given the close economic and financial ties between the United Kingdom and its European partners, the ECB naturally has a keen interest in understanding the implications of the ongoing negotiations for the future EU-UK relationship. It will therefore closely monitor the implications of the United Kingdom's exit from the EU and its future relationship with the EU for the ECB's core tasks and areas of responsibilities. For instance, the ECB will look at possible models for governing the new relationship with the United Kingdom as a third country from the perspective of its economic and financial stability implications for the euro area and with a view to preserving the benefits of integration within the EU.

Three dimensions are of key relevance for the ECB: banking supervision, financial stability and the workings of Economic and Monetary Union (EMU). This contribution will discuss these aspects in turn and sketch out issues and questions arising from the United Kingdom's departure from the EU for the European financial and economic architecture.

2 Ensuring consistent supervision and a level playing field for all banks in the euro area

The supervision of banks is the first dimension through which Brexit has direct implications for the work of the ECB. Staff from the Single Supervisory Mechanism (SSM) are in close contact with banks considering relocating to the euro area as well as with euro area banks currently operating in the United Kingdom. The message to banks, as emphasised earlier this year by Danièle Nouy, Chair of the Supervisory

¹⁰ See European Central Bank (2016), *Financial Stability Review*, November.

Board, is clear: the clock is ticking.¹¹ Given the uncertainty surrounding the outcome of the negotiations and the arrangements for the future EU-UK relationship, all banks need to engage in timely preparations, including for the possibility of a hard Brexit or a no-deal scenario. The ECB will ensure that all banks operating in the euro area meet the standards of European banking supervision, thus contributing to the safety and soundness of our banking system, regardless of the location banks ultimately choose. Brexit must not lead to a race to the bottom in supervisory standards. ECB Banking Supervision has made clear that it will not accept “empty shells” in the euro area. Any bank operating in the euro area needs to have adequate local risk management, sufficient local staff and operational independence. This means that banks that relocate are expected, among other things, to conduct real operational activities: they should not permanently book all of their exposures back-to-back with another entity outside the euro area. Banks also need to have in place adequate recovery planning, including an assessment of the risks and consequences arising from Brexit.

3 Safeguarding financial stability in the post-Brexit environment

The broader financial stability implications of Brexit are the second dimension through which the United Kingdom’s decision to exit the EU affects the ECB’s core tasks and responsibilities. As a central bank of issue, the ECB has a responsibility to safeguard financial stability and the smooth operation of payment systems in the euro area, including with a view to ensuring a frictionless transmission of monetary policy. It is therefore essential to establish a framework that ensures the safety and stability of the financial system when the United Kingdom is no longer a member of the EU.

In practice this means that as the United Kingdom leaves the institutional, supervisory and regulatory framework of the EU, the resulting challenges for the conceptualisation of the future EU-UK financial and economic relationship need to be addressed. How open should a financial system be towards firms operating from third countries? Any answer to this question needs to take into account both financial stability considerations and the benefits of financial integration. In the euro area, the crisis has shown that financial integration needs to be accompanied by a strong and integrated regulatory, supervisory and oversight framework. Otherwise the risk is that financial integration unravels in a crisis in the form of sudden halts in capital flows with major implications for the real economy. As with banking supervision, any future relationship with the United Kingdom should therefore not represent a step backwards as regards the regulatory, budgetary, judiciary and enforcement instruments and structures that have been established to preserve the stability of the Single Market and the common currency, especially in times of crisis. On the

¹¹ See Nouy, D. (2017), “Banks and Brexit – the clock is ticking”, [speech](#) at a technical workshop on Brexit organised by the ECB, Frankfurt, 30 June.

contrary, the regulatory architecture needs to be further enhanced where necessary, including with regard to adequate resolution and recovery planning.

Such considerations also need to inform the discussion of the different proposals for the future provision of financial services between the United Kingdom and the EU. One such proposal is to continue trading on the basis of a comprehensive Free Trade Agreement (FTA). Yet, while the EU's existing FTAs often cover a far-reaching scope for trade in goods, they include only very limited provisions for trade in financial services. And as they allow only very limited market access for financial services, they also lack adequate provisions for the supervisory, regulatory and judicial oversight necessary to mitigate financial stability risks. Other proposals, such as approaches based on the equivalence of regulatory standards and frameworks, offer a potential solution but are not without drawbacks either. These drawbacks relate in particular to the binary and static nature of equivalence decisions, the absence of dispute settlement mechanisms and the need to rely on cooperation with third country supervisory authorities for the enforcement of equivalence decisions in practice. Therefore, one question for discussion when it comes to market access will be that of adequate supervisory and enforcement mechanisms. What institutional and supervisory underpinnings are needed to adequately manage potential risks? What solutions can be envisioned for enforcement and dispute settlement in the context of global cooperation?

The financial architecture of the EU, and of the euro area in particular, has been considerably strengthened in recent years. The single rulebook and the European Supervisory Authorities ensure a level playing field across the Single Market. For example, the Bank Recovery and Resolution Directive¹² provides for a common approach towards dealing with failing banks and safeguarding financial stability while minimising recourse to taxpayer's money. The euro area has gone even further. The creation of the European Stability Mechanism provides a tool for crisis resolution at euro area level. The establishment of the banking union was an essential step to mitigate the bank-sovereign nexus and ensure the safety and soundness of the European banking system. The SSM ensures consistent supervision across the banking union, while the Single Resolution Mechanism (SRM) guarantees an orderly resolution of failing banks with minimum impact on the real economy, the financial system and the public finances of the Member States. Equivalence regimes do not provide a similarly firm institutional underpinning for supervision and crisis management. Let's take the example of crisis management: while Cross-Border Stability Groups and Crisis Management Groups have been set up to increase cooperation and coordination between key home and host authorities in times of crisis on a global level, they do not match the institutional strength of the SRM.

¹² 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, p. 190).

4 Preparing the regulatory architecture for the post-Brexit world

As the examples above illustrate, the European financial architecture has been considerably strengthened since the crisis. Further adjustments in financial legislation are now needed to adequately prepare the regulatory environment for the time when the United Kingdom is no longer a member of the EU and the Single Market, and financial institutions based in the United Kingdom can no longer use the passport to provide services in the EU. The concrete design of the regulatory framework will need to be the outcome of political discussions between the co-legislators. From a central banking perspective, a few proposals currently under discussion would provide an opportunity to prepare the regulatory architecture for a post-Brexit world. One example is the ongoing review of the Capital Requirements Regulation¹³ and the Capital Requirements Directive¹⁴. For instance, the intermediate parent undertaking proposal would allow certain third-country branches to be brought under European banking supervision. We also need to look at the supervision of large investment firms, in particular those that may pose systemic risks. The activities of these firms might in many ways be similar to those conducted by banks. In this case, it makes sense to supervise such firms as if they were banks, in line with the principle that similar risks are treated similarly. This is already established practice in the United Kingdom and United States.

We also welcome the European Commission's proposal on a review of the European Market Infrastructure Regulation¹⁵ to ensure more consistent and robust supervision of central counterparties (CCPs) in the EU and third countries, in particular with regard to systemically important third-country CCPs. This proposal also includes an enhanced role for the central banks of issue, including the Eurosystem as the central bank of issue of the euro, in areas of key importance for our central bank competences (e.g. liquidity risk management and settlement).

5 Strengthening financial market integration in Europe beyond Brexit

However, Brexit not only requires finding an appropriate framework for the future relationship with the United Kingdom. Further steps are also needed towards both promoting capital market integration in the EU and strengthening the resilience of the European economy. This is the third dimension. With the potential consequences of Brexit for London as a financial centre, financial markets risk becoming more

¹³ 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).

¹⁴ 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).

¹⁵ 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).

fragmented. In this environment, more robust financial integration can improve the efficiency of credit allocation, facilitate private risk sharing, and help diversify sources of financing.

Capital markets can thus play a role in cushioning macroeconomic shocks – making our economies more resilient and less reliant on public risk sharing. Swift progress towards a capital markets union is therefore needed to cushion the potential impact of a less deep capital market within the EU on the cost of capital for households and non-financial corporations. From the perspective of EMU, an ambitious capital markets union project is a natural complement to the banking union.

Two areas of the banking union warrant further work. First, its third pillar, a common deposit insurance system, is still missing, and further progress is needed towards a common backstop for the Single Resolution Fund. While supervisory and resolution decisions are taken at European level, the relevant risk-sharing mechanisms, such as deposit insurance schemes, are still at the national level. Thus, there is a need to align liability and control – one of the fundamental principles of the banking union. Second, when one considers banks' balance sheet exposures, the banking union is still not sufficiently well established. The importance of breaking national silos in banking cannot be overstated. As long as the bank-sovereign nexus remains in place, financial institutions may not be able to accommodate the temporary financing needs of firms, households and the public sector in the face of adverse macroeconomic fluctuations. In this way, financial markets risk propagating rather than absorbing shocks. A more unified European banking market will also improve banks' ability to allocate capital to the most productive economic sectors and thus contribute to long-term macroeconomic performance. More ambition is thus required in harmonising the underlying rules and standards and completing the institutional framework. In order to facilitate cross-border integration of financial institutions when there is a business case for doing so, it is important that credit institutions face a single set of rules and conditions, regardless of the location of their activities. This was the intention of the single rulebook but it is not yet the reality, partly because of national divergences in the transposition of directives and the non-harmonised exercise of options and national discretions.

More generally, the Single Market – including that for financial services – provides the framework for supervisory and regulatory convergence through common institutions that ensure the homogeneity of rules and include a common dispute settlement mechanism in the form of the Court of Justice of the European Union. Together, these institutions provide the necessary protection for citizens, investors and businesses to engage in cross-border activities. This also reflects a lesson learned from the crisis: opening up markets has to go hand in hand with regulatory and supervisory convergence to preserve financial stability and ensure a level playing field. Indeed, it underscores the need to move ahead on securing all facets of the institutional foundations of EMU. Whatever the outcome of the negotiations with the United Kingdom, the coherence of the European project and the integrity of the Single Market must not be compromised. This also implies that whatever form the new EU-UK relationship takes, cooperation with the United Kingdom as a third country cannot replicate the full benefits of integration and Single Market

membership. Any new arrangements will need to reflect a balance of rights and obligations and include commensurate governance arrangements. Given these challenges, the current high level of trust, cooperation and information sharing between the ECB and the Bank of England represents a key asset for protecting market participants and preserving financial stability.

6 Conclusion

The United Kingdom's strong economic and financial links with the rest of the EU need to be reflected in the new relationship with the United Kingdom as a third country, including when preparing the post-Brexit EU regulatory environment. The exact form of this new relationship and the post-Brexit regulatory framework is for political actors to decide. From a central banking perspective, it is important to keep in mind that the benefits of financial integration can only be reaped if financial stability is preserved. Any future relationship with the United Kingdom should therefore not represent a step backwards as regards the regulatory, budgetary, supervisory, judiciary and enforcement instruments and structures that have been established to preserve the stability of the Single Market and the common currency, especially in times of crisis. Whatever form the new relationship with the United Kingdom takes, Brexit must not lead to a race to the bottom in regulatory and supervisory standards and must not compromise the coherence of the European project. But Europeans also need to look beyond Brexit to strengthen the resilience of the European economy and counter financial fragmentation. This makes swift progress on the twin projects of the capital markets union and the banking union ever more essential.

The scope of transitional arrangements under Article 50 TEU

By Hubert Legal¹

The scope of transitional arrangements is obviously a decisive issue – which is why I wish to be careful and precise in my choice of words about it.

The concept we define for a transition is not a mere matter of political choice; it is a matter of law. It remains to be seen whether the European Court of Justice (ECJ) may be asked to offer an opinion about the compatibility of a withdrawal agreement with the Treaties; my view is that it may not – but it will be a matter for the Court itself to decide if the question is brought to it. At any rate, there is no doubt the decision by the Council to conclude the agreement may be submitted to an action in annulment by the ECJ, as well as to a request by a national court for a ruling on its validity.

Just imagine the Court were to find the decision to conclude the agreement illegal or invalid under EU law while obligations have already been created for the Union under international law by the conclusion of the agreement itself – which *per se* cannot be annulled – we (by which I mean the Union institutions and the remaining Member States) would be placed in a disastrous situation of conflicting obligations.

The scope of transitional arrangements is precisely an issue on which not only the spirit but also the letter of Article 50 TEU imply definite constraints which may not be of fundamental importance for the UK side but which are crucial for the EU legal order.

Whether EU law applies or not or whether an essential component of the EU order may be affected by an arrangement is not an issue on which the ECJ may be expected to show any complacency if it is requested to undertake a review – which it is likely to be.

So it would be unwise here to treat legal constraints as of secondary importance.

But, ever since the UK referendum took place, it has been a view expressed by direct and indirect representatives of UK business interests that a cliff-edge effect had to be avoided and that, since the two year period foreseen by Article 50 TEU was too short to establish new rules under international law, the challenge could only be met by using the withdrawal agreement to put in place a period during which access for UK operators to the single market (and *vice versa*) would remain guaranteed, post withdrawal, on terms equivalent to the present rules. This equivalence would however not be based on EU law but on the recognition by the withdrawal agreement of the initial identity, as regards material law, of the EU *acquis*

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and of the UK legislation based on the (forthcoming) European Union (Withdrawal) Act (formerly known as Great Repeal Bill). Nothing would prevent UK law from progressively diverging from this initial material equivalence of rules. Clearly this approach offers the UK law-makers an entire freedom and the UK industries an entire preservation of their market access to EU territory for a period of time additional to the two years foreseen by the Treaties.² In fact the United Kingdom would leave the EU framework on the date decided by them of 29 March 2019 at the latest but they would be exposed to the economic and legal consequences of this decision only at a later time when they are ready for it.

I am not talking about whether it is fair or not. All I am saying is that, in legal terms, this would be a problem as regards compatibility with the EU legal order. The sequencing which is integral to the EU negotiator's mandate is the result of a legal analysis of the structure of Article 50 TEU shared by the 27 Member States, the European Commission, the Council and European Parliament on the consistent advice of their legal services.

What does Article 50 TEU say about transition?

First, concerning the process itself, Article 50 TEU deals with a withdrawal, and not with a separation. Two aspects to this: One, a withdrawal is a **unilateral** action. It is the UK authorities only that have decided to leave and have notified the European Council of their decision. This action has brought about the automatic consequence that the law of the Union will cease to apply to the United Kingdom. The withdrawal agreement is not the source of this effect and cannot alter it. The choice to leave has been enacted, and cannot be revoked indirectly through the negotiation of a transition. Concluding an agreement is not even mandatory. An agreement may only contain **arrangements** about the **modalities** of how EU law ceases to apply, not about the already decided principle. EU law, as such, cannot continue to apply directly once the withdrawal is effective, and may only apply indirectly under strict limits and conditions.

Second, a withdrawal does not affect the legal and political personality of the Union – that remains unchanged in its **integrity**. There is no question of separating the persons and assets of two equal partners, because one withdrawing Member State cannot be equal to the Union of 27 others and because the Union is not separated and its assets remain its own – the very purpose of Article 50 TEU being to see to it that the sovereign right of a Member State to go may not be exercised in a manner detrimental to the rights and interests of the Union – in particular to its ability to move ahead in its integration process. For the withdrawing Member State, a withdrawal agreement is an instrument of international law; between the Union and the 27 Member States, it is an act of secondary law that cannot take precedence over the primary law of the Union and cannot affect the institutional or material structure of the Union. Therefore the former Member State being a foreign state, no extraordinary status of quasi-membership could be granted to it, even on a

² This view has been expressed again very recently, and characterised as the invitation to the EU negotiator to accept “a sensible approach to phasing”.

temporary basis, if this amounted to changing anything of the constitutional order of the Union, since this would require a Treaty change and full ratification process by the Member States in accordance with their national requirements. Article 50 TEU does not foresee such ratification for the withdrawal agreement.

The European Council guidelines of 29 April 2017 fully recognize this interpretation in the core principles they set for the negotiation **in all its phases**:

Preserving the integrity of the Single Market excludes participation based on a sector-by-sector approach. A non-member of the Union, that does not live up to the same obligations as a member, cannot have the same rights and enjoy the same benefits as a member. The four freedoms of the Single Market are indivisible and there can be no “cherry picking”. The Union will preserve its autonomy as regards its decision-making as well as the role of the CJEU.

Please pay particular attention to paragraph 3 of these guidelines, which states: *The core principles set out above should apply equally to the negotiations on an orderly withdrawal, to any preliminary and preparatory discussions on the framework for a future relationship, and to any form of transitional arrangements.*

The phased approach to negotiations is thus introduced by paragraph 3.

There are two facets to the arrangements: the orderly withdrawal that can be negotiated irrespective of any future relationship, and other transitional devices – that are consecutive to an agreement, or at least to the identification of an overall understanding on a future framework under international law.

This is not to say that the final version of a withdrawal agreement, if we ever reach that stage, cannot consolidate in a single package of arrangements the orderly phasing out and any phasing in offering a bridge to a new framework; but they are structurally different and their discussion is subject to specific requirements and therefore cannot be simultaneous.

For the time being, the Commission is empowered to conduct negotiations only on the orderly withdrawal, no discussion on a framework for future relationship being authorised for now, and therefore no discussion either on a possible bridge towards such framework. The Commission's current mandate is to clarify termination and minimize disruption on 29 March 2019: to provide clarity and settle the disentanglement in the terms of point 4 of the guidelines and 9 of the negotiating directives. The financial settlement, the right of expatriates and the issue of the Irish border are three specific constituents of this effort towards order and clarity – which concerns all legal situations and relations established with EU law applying to the United Kingdom as their basis.

Just to name examples, loan agreements by the European Investment Bank, banking contracts entered into by companies before Brexit, mandates to trading agents are among thousands of relations that obviously need certainty about how they will be affected. Beyond individual relations, certain collective legal regimes established in the context rather than on the basis of EU law may also be concerned.

The operating principle of this effort is that, if EU law ceases to apply to the United Kingdom on a given date – that of the withdrawal – collective or individual relations based on EU law may, depending on their legal form and content, have a lifespan authorizing their effects to be protracted beyond that date until the first event in their life cycle that makes termination possible. Some circumscribed parts of the EU acquis, on which these relations closely depend, may also have to be temporarily and conditionally maintained for the same purpose.

The two main rules there are specificity and necessity. **Specificity** because the duration of the survival of legal links and situations beyond withdrawal depends on their particular characteristics; **necessity** because the political withdrawal and the termination of legal links have to be simultaneous under Article 50 TEU and arrangements can only adjust modalities where immediate cessation would be impossible due to the violation of other principles of law – like the force of contracts and legitimate expectations to the extent they apply – or excessively difficult to achieve materially.

What will be left undecided will be for judges to settle, with the risks naturally involved. Therefore the possibility should not be ruled out that the Council decision to conclude the agreement could contain additional specifications concerning the effects of the withdrawal on the Union side – not to leave too many questions unanswered, at least as among the EU27.

But the orderly withdrawal cannot justify a general roll-over of the rights enshrined in the EU acquis, be it for a limited period of time, for reasons of mere commodity. And in any case, it is the Union's view, as stated by European Council, that "cherry-picking" among single market freedoms is impossible, that any prolongation of the Union acquis implies the application of regulatory, budgetary, supervisory, judiciary and enforcement instruments and structures and that membership rights and benefits are reserved for members. This leaves little political scope for any block prolongation of the current status of rights if one excludes the obvious method foreseen by Article 50 TEU for this purpose, which is to obtain the unanimous agreement of the European Council at 27 and of the withdrawing Member State to postpone the date of withdrawal and prolong the withdrawal period.³

Admittedly, transitional arrangements may also take into account the framework for future relations. This leaves open the possibility not to phase out legal links that existed on EU bases and that will continue to exist on international law bases constituting the new framework. There is no reason in such a case to move down from the current level of intensity to zero before moving up again to a level equivalent to the current one. Such cliff-edge effect would indeed be unnecessarily disruptive. The criteria of specificity and necessity for a continuation do not apply in this case, but the condition is that the bridge is secure; i.e. time-limited, resting on a clear and guaranteed understanding of what the framework will be made of, and with

³ The claim expressed by some proponents of a "soft Brexit" to temporarily maintain membership of the single market makes no sense since there is no such membership. Forms of access can be based on an international status, such as that offered by the EEA to EFTA States, but even that requires Treaty and cannot be temporary.

a scope that does not extend beyond the material coverage the future permanent agreement is expected to have. The bridge is a phasing in, a form of provisional application of legal links yet to come. Maximum breadth of the alley is not what we have now but what may safely expect to get in the stable future.

Would it be conceivable to grant the United Kingdom a prolonged right to offer financial services in the Union if there is no political consensus about this forming part of our future trade agreements? This is different from allowing existing service contracts to continue to be performed, as part of the phasing out, i.e. of the orderly withdrawal.

Therefore, what is decisive to shape the bridging kind of transitional arrangements is the nature and scope of the trade and other agreements the Union finds it in its interest to conclude with the United Kingdom for the future – which is a subject linked to Article 50 TEU, but of which the procedural legal basis is Article 218 TFEU and the procedure likely to require common accord. Taking into account such developments in designing transitional arrangements is an option that may be considered if the discussions on the future status of UK – EU relations have reached a stage that may be recognized as offering political certainty and if this is felt to be desirable in the Union's interest. But putting together bridging devices is not something the Union is obliged to do; and – first and foremost – it is not something even to consider before having formed a firm view of common intentions for the stable legal future.

In a word, transition phase 2 depends on the precise knowledge we have, in good time, of the landing zone.

To conclude, to offer comfort to operators by granting market access without EU membership for the United Kingdom throughout any period of time that could be welcome for prolonged thoughts and deliberations on a future status is not something the withdrawal agreement could easily achieve. Reasonable economic agents should have already integrated that a radical change of legal framework for relations with the United Kingdom is definitely scheduled to happen, and should have started preparing themselves for it 14 months ago, and at the latest 5 months ago when the clock has started ticking. Some sort of a cliff-edge is inevitable and, even if it is made less dramatic by adequate arrangements, it will be something the word comfort does not describe for those insufficiently prepared. Just a lawyer's humble advice to managers.

Brexit and the WTO: challenges and solutions for the United Kingdom (and the European Union)

By Christoph Herrmann¹

1 Introduction

The withdrawal of the United Kingdom from the European Union raises numerous complicated legal questions, primarily of Union law, but also of other legal frameworks. Due to the peculiar “parallel membership” of the Union and its Member States in the World Trade Organization (WTO) (see section 2), the legal order of the WTO is also profoundly challenged by the unprecedented process of a State, which is a member of the WTO in its own right, leaving a customs union and regional economic integration organisation, which is also itself a member of the WTO. In the following contribution, we will try to sketch out the key legal problems of disentangling the parallel membership of the Union and United Kingdom under WTO law (see section 3). In sum, it seems that the numerous complicated problems will require a huge amount of time and negotiation. They may also result in uncertainty for traders for a considerable amount of time. However, none of the problems is of such a magnitude that it cannot be overcome, in particular when all concerned parties act in good faith when discussing solutions.

2 Legal background: the (current) parallel membership of the Union and the United Kingdom in the WTO

At the time when the Union’s predecessor, the European Economic Community (EEC) was founded on 1 January 1958, the “predecessor” of today’s WTO legal order, the General Agreement on Tariffs and Trade (GATT), signed on 30 October 1947 was already celebrating the tenth anniversary of its “provisional application”, i.e. the limited application between the Contracting Parties. By that time, the foundation of an International Trade Organization, as originally envisaged, had failed.²

The founding six Member States of the EEC were hence already bound by international trade law, i.e. the GATT, when they agreed to establish a customs union among themselves by 1 January 1970. In fact, the decision to establish a customs

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² Jackson (1969).

union with broad product coverage paid direct tribute to the most-favoured-nation (MFN) principle enshrined in Article I:1 of the GATT and the declared unwillingness of the GATT trading partners to grant a (further) waiver to the European integration project.³ Hence, the conditions of Article XXIV:5 and XXIV:8 GATT had to be met by establishing either a free trade area (FTA) or a customs union. The EEC Treaty also provided for a common commercial policy, which – after the lapse of the transition period – had to be conducted on the basis of “uniform principles” (Article 113 EEC Treaty). The European Court of Justice (ECJ) interpreted from this that the common commercial policy constituted an exclusive competence of the then EEC⁴. This position is now firmly written into Article 3(1)(e) TFEU.

When the WTO was established on 1 January 1995 on the basis of the Marrakech Agreement⁵, concluding the Uruguay Round of multilateral trade negotiations, the WTO Agreement provided for membership of both the *European Communities*⁶ and its Member States as original members of the WTO, thus not requiring accession, but only ratification (cf. Article XI:1 WTO Agreement).⁷ As is the case today regarding the most recent generation of trade agreements of the Union⁸, it was controversial whether the European Community enjoyed full legal power under Article 113 TEC to accede to the WTO alone or whether the Marrakech Agreement required mixity on the part of the European Community. The answer was given by the ECJ in the notorious Opinion 1/94, which paved the way for the parallel membership of the WTO which the Union⁹ and its Member States enjoy today.

3 The “WTO option” in the further Brexit process

When the future of trade relations between the Union and the United Kingdom is being discussed, the so called “WTO option” is often described as a fall-back position. To be clear on this matter: it is neither an option nor a fall-back. The truth of the matter is that WTO law will be applicable to the trade relations between the Union and the United Kingdom after 30 March 2019 in any case: on the assumption that there will be neither a prolongation of the two year period under Article 50(3) TEU, nor a revocation of the withdrawal notification, nor the entry into force of the withdrawal agreement.¹⁰ Whether or not the Union and the United Kingdom will

³ Herrmann and Streinz (2014).

⁴ Opinion of the Court 1/75, Local Costs, ECLI:EU:C:1975:145.

⁵ Council Decision of 22 December 1994 concerning the conclusion on behalf of the European Community, as regards matters within its competence, of the agreements reached in the Uruguay Round multilateral negotiations (1986-1994) (OJ 1994 No L 336/3).

⁶ The WTO Agreement provides for membership of the European Communities, as it was not clear during the negotiations, how many of the original three would accede. In 1994, only the “European Community” acceded to the WTO. Yet, in WTO parlance, it was always spoken of the “European Communities” using the verb in the singular form (like for the “United States”).

⁷ For details of the EU’s membership in the WTO, see Herrmann and Streinz (2014).

⁸ The most recent case in that regard was, Opinion of the Court 2/15 (Free Trade Agreement between the European Union and the Republic of Singapore), ECLI:EU:C:2017:376.

⁹ On 1 December 2009 the EU succeeded the EC as member of the WTO, cf. Article 1(3)(3) TEU.

¹⁰ See also Ungphakorn (2017).

reach a trade deal – an FTA or customs union – on a so called “WTO plus” basis, is a different question, but it does not affect the applicability of WTO law between them.

3.1 The membership of the United Kingdom in the WTO

First, despite being uncontroversial, it is worth mentioning that the United Kingdom is a full member of the WTO in its own right, and it will remain a member after Brexit.¹¹ The United Kingdom was a Contracting Party to the GATT as early as 1 January 1948, when its provisional application began, and it became an “original member” of the WTO on 1 January 1995, as explained above. After the Treaty of Lisbon and its subsequent interpretation by the European Court of Justice¹², one may question whether this status is still justified under Union law¹³. However, the continuous membership of the EU Member States – despite their lack of WTO law related competences – is unquestionably an advantage now. What will change on 30 March 2019 is the representation in the WTO: whereas today the European Commission acts for the Union and the Member States, the United Kingdom will be on its own after 30 March 2019 (and the Union will be down to 27 votes under Article IX:1 WTO Agreement). Similarly, of course, responsibility and attribution for breaches of WTO law will change. Furthermore, WTO law will apply as between the United Kingdom and the Union (and its 27 Member States), contrary to the previous situation, where WTO law could only be invoked by Member States against the Union or against each other on behalf of their respective overseas territories to which the Treaties do not apply.¹⁴

3.2 Rights and obligations of the United Kingdom as future stand-alone WTO member

What exactly does the continuous membership of the United Kingdom in the WTO mean in legal terms? The WTO legal system rests on two different pillars: the legal rights and obligations deriving from the multilateral and plurilateral agreements (cf. Article II:2 and II:3 WTO Agreement) and the specific commitments of individual members. Whereas the first are broadly the same¹⁵ for all WTO members (multilateral) or those which have subscribed to them (plurilateral), the latter are individual, member specific terms of membership, in particular with a view to tariffs, tariff rate quotas (TRQs), agricultural subsidies and market access for services.

¹¹ Häberli, (2017) 3, pp. 87-91 (at 87); Hillman and Horlick (2017), p. 5.; Mishra (2017), p. 9 (10).

¹² Case C-414/11, *Daiichi Sankyo and Sanofi-Aventis Deutschland v DEMO Anonimos Viomikhaniki kai Emporiki Etairia Farmakon*, EU:C:2013:520, Case C-137/12, *Commission v Council*, EU:C:2013:675, and Opinion 3/15 (Marrakesh Treaty on access to published works), EU:C:2017:114.

¹³ See Herrmann (2010), pp. 193 (200 et seq.).

¹⁴ See Herrmann and Streinz (2014), paras. 97 et seq. An example of the latter situation is provided by the case European Union – Measures on Atlanto-Scandian Herring, WT/DS496 where the complaint was brought by Denmark, on behalf of the Faroe Islands. The case was settled in August 2014, WT/DS469/3, G/L/1058/Add.1.

¹⁵ The set of obligations is sometimes modified for developing or least-developed WTO members in the agreements themselves. Furthermore, individual members may be subject to customised set of rules under their respective accession protocol (cf. Article XII WTO Agreement).

Specific conditions under a settlement of a WTO dispute or authorized retaliations under the Dispute Settlement Understanding (DSU) form a hybrid category, as do trade remedies which may legally be employed once certain procedural and substantive criteria have been met. For all these features, the legal effects of Brexit need to be assessed separately.

3.2.1 Legal rights and obligations

Following Opinion 1/94 of the ECJ¹⁶, the Marrakech Agreement had to be concluded as mixed agreement, i.e. it had to be ratified by all EU Member States.¹⁷ Arguably, this act of ratification can be understood as applying to the undivided “single undertaking” of the WTO Agreement and the multilateral agreements of Annexes 1, 2 and 3, irrespective of the exact delimitation of competences between the then European Community and its Member States, in particular since no declaration of competences was submitted by the European Community.¹⁸

Yet, despite the lack of progress in the Doha Development Round, the WTO legal framework has not been static over the past 23 years. Repeatedly, existing agreements have been changed or amended, e.g. the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)¹⁹ or – most recently – the Trade Policy Review Mechanism (TPRM)²⁰. Moreover, additional agreements have been concluded, namely the Information Technology Agreement (ITA)²¹ and the Agreement on Trade Facilitation (ATF)²². Contrary to the Marrakech Agreement, these amendments and complements – to the extent that the amendment required ratification – were usually concluded as Union-only agreements, raising the question of their application to the United Kingdom after Brexit. Whereas amendments such as the most recent one concerning the TPRM are – on the basis of Article X:8 WTO Agreement – binding on all WTO members anyway (hence also on the United Kingdom), or are related to the tariff matter analysed below (in particular the ITA), others need to be accepted, such as the ATF and the TRIPS amendment (cf. Article X:3 WTO Agreement). The latter was only accepted by the European Community (prior to the Lisbon Treaty), and a declaration was made that this would be binding on the Member States *as a matter of European Community law* (Article 300(7) TEC). However, the acceptance was not made *on behalf of the European Community's Member States*.²³ For the ATF, the similar instrument of acceptance does not even

¹⁶ Opinion 1/94 (Agreements annexed to the WTO Agreement), ECLI:EU:C:1994:384.

¹⁷ Herrmann and Streinz (2014), paras. 35 et seq.

¹⁸ Cf. ECJ, Case C-53/96, *Hermès* [1998] ECR I-3603, para. 24. See also Mishra (2017), p. 9 (13).

¹⁹ Decision [WT/L/641](#) of 6 December 2005 of the WTO General Council, entered into force on 23 January 2017.

²⁰ See [Trade Policy Review Mechanism \(TPRM\)](#) and the related proposal WT/TPR/399 of 10 July 2017.

²¹ The original Ministerial Declaration WT/MIN(96)/16 of 13 December 1996 already named the European Communities only. The same is true for the Ministerial Declaration WT/MIN(15)/25 of 16 December 2015 on the Expansion of Trade in Information Technology Products.

²² General Council decision WT/L/940 of 28 November 2014, Protocol amending the Marrakesh Agreement establishing the World Trade Organization, insertion of the Agreement on Trade Facilitation into Annex 1A of the WTO Agreement.

²³ See Instrument of Acceptance by the European Community, of the Protocol amending the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), of 19 November 2007.

mention the binding character under Union law anymore (now Article 216(2) TFEU).²⁴ However, a footnote to the Protocol amending the WTO Agreement refers to the calculation of the two-thirds quorum required by Article X:3 WTO Agreement. According to that footnote, the acceptance by the Union shall be counted for the number of its Member States, also being members of the WTO (i.e. 28 as of 1 October 2015, when the instrument of acceptance was notified to the WTO). This can be read as an indication of the instrument being binding also on the EU's Member States under WTO rules.

Generally, two options to solve the matter spring to mind: one option is a solution using the principles applying to State succession *by analogy*²⁵, while another option is the unilateral formal signature and ratification of the respective agreements by the United Kingdom, to the extent that the instrument is still open to acceptance. This is clearly the case for the ATF, but at first glance not for the TRIPS amendment, where acceptance is currently only possible until the end of December 2017 (subject to a possible extension, which is currently pending).

However, the second option is not always available. A particularly complicated case is presented by the Government Procurement Agreement (GPA), which does not provide for mere adoption by non-participating WTO members. The conditions for accession to the GPA need to be agreed between the signatories of the GPA and the acceding WTO member government. Yet, as has been pointed out,²⁶ the United Kingdom is currently bound by the GPA as an EU Member State and an extensive list of coverage of UK public bodies is contained in the EU schedule of coverage.²⁷

Still, it is conceivable that other GPA signatories would like to use Brexit to negotiate an expansion of the coverage on part of the United Kingdom and would therefore oppose the view that the United Kingdom could be treated pragmatically as a GPA contracting party. In particular, this approach may be taken as – on the basis of denying the United Kingdom automatic GPA-signatory status – compensation from the Union for loss of market access to EU procurement markets can be claimed.²⁸ At any rate, the United Kingdom (and the Union) would have to notify its coverage annexes as a rectification or modification under Article XXIV:6 GPA.²⁹ In a joint letter of 11 October 2017, the Union and the United Kingdom have indicated the intention

²⁴ Cf. WT/Let/1090 re. WLI/100 of 16 October 2015.

²⁵ Quite obviously the principles could not apply directly as the EU is unquestionably not a State (see Mishra (2017), in: Hillman and Horlick (2017) (eds.), p. 9 (11 et seq.)).

²⁶ Bartels (2016), available at www.ictsd.org/opinion/understanding-the-uk.

²⁷ The UK did originally sign the GPA, subject to ratification, but did not ratify the GPA 1994 prior to 1 January 1996; the Protocol Amending the Agreement on Government Procurement that entered into force on 6 April 2014 could hence not even be accepted by the UK (cf. WTO, Status of WTO Legal Instruments, 2015, p. 124 and p. 127). The UK has hence not become a party to the GPA in its own right under Article XXIV GPA.

²⁸ Such a strategy is in particular proposed by Kim, Kuelzow and Strong (2017).

²⁹ The procedure is described in more detail by Kim, Kuelzow and Strong (2017). For a discussion whether the UK should strive for GPA party status at all see Lumley, The United Kingdom's Public Procurement Regime in a Post-Brexit Landscape, in: Hillman/Horlick (eds.), Legal Aspects of Brexit, 2017, p. 101 (110 et seq.).

of the United Kingdom to remain “subject to the rights and obligations it currently has under the Government Procurement Agreement”.³⁰

3.2.2 Terms of membership: specific commitments

The individual terms of membership of an original member result from the different commitments it has undertaken under the different agreements. They are contained in schedules which are legally integrated into the overall package of rights and obligations. In practice, they make up the backbone of the actual agreements and the original GATT was drafted in a way to protect the tariff commitments against circumvention; hence also the sequencing in the title (“...*tariffs and trade*”) and the systematic position of Article II in the GATT, right after the MFN clause. It is these individual terms of membership of the United Kingdom, where the uncertainty is the greatest and the controversy is most intense, with the key question being whether the United Kingdom’s current obligations as an EU Member State – for the performance of which the United Kingdom could be held liable before the DSU at present³¹ – would remain binding on the United Kingdom after Brexit as well – or whether they would have to be (re-)negotiated entirely in “tortuous negotiations”, as the Director General of the WTO Roberto Azevêdo originally phrased it in a public intervention in the Brexit debate in May 2016.³²

Tariffs

According to Article XI:1 WTO Agreement, original membership in the WTO required the annexing of Schedules of Concessions and Commitments to the GATT 1994 for the respective member. Paragraph 1(b)(i) of the GATT 1994 incorporates GATT 1947 and the respective protocols and certifications relating to tariff conditions into the WTO legal framework. Under Article II:7 GATT, the schedules are made an integral part of Part I of the GATT, and Article II:1 GATT obliges WTO members to accord treatment no less favourable than described in the schedule to products once imported into the territory to which the schedule “relates”. At present, the Schedule that “relates” to importation of goods into the United Kingdom is the consolidated EU schedule, with the Common Customs Tariff³³ being the correspondent EU instrument. This schedule is binding for the Union and the United Kingdom alike.³⁴

As a consequence, the plan of the United Kingdom to “copy and paste” the EU schedule as far as possible³⁵ has some merits in legal terms as well as for practical

³⁰ Braithwaite and Vanheukelen (2017).

³¹ WTO Panel Report, EC and certain member States – Large Civil Aircraft, WT/DS316/R, paras. 7.174 et seq.

³² Mishra (2017), in: Hillman and Horlick (2017) (eds.), p. 9 (10); see also [Azevêdo addresses World Trade Symposium in London on the state of global trade](#).

³³ Council Regulation (EEC) No 2658/87 of 23 July 1987 on the tariff and statistical nomenclature and on the Common Customs Tariff (OJ L 256, 7.9.1987, pp. 1-675).

³⁴ Bartels (2017), pp. 83 et seq.; Lux and Pickett (2017), p. 92 (96 et seq.).

³⁵ See Braithwaite (2017), para. 13.

and pragmatic reasons.³⁶ Legally, the EU schedule is the only reasonable starting point (or base line) available, as it is binding on the United Kingdom already – even though it is unclear whether the current certified EU25 schedule should be taken or the current, unknown non-certified EU28 schedule³⁷. The alternative, to go back to the UK pre-1973 EEC accession schedule is hardly perceivable – and it would certainly meet severe opposition by trading partners as they would lose all benefits from tariff negotiations since. To argue that the United Kingdom had no schedule at all would be even less convincing and acceptable for other WTO members.³⁸

In sum, the replication by the United Kingdom of the current EU schedule of specific commitments does not seem to raise overly complicated questions *per se*. As a result, the United Kingdom would end up with third country MFN bound tariffs which are practically identical³⁹ to those of the Union. However, things are much more complicated where the schedules do not merely state the applicable bound tariffs, but contain tariff rate quotas (TRQs), and the procedure to go through to address this issue is far from obvious.

Tariff rate quotas (TRQs)

Schedules of tariff concessions do not only consist of bound tariffs, which can easily be applied by the United Kingdom in the same manner as by the Union to date; they do also contain TRQs, under which certain – usually agricultural – goods can be traded at favourable duty rates, but only up to the quantity (quota) specified in the respective TRQ. The Union has close to 100 TRQs, 86 of which are for agricultural products.⁴⁰ The easiest way to handle this problem would be for the United Kingdom to lower the bound out-of-quota tariff to the in-quota tariff of the Union's TRQ for all imports and abolish the TRQ entirely.⁴¹ The Union could then keep its TRQ. Thereby, market access opportunities for third countries would be enhanced significantly. However, it is unlikely that such a pragmatic solution would be welcomed by UK agricultural lobbies. This means that the Union and the United Kingdom will have to agree to splitting-up the TRQs between them – ideally on the basis of trade patterns of the past three to five years⁴² – and submit this proposal to the WTO members for cumbersome joint negotiations. This seems to have happened over the summer of 2017, but the proposal of the EU27 and the United Kingdom, to apportion the

³⁶ Lux and Pickett (2017), p. 92 (97).

³⁷ Mishra (2017, in: Hillman and Horlick (2017) (eds.), p. 9 (25 et seq.); for a detailed analysis see Kim, Kuelzow and Strong (2017).

³⁸ Lux and Pickett (2017), p. 92 (97).

³⁹ A further question that needs to be sorted out would be the exchange-rate for the translation of specific duties, i.e. tariffs expressed in Euro, into Pound Sterling, cf. Mishra (2017), in: Hillman/Horlick (2017) (eds.), p. 9 (23 et seq.).

⁴⁰ Depending on the source, the figures differ slightly. For a detailed account of the TRQ problem cf. Downes (2017), pp. 741 et seq.

⁴¹ Mishra (2017), in: Hillman and Horlick (2017) (eds.), p. 9 (18). Downes (2017)), pp. 741 et seq. analyses in detail the risks the EU faces in case it follows a different approach.

⁴² Critically to this approach Downes (2017), pp. 741 (751 et seq.).

existing TRQs on the basis of past trade flows, has met opposition by the most relevant supplier countries.⁴³

The situation will be further complicated as trade between the United Kingdom and the EU27, which is currently not reflected in any TRQ of the Union, would have to be reflected somehow, particularly if no FTA (or customs union) between the two sides covering the respective products can be agreed.⁴⁴

Procedural aspects: rectification or modification?

Arguably, following Brexit the United Kingdom would still be bound by obligations (and entitled to rights) similar to those it is subject to (and enjoys) as a Member State of the Union. However, this claim of substantive continuity does not mean that the formal procedure for the United Kingdom (and the Union) would be easy. Furthermore, the diplomatic process of transition should not be confused with the possible outcome of complaints by WTO members directed against the United Kingdom, the Union or both.

For the diplomatic process, there is no template that perfectly fits this unprecedented situation.⁴⁵ It is correct that the GATT CONTRACTING PARTIES⁴⁶ did handle cases of State succession⁴⁷ and the independence of previously dependent customs territories pragmatically.⁴⁸ However, Brexit is different, as it is not a succession case, nor does Article XXVI:5(c) GATT fit the situation.⁴⁹ The Union is not a State, the United Kingdom is already a member of the WTO, but it is not a customs territory that regains its “full autonomy” (cf. Article XXVI:5(c) GATT) either: the United Kingdom would currently not qualify as “customs territory” as defined in Article XXIV:2 GATT, since no “separate tariffs or other regulations of commerce are maintained for a substantial part of the trade of such territory with other territories”. The United Kingdom is part of the EU customs territory as defined in Article 4 of the Union Customs Code⁵⁰, and tariffs and other regulations of commerce are almost identical for the whole of the Union.

Assuming that the current EU schedule of tariff commitments is the relevant starting point, when the United Kingdom submits its new and necessarily to some extent

⁴³ See Bridges News, Vol. 21, No 33, [Brexit: UK, EU Propose Cooperative Approach to WTO Commitments](#), including the linked references to a letter by seven WTO members.

⁴⁴ Downes (2017), pp. 741 (751 et seq.); Mishra (2017), in Hillman and Horlick (2017) (eds.), p. 9 (17 et seq.).

⁴⁵ For a more detailed account of the different avenues available see Downes (2017), pp. 741 (754 et seq.); Lux and Pickett (2017), p. 92 (97 et seq.); Mishra (2017), in: Hillman and Horlick (2017) (eds.), p. 9 (21 et seq.); Kim, Kuelzow and Strong (2017).

⁴⁶ The notion “GATT CONTRACTING PARTIES” refers to the entirety of the membership. After the establishment of the WTO, it has to be read as “the WTO”, cf. Jackson (1969), pp. 119 et seq.; GATT 1994 Introductory text section 2(b).

⁴⁷ The cases of Rhodesia/Nyasaland and the break-up of Czechoslovakia are the most frequently cited examples.

⁴⁸ Bartels (2016), available at www.ictsd.org/opinion/understanding-the-uk

⁴⁹ But see Bartels (2016), *ibid.*

⁵⁰ Regulation (EU) No 952/2013 laying down the Union Customs Code, (OJ L 269, 10.10.2013, p. 1-101).

revised authentic schedule, it will have to be determined whether this can be qualified either as a “modification” or as a “rectification” under the applicable Article XXVIII GATT⁵¹ and the GATT Decision of 1980⁵². Whereas the “copy and paste” exercise of replicating the EU tariffs may qualify as a rectification (1980 Decision paragraph 2), i.e. a change of purely formal character, this is not the case for adjustments caused by changes to specific tariffs that involve a change of currency or for the division of TRQs⁵³. This point has also been emphasized by seven major WTO members in a letter 26 September 2017 addressed to the Union and United Kingdom.⁵⁴ These changes may indeed affect the scope of concessions of the United Kingdom (and the Union) and require negotiations under Article XXVIII GATT.⁵⁵ Generally, in GATT and WTO practice, a broad interpretation of the notion of “modification” in Article XXVIII GATT has been applied.⁵⁶ In any case, changes of either kind will need to be submitted for certification by consensus under paragraph 3 of the 1980 Decision. Whenever any WTO member is of the view that the submitted UK schedules do contain “modifications” changing the scope of concessions, it may block the certification – hence certification can be a lengthy and cumbersome process that goes on for years. Legal arguments claiming that the United Kingdom is entitled to inherit certain rights or obligations may be made in that process, but they will not necessarily expedite it. It is worth keeping in mind that the changes to the EU’s schedules induced by the 2004 enlargement were only certified after twelve years in December 2016.⁵⁷

This begs the question: what would be the United Kingdom’s commitments until certification takes place, and makes the new authentic schedule of the United Kingdom binding? Article XXVIII:1 GATT seems to make negotiations and agreement and the following certification a condition for the modification or withdrawal of a concession, or for an increase of tariffs upon the formation of a customs union (cf. Article XXIV:6 GATT). However, Article XXVIII:3 GATT also clearly states that a WTO member “shall ... be free” to modify or withdraw concessions – the only consequence being a reciprocal right of the affected WTO members to withdraw concessions of equal value. The same holds true for Article XXVIII:4(d) GATT, which may be applicable. The applicable guidelines for Procedures for Negotiations under Article XXVIII of November 1980⁵⁸ similarly provide that WTO members are free to give effect to negotiated modifications prior to formal certification (paragraph 7

⁵¹ For a detailed account of Article XXVIII GATT related practice see GATT (ed.) *Guide to GATT Law and Practice*, 1994, pp. 887 et seq.

⁵² *Procedures for Modification and Rectification of Schedules of Tariff Concessions*, Decision of 26 March 1980, L/4962.

⁵³ Downes (2017), p. 741 (748).

⁵⁴ Permanent Representatives of Argentina, Brazil, Canada, New Zealand, Thailand, United States and Uruguay, [Letter to Julian Braithwaite and Marc Vanheukelen](#), 26 September 2017.

⁵⁵ *European Communities – Regime for the Importation, Sale and Distribution of Bananas, Second Recourse to Article 21.5 of the DSU by Ecuador and Recourse to Article 21.5 of the DSU by the United States*, WT/DS27/AB/RW2/EQU; WT/DS27/AB/RW/USA, paras. 450 et seq.

⁵⁶ Downes (2017), p. 741 (756 et seq.).

⁵⁷ The complete picture of the [EU’s schedule situation](#).

⁵⁸ GATT Doc. C/113 of 5 November 1980, *Procedures for Negotiations under Article XXVIII*, Guidelines Proposed by the Committee on Tariff Concessions.

and 8). On this basis, a recently adopted panel report⁵⁹ came to the conclusion that certification is not a legal condition for a revised schedule to be legally applied, thus limiting the right to react to an uncertified modification to the WTO members having the negotiating rights conferred under Article XXVIII GATT.

Nevertheless, WTO members have an economically plausible case to argue that Brexit reduces the value of the tariff commitments under the GATT and for trade in services under the General Agreement on Trade in Services (GATS) of the United Kingdom and the Union when the market is split up.⁶⁰ This may either support their claims to renegotiate commitments as described above or lead to complaints under Article XXIII:1 GATT and the DSU, be it the regular violation complaints (Article XXIII:1(a) GATT) or the otherwise irrelevant non-violation complaints (Article XXIII:1 (b) GATT) or even situation complaints (Article XXIII:1(c) GATT).

Agricultural subsidies

In addition to specific commitments relating to tariffs and TRQs under the GATT, in the Uruguay Round, WTO members also subscribed to limitations on agricultural subsidies. These commitments are contained in Part IV of the EU's schedule of commitments (cf. Article 3.1 of the Agreement on Agriculture) and relate to export subsidies and domestic support.⁶¹ Whereas export subsidy entitlements of developed WTO members had to be abolished immediately (with only limited exceptions) on the basis of the 2015 Nairobi ministerial declaration,⁶² the entitlements of the Union for domestic support will somehow have to be split up between the EU27 and the United Kingdom. Those are expressed in the Total Aggregate Measurement of Support (AMS). The legal limit of trade distorting agricultural subsidies falling into the so-called "amber box" for the Union is set at EUR 72.4 billion.⁶³ Following the Common Agricultural Policy (CAP) reforms of the past years, the Union is declaring most parts of its CAP-based expenditure as falling into different and unlimited categories under the WTO Agreement on Agriculture. Only EUR 5899.1 million – according to the Union's declaration – qualify as amber box subsidies, making up for about 8% of the Union's total AMS.⁶⁴ Even together with forms of support whose categorization by the Union may be questionable from a WTO law perspective, the Union falls short of its overall entitlement.⁶⁵ This should

⁵⁹ European Union – Measures Affecting Tariff Concessions on Certain Poultry Meat Products, Panel Report, WT/DS492/R, adopted 19 April 2017, para. 7.550 and footnote 750.

⁶⁰ Lux and Pickett (2017), p. 92 (101 et seq.); Downes (2017) p. 741 (747 et seq.).

⁶¹ For a comprehensive analysis of the questions raised by Brexit relating to agricultural subsidies cf. Kim, Kuelzow and Strong (2017), Mathews (2016); Mishra (2017 in: Hillman/Horlick (2017) (eds.), p. 9 (18 et seq.); Swinbank, World Trade Rules and the Policy Options for British Agriculture Post-Brexit, UKTPO Briefing Paper 7, January 2017. For a detailed description of the underlying WTO law see McMahon (2006).

⁶² Ministerial Decision of 19 December 2015, WT/MIN(15)/45, para. 6.

⁶³ Swinbank, World Trade Rules and the Policy Options for British Agriculture Post-Brexit, UKTPO Briefing Paper 7, January 2017, pp. 4 et seq.

⁶⁴ Swinbank, World Trade Rules and the Policy Options for British Agriculture Post-Brexit, UKTPO Briefing Paper 7, January 2017, p. 5.

⁶⁵ Swinbank, World Trade Rules and the Policy Options for British Agriculture Post-Brexit, UKTPO Briefing Paper 7, January 2017, p. 5.

leave sufficient leeway for negotiating a chopping-off of a UK part from the Union's current AMS, thus satisfying all partners' needs.

To the extent that the United Kingdom does not intend to increase farm payments significantly or switch to forms of subsidization which are illegal under WTO rules, the problems related to agricultural subsidies should hence be limited and rather relate to practicalities of working out a UK policy and complying with WTO obligations concerning notifications, reporting and the like.⁶⁶

Specific commitments for services trade

Since 1995, trade in services has been governed by the multilateral General Agreement on Trade in Services (GATS). However, the GATS provides more of a framework for services trade liberalisation than generating such liberalisation itself. Somewhat differently from trade in goods, trade in services is scarcely subject to hard legal obligations beyond the MFN principle enshrined in Article II:1 GATS. Market access obligations as well as national treatment obligations are subject to a WTO member having entered into specific commitments (cf. Article XX GATS). Contrary to the impression one may get from the wording of Article XX:1 GATS ("specific commitments it undertakes under Part III of this Agreement"), specific commitments are also relevant for Part II obligations (e.g. Article VI:1 GATS). Hence, WTO members must have a Schedule of Specific Commitments in relation to market access and national treatment for services trade (cf. Article XI:1 WTO Agreement).

Currently, the United Kingdom has no individual Schedules of Commitments under the GATS, but is bound by the EU schedules, of which there are five currently in force. These cover the main commitments⁶⁷, exceptions from MFN⁶⁸, commitments relating to mode 4⁶⁹ (movement of natural persons), telecommunication services⁷⁰ and financial services⁷¹. None of these schedules apply to the EU28 as a whole (or all of its Member States): they do apply to the EU12 or at best to the EU15 (namely the annexes on telecommunications and financial services): However, the United Kingdom is covered by them. The situation is hence somewhat similar to the one relating to tariffs.⁷² Yet, due to the shared competence for trade in services back in 1994, the schedules are explicitly those of the Union *and its Member States*. They even identify Member State specific limitations and conditions. The disentangling should hence be much easier. However, a notification and – most likely – negotiations about compensatory adjustments will be required on the part of the United Kingdom (and the likewise the Union). This is particularly the case since Brexit would significantly reduce the value of concessions of the United

⁶⁶ Mathews (2016).

⁶⁷ WTO Document GATS/SC/31, 15 April 1994.

⁶⁸ WTO Document GATS/EL/31, 15 April 1994.

⁶⁹ WTO Document GATS/SC/31/Suppl.2, 28 July 1995.

⁷⁰ WTO Document GATS/SC/31/Suppl.3, 11 April 1997.

⁷¹ WTO Document GATS/SC/31/Suppl.4/Rev.1 of 18 November 1999.

⁷² Ungphakorn (2017).

Kingdom/EU27 under Mode 3 (“commercial presence”). For example, in the financial services sector, this would be due to the loss of enhanced market access for cross-border supply under Union free movement of services rules (e.g. passporting rights), if such rights are not maintained on the basis of a post-Brexit EU-UK trade in services agreement. This seems unlikely with regard to trade in financial services, as the Union has previously not concluded any such agreement⁷³. The procedure for this whole exercise is laid down in Article XXI GATS and the Procedures for the implementation of Article XXI of the GATS (Modification of Schedules)⁷⁴.

Mutually satisfactory solutions and retaliation under the DSU

Little attention has been given so far to the future applicability of the outcome of past dispute settlement proceedings that involved the Union. Different scenarios are relevant in that context:

(i) Where the EU has been granted authorization to withdraw concessions vis-à-vis a respondent WTO member government after a successful complaint (Article 22.2-22.9 DSU), one would expect that this authorization does continue to apply to the Union (even though one may question the size given that the trade benefits that were originally impaired may partially have been belonging to trade from the United Kingdom), but not to the United Kingdom.

(ii) Where another WTO member has been allowed to withdraw concessions vis-à-vis the Union (alone) subsequent to a successful complaint, the situation seems to be similar to the one described above, with the United Kingdom being the one benefitting from the non-applicability of the authorization to it. However, this solution would not entirely fit a situation where the original measure contested before the DSB was either (also) attributable to the United Kingdom or where the United Kingdom would continue to apply an EU measure found inconsistent with the WTO agreements.

(iii) Where the Union and another WTO member have reached a mutually satisfactory solution (Art. 3.3-3.6 DSU), the situation would depend mostly on the particular case concerned. Prima facie, such solutions can only be binding on the parties, i.e. the Union and the other WTO member, but the facts of the case may call for an application to the United Kingdom after Brexit.

As most of the other problems raised above, finding a solution will require intense negotiations by the United Kingdom and the Union with their trading partners and issues unsettled in these negotiations may give rise to dispute settlement later on.

⁷³ For a comprehensive overview of the problems related to financial services cf. EURO-CFG, Implications of Brexit on EU Financial Services, European Parliament, Directorate General for Internal Policies, Policy Department A, Study for the ECON Committee, 2017.

⁷⁴ WTO Document S/L/80, 29 October 1999.

Continued application of trade remedies

A further problem relates to the application of trade defence instruments (TDIs) such as antidumping or countervailing duties to imports into the Union. Again, different aspects need to be distinguished. First, it seems clear that the United Kingdom will not be able to continue to apply TDIs that were imposed by the Union on the basis of EU TDI legislation, even if this legislation (including the specific anti-dumping regulations) were declared to continue to apply in the United Kingdom on the basis of the European Union (Withdrawal) Bill.⁷⁵ In doing so, the United Kingdom would clearly violate its obligations under the applicable WTO provisions, in particular Article VI GATT and the Antidumping Agreement, since the United Kingdom would neither be able to demonstrate that the concrete imports were damaging UK industries nor that UK authorities had undertaken an antidumping investigation in line with the Antidumping Agreement.⁷⁶

A different problem would arise for the Union with regard to those TDIs, in particular antidumping duties, where the industry quorum in favour of an investigation or the determination of the relevant prices or material injury to “domestic industries” did take into account UK industries.⁷⁷ Here, at least an interim review of TDIs applied will be required.⁷⁸

4 Conclusion

Brexit brings about numerous problems relating to WTO law. The peculiar parallel membership of the Union and its Member States – despite being explicitly provided for in the WTO Agreement – makes things complicated, as the United Kingdom is unquestionably a WTO member in its own right, but the exact individual terms and conditions of its membership still need to be determined. For some parts, in particular with a view to tariffs and services commitments, the “copy and paste”-exercise envisaged by the United Kingdom will work out rather well, but possibly not without some diplomatic arm-wrestling at Geneva’s negotiation tables. For other aspects, in particular for TRQs, things look a lot more problematic. The right procedures for the upcoming exercise remain somewhat unclear, but a pragmatic approach of the WTO and its members should be capable of removing any such uncertainty. Undoubtedly, some legal questions raised by Brexit will give rise to dispute settlement in the future; the application of TDIs may be the most likely candidate for that matter.

The best advice for the United Kingdom (and the Union alike) would be to confront the situation head-on, quickly and with a cooperative approach, open and willing to compensate trade partners for alleged losses of market access. At the same time, it

⁷⁵ Lux and Pickett (2017), p. 92 (110 et seq.) rightly point out, that EU trade remedies will cease to apply after Brexit, but – presumably – at the time of their writing the plan for the UK’s withdrawal bill was not yet known.

⁷⁶ Lux and Pickett (2017), p. 111.

⁷⁷ For an example see Kim, Kuelzow and Strong (2017).

⁷⁸ Lux and Pickett (2017), p. 110.

would be greatly helpful if other WTO members did not see Brexit primarily as an opportunity to exploit in order to enhance their market access into the EU27 and United Kingdom,⁷⁹ but as a challenge for the multilateral trading system calling for cooperative and solution-oriented action.

At the time of writing, the United Kingdom and the Union were expected to come up with a joint proposal how to address the legal problems described in this paper. First discussions in the WTO, which became public in October 2017⁸⁰ indicate that the process will not be an easy or quick one, in particular – but not exclusively – with a view to TRQs. It is to be awaited whether a more comprehensive proposal will constitute a solid basis for the necessary discussions in the WTO. It should be recalled that all resources that have to be vested in the WTO negotiations will be lacking – in particular on the UK side – for negotiations on Free Trade Agreements, where they are desperately needed as the United Kingdom will – in all likelihood – lose market access under EU Free Trade Agreements once Brexit becomes effective.

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⁷⁹ For such a perspective, see in particular Kim, Kuelzow and Strong (2017).

⁸⁰ See Bridges News, Vol. 21, No 33, [Brexit: UK, EU Propose Cooperative Approach to WTO Commitments](#).

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Brexit and the future of Europe: seizing the opportunity to complete the European Union

By Federico Fabbrini¹

1 Introduction

The decision of the United Kingdom to leave the European Union represents a watershed moment in the history of European integration.² Since the June 2016 referendum,³ much attention has been given to the implications that Brexit has on the United Kingdom, and its internal constitutional settlement; and since the notification of withdrawal in March 2017,⁴ the focus has been on the practicalities of the divorce between the United Kingdom and the Union, and their future relations.⁵ Nevertheless, Brexit has important constitutional implications for the European Union too, and arguably represents a wake-up call for the remaining Member States. Culminating a decade in which the Union has been increasingly questioned, Brexit challenged the integration paradigm that had dominated the project of European unification since the Treaties of Paris and Rome, and exposed the weaknesses of the current EU constitutional set-up. Even though the decision of the United Kingdom to leave the Union may have been influenced by idiosyncratic national factors, there is little doubt that the recent set of internal and external crises – the euro, migration, the rule of law, terrorism, foreign affairs – have taken a toll on the Union and its standing.⁶

In fact, the need to overhaul the European Union to improve its effectiveness and legitimacy is not an exclusive slogan of the Brexiteers. On the contrary, the idea that the process of European integration has to be relaunched through adequate constitutional reforms has been institutionally articulated at the highest European and national level. In the context of the euro-crisis, proposals to deepen and complete Europe's Economic and Monetary Union (EMU) have been advanced most notably by the so-called "Four Presidents' Report"⁷ – a document written by the Presidents of the European Council, the European Commission, the ECB and

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² See Fabbrini (2017).

³ The UK Electoral Commission, [EU referendum results](#).

⁴ Letter of UK Prime Minister Theresa May to European Council President Donald Tusk, 29 March 2017.

⁵ See Armstrong (2017).

⁶ See Tsoukalis (2016).

⁷ Four Presidents' Report, "Towards a Genuine EMU", 5 December 2012.

Eurogroup in 2012 – as well as by the “Five Presidents’ Report”⁸ – a document prepared by the Presidents of the European Commission, European Council, ECB, Eurogroup, and European Parliament in 2015. Moreover calls to enhance the European Union with alternative roadmaps for constitutional reforms have been made during the celebrations of the 60th anniversary of the Treaty of Rome by the European Commission,⁹ the European Parliament,¹⁰ as well as by the Heads of State and Government and the leaders of the Union institutions meeting in Bratislava,¹¹ and Rome.¹²

The main argument of this chapter is that Brexit increases the urge – but simultaneously creates the opportunity – to reform the EU constitutional architecture.¹³ The withdrawal of the United Kingdom compels the Union and its remaining Member States to engage in some significant legal and constitutional reforms in order to adapt the EU legal framework to the new normal of a Union of 27. As this chapter explains, after the United Kingdom leaves the European Union – by default in March 2019, two years after the notification under Article 50 TEU – the remaining Member States will need to amend several provisions of the Treaties. Moreover, the Union institutions and the Member States will need to adopt other key legal acts – such as a new decision concerning the allocation of the seats for the European Parliament, and new rules on the funding of the Union – which essentially have a constitutional status. The reforms necessitated by Brexit touch upon important institutional and financial aspects of the functioning of the Union, and as such will force Member States and Union institutions to engage in high-stakes bargaining and negotiations. In this context, the reform proposals articulated in the context of the euro-crisis and the celebrations of the Treaty of Rome, may acquire a new relevance and become parts of a package of constitutional amendments designed to enhance the functioning of the European Union.

This chapter claims that Brexit represents a wake-up call for the European Union – removing any remaining hypocrisy on the unsustainability of Europe’s status quo. At the same time, Brexit also offers a window of opportunity to take seriously the high-level roadmaps for constitutional reform that have been advanced during the last few years. Since Brexit will force significant constitutional revisions in the Union – whether the Member States and the Union institutions like it or not – this creates the possibility to implement reforms which are needed to improve the Union’s effectiveness and legitimacy. Of course, the prospect of constitutional change in the Union raises difficulties – and this chapter acknowledges the existence of legal obstacles and political opposition in some Member States which may complicate any reform plan. Nevertheless, this chapter emphasizes how recent experiments in

⁸ Five Presidents’ Report, “Completing Europe’s EMU”, 22 June 2015.

⁹ See European Commission, White Paper “The Future of Europe”, 1 March 2017.

¹⁰ See e.g. European Parliament resolution of 5 April 2017 on negotiations with the United Kingdom following its notification that it intends to withdraw from the European Union, P8_TA(2017)0102.

¹¹ Bratislava Declaration, 16 September 2016.

¹² Rome Declaration of the leaders of 27 Member States and of the European Council, the European Parliament and the European Commission, 25 March 2017.

¹³ The argument I am advancing in this chapter develops views I have already articulated in Fabbrini (2017), as well as Fabbrini (2016b).

interstate cooperation on the side of the Union have reduced the ability of any given Member State to veto reforms desired by a large majority of Member States: as such, the chapter suggests that multi-speed integration remains a distinctive possibility in case efforts to reform the EU constitutional system after Brexit were to falter for idiosyncratic national reasons.

This chapter is structured as follows. Section 2 provides an overview of the Treaty amendments that are necessitated by the withdrawal of the United Kingdom, Section 3 discusses the changes to be made to the European Council decision on the composition of the European Parliament, and Section 4 details the implications that Brexit will have on the EU financial framework. Subsequently, Section 5 summarizes the main proposals for constitutional change advanced during the euro-crisis, and Section 6 considers the plans for reforms articulated in the context of the celebrations of the 60th anniversary of the Rome Treaty. Section 7 then explains how the changes necessitated by Brexit touch precisely upon the same substantive and institutional areas identified in the above-mentioned reform proposals – suggesting that this creates the space for a grand constitutional bargain. Section 8, finally, considers the challenges ahead and concludes that multi-speed integration remains an option to overcome deadlock and to reform the European Union.

2 Brexit and the EU Treaties

The departure of the United Kingdom will eventually require the Union institutions and the remaining Member States to adjust a number of key EU law measures, including provisions of the Treaties. The most glaring treaty amendment regards Article 52 TEU. This clause – which is then further specified by Article 355 TFEU – lists the Member States of the Union, including the United Kingdom. Article 52 TEU has been updated over time to account for EU enlargement. The last amendment occurred in 2013, when Croatia joined the Union. On that occasion, Article 13 of the Act concerning the conditions of accession of the Republic of Croatia – annexed to the Treaty between the 27 Member States and Croatia – modified Article 52 TEU to include Croatia among the list of Member States.¹⁴ After the United Kingdom withdraws from the Union, Article 52 TEU will necessarily have to be modified to remove the United Kingdom from the list of states to which the Treaties apply. However, an important point must be underlined. Article 49 TEU (which regulates enlargement) explicitly authorizes “adjustments to the Treaties on which the Union is founded” to be made in the accession agreement between the Member States and the applicant state. Hence, formal modifications of the Treaties which result from the accession of a new Member State can be dealt with in the accession treaty and accompanying documents – without the need for a revision of the Treaties according to the rules of Article 48 TEU.

¹⁴ See Article 13 of the Act of 24 April 2012 concerning the conditions of accession of the Republic of Croatia and the adjustments to the Treaty on European Union and the Treaty on the Functioning of the European Union (OJ L 112/25, 24.4.2012), p. 27.

By contrast, Article 50 TEU (which regulates withdrawal) does not mention an equal rule, and only states that the Union shall “conclude an agreement with [the withdrawing] State, setting out the arrangement for its withdrawal, taking into account of the framework for its future relationship with the Union”. Since the agreement with the withdrawing state is negotiated by the Union as any normal international pact pursuant to Article 218(3) TFEU – and is thus a legal act hierarchically inferior to the Treaties¹⁵ – this implies that in order to modify Article 52 TEU and remove the name of the United Kingdom from the list of Member States, resort should be made to the normal amendment procedure of Article 48 TEU. An international agreement concluded by the Union, in fact, cannot modify primary law.¹⁶ In other words, while in the case of enlargement the accession agreement suffices to introduce formal amendments to the Treaties (such as a change to Article 52 TEU), in the case of withdrawal the secession agreement cannot do so: even a banal and formal adjustment to the Treaties such as the one under discussion here needs to be undertaken through the revision procedure set out in Article 48 TEU.

As is well known Article 48 TEU outlines two revision procedures to amend the Treaties: a simplified revision procedure, and an ordinary revision procedure. However, according to Article 48(6) TEU the simplified revision procedure can only be used to “revise all or part of the provisions of Part Three of the TFEU” and on condition that the amendment “shall not increase the competences conferred on the Union in the Treaties.” In order to modify Article 52 TEU, therefore, resort has to be made to the ordinary revision procedure. This procedure requires the European Council to “convene a Convention composed of representatives of the national Parliaments, of the Heads of State or Government of the Member States, of the European Parliament and of the Commission” and charged to “adopt by consensus a recommendation [to amend the Treaties] to a conference of representatives of the governments of the Member States.” Pursuant to Article 48(3) TEU the European Council may decide by a simple majority “not to convene a Convention should this not be justified by the extent of the proposed amendments” – but it must obtain the consent of the European Parliament to do so: hence the European Parliament can insist on calling a Convention to examine proposals for revisions to the Treaties.¹⁷ Finally, amendments to the Treaties have to be agreed by common accord by a conference of representatives of the Member States and “shall enter into force after being ratified by all the Member States in accordance with their respective constitutional requirements.”

In sum, when the United Kingdom withdraws from the Union, the other Member States will eventually need to amend the Treaties, at the minimum to modify Article 52 TEU (and, relatedly, Article 355 TFEU). It is quite possible that the remaining 27 Member States in the European Council will quickly agree to modify Article 52 TEU and decide that a Convention is not required for such a formal amendment. However, Article 48 TEU gives the European Parliament a right to insist on convening a Convention. Considering that the European Parliament has on

¹⁵ See Article 218(11) TFEU.

¹⁶ See Craig (2010), p. 401.

¹⁷ See Piris (2010), p. 104.

multiple occasions called for setting up a new Convention,¹⁸ it cannot be excluded that the European Parliament will exploit the opportunity created by Brexit to force the European Council to eventually set in motion a broader project of revisions and updates of the Treaties.

3 Brexit and the rules on the composition of the European Parliament

In addition to the above-mentioned formal amendment to the Treaties, when the United Kingdom withdraws from the Union, the composition of the European Parliament will also have to be modified to account for the secession of one of its (most populous) Member States. Whereas the Treaty provisions dealing with the European Council, the Council, the European Commission and the European Court of Justice (ECJ) can be applied without much ado to a Union of 27 Member States, institutional engineering is needed to adapt the European Parliament to the new reality. According to Article 14(2) TEU, the European Parliament is composed of a maximum 750 members, plus the President – hence, for a total of 751 MEPs, to be elected in the various Member States according to the principle of degressive proportionality “with a minimum threshold of six members per Member State. No Member State shall be allocated more than ninety-six seats.” As Article 14(2) TEU clarifies, the specific allocation of seats to the various Member States is determined in a European Council decision, “adopted by unanimity, on the initiative of the European Parliament and with its consent” which has to be implemented through appropriate national legislation designed to set the specific rules on the election of the MEPs assigned to each state.

Currently, the composition of the European Parliament is set out in a European Council decision adopted in June 2013.¹⁹ This decision – the first passed since the entry into force of the Lisbon Treaty – determined the apportionment of seats in the eighth elections of the European Parliament in June 2014 and was the result of a long wrangling among the Member States.²⁰ In fact, concerns about the allocation of seats in the European Parliament among the Member States played out in the negotiations leading to the Lisbon Treaty and are reflected in the fact that Declarations No 4 and No 5, annexed to the Treaties, address this issue specifically. Declaration No 4, in particular, indicates that “the additional seats in the European Parliament” (i.e. the 751st seat) will be attributed to Italy, and Declaration No 5 states that the European Council “will give its political agreement on the revised draft Decision on the composition of the European Parliament for the legislative period 2009-2014, based on the proposal from the European Parliament.” These declarations – which technically are not binding, and do not have the same legal values as the Treaties – testify however to the difficulties of finding an acceptable

¹⁸ See *infra* Sections 5-6.

¹⁹ European Council Decision of 28 June 2013 establishing the composition of the European Parliament, 2013/312/EU (OJ L 181/57, 29.6.2013).

²⁰ See further Fabbrini (2015), p. 823.

inter-state and inter-institutional compromise, on an issue which is seen by national governments as a proxy for the status of their country within the Union.

Following the departure of the United Kingdom, the European Council and the European Parliament will have to agree on a new decision on the allocation of seats. In fact, the June 2013 European Council decisions already anticipated that a new formula for the allocation of seats had to be agreed upon in view of the 9th European Parliament elections in 2019,²¹ and the European Parliament is expected to come up with a proposal shortly. Yet, it is clear that the withdrawal of the United Kingdom creates space for major new demands by several Member States, and for a potential significant reshuffling of seats. In fact, the current European Council decision assigns 73 seats to the United Kingdom in the European Parliament – the third largest delegation (after Germany and France, and on a par with Italy).²² Considering that the new decision will have to be proposed by the European Parliament, approved unanimously by the European Council, sanctioned by the European Parliament – and then de facto ratified domestically by all Member States, since national legislation will have to be put in place to regulate the specific modalities for electing the number of MEPs assigned to each Member State by the decision – it is clear that much will be at stake during the negotiations.

In sum, the need to adopt a new decision on the composition of the European Parliament to accommodate the withdrawal of a (populous) Member States like the United Kingdom seems to create another window of opportunity for significant updates and revisions to the EU institutional set-up. As amending this European Council decision is – in terms of complexity – almost tantamount to a Treaty revision, it cannot be excluded that the opportunity will be exploited to call for a more fully-fledged change to the EU institutional architecture, or at least to some other specific amendments to EU primary law, which may be part of a package-deal on how to assign seats among the 27 Member States within the European Parliament. After all, comparative studies reveal that choices on the allocation of seats in federalism-based systems are often taken within the framework of broader constitutional bargains, when units which may be losing out in terms of corporate representation can be compensated with other payoffs.²³

4 Brexit and the financial provisions of the Union

Another area of change compelled by Brexit concerns then the finances of the Union. Following the withdrawal of one of its (richest) Member States, the Union institutions will need to revise the complex legal architecture on the financing of the European Union. The EU financial framework is set out in a Council decision on the own resources of the Union in accordance with Article 311 TFEU – which determines revenues – on a Multi-Annual Financial Framework (MFF) Regulation foreseen by Article 312 TFEU – which regulates expenditures – as well as on yearly budgets

²¹ See Article 5, European Council Decision 2013/312/EU.

²² See Article 3, *ibid.*

²³ See Rodden (2002), p. 151.

adopted according to the procedure of Article 314 TFEU. The amendments to these acts do not technically amount to a Treaty change – but they are effectively akin to them. While the MFF regulation has to be adopted by the Council acting unanimously, and with the consent of the European Parliament, the decision on the own resources of the Union requires unanimous agreement between national representatives in Council, consultation of the European Parliament and subsequent ratification by the Member States in accordance with their respective national constitutional requirements – just like for Treaty amendments.

The current rules on the financing of the Union were set in a package of legal measures adopted after the entry into force of the Lisbon Treaty. Specifically, on the revenue-side, the own resources of the Union are set in a Council decision adopted in May 2014.²⁴ On the expenditure side, instead, rules are condensed in a Council regulation adopted in December 2013, which sets the MFF for 2014-2020.²⁵ Both these legal measures were the result of highly complex political negotiations. A proposal for a new own resources decision was tabled by the Commission in 2011,²⁶ and it took three years to approve it in the Council: in fact, the own resources decision is still subject to parliamentary ratification in several Member States (but will apply retroactively as from 1 January 2014, when national ratification will be completed).²⁷ At the same time, negotiations for the MFF 2014-2020 broke down on several occasions, and the intervention of the European Council (in place of the Council) was necessary in order to find a compromise among the Member States.²⁸

As is well-known, the difficulties in negotiating the own resources decision and the MFF regulation are a result of the way in which the Union is currently funded.²⁹ Since, despite the letter and the spirit of the Treaties, today resources are mostly transferred to the Union from Member States' coffers, Member States consider the contributions they make to the EU budget as their money, and aggressively measure the difference between their contributions to, and their receipts from, the EU budget. As a result of this state of affairs, the decision-making process regarding the EU budget has been captured by endless negotiations among the Member States about the precise costs and benefits that each Member States would incur. Because no Member State is willing to transfer its money to the EU budget for the benefit of other Member States, the discussion about the funding of the Union have become increasingly costly and decreasingly effective – every Member State having a veto power on how much resources the Union should raise and how it should spend.

Given this situation, it is to be expected that after Brexit the negotiations of the new EU financial framework will be highly contentious. Although the United Kingdom enjoys a famous rebate (obtained in 1984, and preserved ever since) which allows it

²⁴ Council Decision of 26 May 2014 on the system of own resources of the European Union, 2014/335/EU, Euratom (OJ L 168/105, 7.6.2014).

²⁵ Council Regulation (EU, Euratom) No 1311/2013 of 2 December 2013 laying down the multiannual financial framework for the years 2014-2020 (OJ L 347/884, 20.12.2013).

²⁶ See European Commission proposal for a Council Decision on the system of own resources of the European Union, 29 June 2011, COM(2011) 510 final.

²⁷ See Article 11 Council Decision 2014/335/EU, Euratom.

²⁸ See European Council meeting, 22-23 November 2012.

²⁹ See Fabbrini (2014), p. 155.

to pay less than it should, it still remains one of the major contributors to the EU budget – the fourth total net payer into the EU coffers (after Germany, France and Italy).³⁰ Hence, when the United Kingdom withdraws from the Union, the question will arise as to how to handle the loss of UK contributions to the EU budget. In principle, the Union could reduce expenditures in proportion to the UK quota – but it seems unlikely that Member States which are net beneficiaries of EU spending would endorse such an outcome. Alternatively, the Member States which are net contributors to the EU budget could increase their contributions to make up the shortfall – but again it seems unlikely that Member States which are already paying more into the EU budget than what they get in return would endorse this option. In this context, therefore, Brexit may create a window of opportunity for a more significant constitutional rethinking of the Union’s system of own resources.

In sum, the need to adopt new legal rules for EU revenues and expenditures for the post-2020 financial framework attains a new meaning as a consequence of the United Kingdom’s departure from the Union. Given the complexities already characterizing the negotiations of the EU financing system, it is to be expected that the withdrawal of one of the (richest) Member States will further heat up the tone of the future negotiations, between Member States, and among Union institutions. Since the adoption of the MFF regulation and, particularly, of the own resources decision, are practically tantamount to a Treaty revision – as reflected in the need of state ratifications according to national constitutional requirements – major challenges are to be expected. Brexit changes the stakes in the negotiations, tipping the balance in favour of some kind of reform. Although until now national governments have been lukewarm regarding initiatives to endow the Union with adequate taxing and spending powers – independent from Member States’ financial transfers – in the aftermath of Brexit these ideas may become more attractive as a way to provide adequate funding to the Union.³¹

5 Reform proposals and the euro crisis

While Brexit requires institutional and substantive adaptations in the EU constitutional architecture, calls to reform the Union and to enhance its effectiveness and legitimacy had been made at the highest institutional level well before Brexit. In the context of EMU, in particular, despite the manifold legal and institutional changes introduced to respond to the crisis, wide-ranging proposals have been advanced since 2010 with the aim to complete EMU.³² Following an explicit mandate of the European Council, the President of the European Council, jointly with the Presidents of the European Commission, the Eurogroup and the ECB, delivered in December 2012 a report “Towards a Genuine EMU,”³³ which outlined a road-map of EMU reforms, including deeper economic, banking and fiscal union coupled with a new

³⁰ See European Commission, “EU Expenditure and Revenue 2014-2020”.

³¹ See Traversa and de la Motte (2015), p. 343.

³² See Fabbrini (2016a).

³³ Four Presidents’ Report (n 6).

framework of democratic legitimacy and accountability. And following the European Parliament elections in May 2014, and the appointment of a new European Commission in October 2014, the Heads of State and Government of the euro area Member States entrusted the President of the European Commission, in close cooperation with the Presidents of the European Council, the Eurogroup, and the ECB, with the task to bring forward the work on the future of EMU³⁴ – an effort which resulted in the publication in June 2015 of a report, signed also by the President of the European Parliament, on “Completing Europe’s EMU.”³⁵

The European Commission, the ECB, and the European Parliament have then also been separately pushing for further changes in the functioning of EMU. In November 2012 the European Commission unveiled a blueprint for a deep and genuine EMU, opening a debate on future reforms,³⁶ and in October 2015 it charted its proposed steps to complete EMU.³⁷ The President of the ECB has on multiple occasions underlined the importance of overcoming the asymmetry of EMU, by complementing monetary policy with a real supranational economic policy.³⁸ And the European Parliament has repeatedly expressed its desire that constitutional changes be brought back on the agenda of the Union institutions, including by reviving the Convention method to re-discuss the architecture of EMU.³⁹ In particular, the European Parliament has made the case in favour of endowing the euro area with a fiscal capacity – that is, a counter-cyclical stabilization mechanism that can be used to ensure the proper functioning of EMU – and has called for greater parliamentary scrutiny in the framework of EU economic governance.⁴⁰ At the same time, the European Parliament has stated that action should be taken to re-incorporate within EU law the EMU-related intergovernmental treaties concluded outside the EU legal order, using that opportunity for a broader overhaul of the EMU constitutional system.⁴¹

Moreover, several national governments have made the case for further legal and institutional reforms in EMU, aimed at enhancing the effectiveness and legitimacy of the euro area. Among others, the former French President brought forward the idea

³⁴ Euro Summit Statement, 24 October 2014, para. 2.

³⁵ Five Presidents’ Report (n 7).

³⁶ European Commission Communication, “A Blueprint for a Deep and Genuine EMU. Launching a European Debate”, 28 November 2012, COM(2012) 777 final.

³⁷ See European Commission Communication, “On Steps Toward Completing Economic and Monetary Union”, 21 October 2015, COM(2015) 600 final.

³⁸ See e.g. ECB President Mario Draghi, Introductory statement in front of the EP, 15 June 2015 (expressing its support for “a quantum leap towards a stronger, more efficient institutional architecture” for EMU).

³⁹ See European Parliament Resolution of 20 November 2012 towards a Genuine EMU, P7_TA(2012)0430 para. 6; and European Parliament Resolution of 12 December 2013 on the constitutional problems of multi-tier governance in the European Union, P7_TA(2013)0598 paras. 67-69.

⁴⁰ See European Parliament Resolution of 23 May 2013 on future legislative proposals for EMU, P7_TA(2013)0222; and European Parliament Resolution of 24 June 2015 on the review of economic governance framework: stock-tacking and challenges, P8_TA(2015)0238.

⁴¹ See European Parliament Resolution of 2 February 2012 on the European Council meeting of 30 January 2012, P7_TA(2012)0023, para. 7.

to create a Eurozone presidency and endorsed the call for an EMU fiscal capacity.⁴² The Italian Minister of Finance proposed the creation of a European unemployment insurance scheme.⁴³ And the then French and German Ministers of the Economy argued that the Union needs institutional changes to handle its democratic and executive deficit.⁴⁴ In fact, although the European Council as a whole has so far shied away from endorsing any major blueprint for constitutional change in the Union, such as the creation of a Eurozone treasury, proposals for legal and institutional reforms have been supported by the national governments of, among others, Spain⁴⁵ and Belgium.⁴⁶ And the German government too has emphasized the need to change the Treaties, to either reform the institutions,⁴⁷ or improve the rules.⁴⁸

6 Reform proposals and the anniversary of the Treaty of Rome

The debate on EU constitutional reform then received a further boost on the occasion of the celebrations of the 60th anniversary of the Treaties of Rome in March 2017. As this historic moment arrived exactly at the time when the United Kingdom triggered Article 50 TEU, the Union institutions and the Member States sought to reflect on how to absorb the loss of the United Kingdom while charting a new way forward. The results of these reflections go beyond the EMU-focused debate that took place during the euro-crisis, but the blueprints produced on the road to Rome reflect varying levels of ambition. In March 2017, the European Commission published a White Paper aimed at opening a debate on the future of the Union at 27 Member States.⁴⁹ The White Paper, which was then complemented in 2017 by several sector-specific contributions,⁵⁰ outlined five alternative scenarios: (i) carrying on; (ii) nothing but the single market; (iii) those who want more do more; (iv) doing

⁴² See French President François Hollande, “Intervention liminaire de lors de la conférence de presse”, Paris, 16 May 2013, 6 (speaking of “un gouvernement économique qui se réunirait, tous les mois, autour d’un véritable Président”).

⁴³ See Italian Minister of Finance Pier Carlo Padoan, “European Unemployment Insurance Scheme”, October 2015.

⁴⁴ See French Minister of the Economy Emmanuel Macron and German Minister of the Economy Sigmar Gabriel, Op-Ed, “Europe Cannot Wait Any Longer”, *The Guardian*, 3 June 2015 (stating that “to make its institutions work [...] Europe will need to address its democratic deficit as well as its executive one.”).

⁴⁵ See Government of Spain, “Better Economic Governance in the Euro area: Spanish Contribution”, May 2015, 7.

⁴⁶ See Government of Belgium, “Report on Preparing for Next Steps in Better Economic Governance in the Euro Area”, 27 April 2015, 3.

⁴⁷ See Berlin Group, Final Report of the Future of Europe Group of the Foreign Ministers of Austria, Belgium, Denmark, France, Italy, Germany, Luxembourg, the Netherlands, Poland, Portugal and Spain, 17 September 2012.

⁴⁸ See German Finance Minister Wolfgang Schäuble, “Strategy for a European Recovery”, Keynote speech at the 5th Bruges European Business Conference, 27 March 2014 (speaking in favor of a “European budget commissioner, who would be able to reject national budgets if they don’t correspond to the rules we have jointly agreed”).

⁴⁹ European Commission White Paper (n 8).

⁵⁰ See e.g. European Commission reflection paper on “The Social Dimension of Europe”, 26 April 2017 and European Commission reflection paper on “The Deepening of Economic and Monetary Union”, 31 May 2017.

less more efficiently; and (v) doing much more together. These scenarios were presented by the European Commission to the Member States for considerations.

While the initiative of the European Commission did not specify a preferred option, the European Parliament has been more consistent in advancing a vision for constitutional reforms in the Union after Brexit. The European Parliament recently approved a set of resolutions which combine calls for a greater exploitation of the legal and institutional mechanisms currently available under the Treaty of Lisbon, while outlining a roadmap for Treaty reforms in the mid-term. On the one hand, the European Parliament has claimed that the action should be taken *à traité constant*, with further integration in the area of economic governance, social policy, and defence.⁵¹ Moreover, the European Parliament has reaffirmed its intention to set up a fiscal capacity for the Union, based on real EU taxes,⁵² as recently indicated also in the final report of the High Level Group on Own Resources chaired by former Italian Prime Minister and European Commissioner Mario Monti.⁵³ On the other hand, however, the European Parliament has also unveiled its plans for constitutional changes beyond the Treaty of Lisbon, aimed at overhauling more fundamentally the EU institutional architecture,⁵⁴ and it has emphasized how Brexit should be used to this end.⁵⁵

Finally, the Heads of State and Government have also debated the future of the Union, first in a declaration signed in Bratislava in September 2016,⁵⁶ and then in a declaration signed in Rome – together with the Presidents of the European Council, European Commission and European Parliament – in March 2017.⁵⁷ While this declaration is mostly focused on celebrating the achievements of 60 years of European unity, it indicates space for future interstate cooperation in the field of internal security, economic growth, social protection as well as foreign policy and defence – an area where rapid changes have occurred since the election of the new US administration.⁵⁸ The declaration avoids any discussion on the legal and institutional mechanisms to achieve these objectives, and contents itself with proclaiming that the Member States and institutions of the Union will “promote a democratic, effective and transparent decision-making process and better delivery.” Nevertheless, the compromise reached in the Rome has not obfuscated the calls –

⁵¹ See European Parliament resolution of 16 February 2017 on improving the functioning of the European Union building on the potential of the Lisbon Treaty, P8_TA(2017)0049.

⁵² See European Parliament resolution of 16 February 2017 on budgetary capacity for the Eurozone, P8_TA(2017)0050.

⁵³ See Mario Monti, High Level Group on Own Resources, final report and recommendations, “Future Financing of the EU”, December 2016.

⁵⁴ See European Parliament resolution of 16 February 2017 on possible evolutions of and adjustments to the current institutional set-up of the European Union, P8_TA(2017)0048.

⁵⁵ See also European Parliament resolution of 28 June 2016 on the decision to leave the EU resulting from the UK referendum, P8_TA(2016)0294.

⁵⁶ See Bratislava Declaration (n 10).

⁵⁷ See Rome Declaration (n 11).

⁵⁸ See High Representative of the EU for Foreign Affairs and Security Policy, A Global Strategy for the EU Foreign and Security Policy, June 2016; European Parliament resolution of 22 November 2016 on the European Defence Union, P8_TA(2016)0435; Foreign Affairs Council Conclusions, 6 March 2017, Annex – Concept Note: Operational Planning and Conduct Capabilities for CSDP Missions and Operations; and European Council Conclusions, 23 June 2017, EUCO8/17.

notably by the Italian President,⁵⁹ and the speakers of parliaments of 14 Member States⁶⁰ – for immediate Treaty changes to establish a federal union endowed with adequate powers and democratic legitimacy.

In fact, a major élan in favour of Treaty reform has followed the French presidential elections in Spring 2017: with the victory of Emmanuel Macron, who had long argued for strengthening EMU with a Eurozone Treasury subject to adequate democratic controls, the topic of constitutional change has squarely returned onto the EU agenda.⁶¹ The new French activism has also prompted the German government to endorse the plan for Treaty reform – as reflected inter alia in the decision of the Franco-German Ministerial Council in July 2017 to prepare a joint document to reform the EMU on the understanding that “l’architecture actuelle de la zone euro présente des défauts persistantes”, which require efforts to reinforce it.⁶² While it remains to be seen whether the recent German parliamentary elections – which have confirmed Chancellor Angela Merkel at the helm of the federal government, but returned a more fragmented Bundestag – will slow this process, ambitious plans on the future of Europe have been unveiled in September by European Commission President Jean-Claude Juncker and by French President Emmanuel Macron, suggesting that there is a momentum for reform.⁶³

7 Grand bargain?

As Sections 2, 3 and 4 have explained, Brexit compels the remaining Member States to engage in important constitutional and quasi-constitutional reforms. While resort to Article 48 TEU will eventually be needed to remove any reference to the United Kingdom from Article 52 TEU (and elsewhere in the Treaties), important changes await in the institutional field of the composition of the European Parliament and in the substantive framework of the finances of the Union. While the European Council decision on the composition of the European Parliament and the Council decision on the own resources of the Union were already scheduled to be renewed before 2019 and 2020 respectively, it seems clear that without a large and rich Member State like the United Kingdom the other Member States and the Union institutions will need to engage in a much more significant grand bargain, both to re-apportion seats and to re-think the revenues and expenditures of the Union for a post-Brexit era. Otherwise,

⁵⁹ See Italian President Sergio Mattarella, “I valori dell’Europa”, intervento in occasione della seduta congiunta delle Camere per il 60° anniversario dei Trattati di Roma, Rome, 22 March 2017 (speaking of the need to relaunch “la riforma dei Trattati”).

⁶⁰ See President of the French Assemblée Nationale Claude Bertolone, President of the Italian Camera dei Deputati Laura Boldrini, President of the German Bundestag Norbert Lammert et al, “Un patto per l’Unione federale”, La Stampa, 26 February 2012.

⁶¹ See French President Emmanuel Macron, Interview, Les Temps, 21 June 2017 (saying that “il faut avoir une intégration plus forte au sein de la zone euro. D’où l’idée, que je défends avec vigueur, d’un budget de la zone euro, doté d’une gouvernance démocratique”) and Interview, Ouest France, 13 July 2017 (saying that “il faudra à un moment des changements de traités, parce que cette Europe est incomplète ; la question n’est pas de savoir si ces changements seront nécessaires, mais quand et comment”).

⁶² See Conseil des Ministres Franco-Allemand, Paris, 13 July 2017.

⁶³ See European Commission President Jean-Claude Juncker, State of the Union Address, Strasbourg, 13 September 2017 and French President Emmanuel Macron, Speech at Université Paris Sorbonne, 26 September 2017.

as Sections 5 and 6 have pointed out, calls to reform the European Union had predated Brexit: in the context of the euro-crisis and during the celebrations of the 60th anniversary of the Rome Treaties many proposals for Union and EMU reform have been advanced at the highest institutional level.

While the nature and the ambition of these reform proposals vary, they identify two main areas for action. First, calls are being recurrently made for changes to the EU institutional architecture – e.g. to enhance the legitimacy of decision-making, or to improve the effectiveness of executive action, possibly through the creation of new institutions. Secondly, reform proposals persistently focus on substantive issues, and notably on the problems of EMU stability, fiscal capacity and EU own resources to finance the growing set of policies that the Union should carry out. Since these are precisely the two areas where the Union institutions and Member States will need to take action following the withdrawal of the United Kingdom, Brexit opens a window of opportunity for implementing a number of constitutional proposals which had been discussed at the highest level for several years – but so far never put into practice. Constitutional change is a serious business and, understandably, Member States and Union institutions engage in it reluctantly. However, since the Treaties and other relevant acts will have to be changed after Brexit anyway, entrepreneurial Union institutions and Member States now have greater margin of manoeuvre to push for further constitutional change. In this context, therefore, the reform proposals debated during the last decade may be taken seriously as part of a grand constitutional bargain between Union institutions and Member States.

As scholars of constitution-making have underlined,⁶⁴ changes to the legal foundations of a political regime hardly ever occur in good times: rather, they tend to occur in moments of crisis, when there is a window of opportunity to exploit. Moreover, constitutions are never ideal documents: rather, they are the result of compromise between competing interests. In order to succeed, processes of constitution-making must ensure that each player around the negotiating table obtains some net gain from the end result. Given the far-reaching adaptations to the EU legal order that the Union institutions and the Member States will need to make because of Brexit, however, the need for a grand bargain significantly increases, and proposals which have been discussed thus far only in the abstract may become real. In fact, more far-reaching institutional and substantive changes to the EU regime could become indispensable for reaching the inter-state and inter-institutional compromises necessary to adapt the Union to the reality of a Union of 27. Therefore, by compelling these reforms, Brexit offers an opportunity which can – and in my view should – be seized to strike a new grand bargain to improve the EU constitutional architecture.

⁶⁴ See Ginsburg et al. (2009), Choudhry and Ginsburg (2016).

8 Conclusion

This chapter has argued that Brexit represents a window of opportunity to reform the constitutional architecture of the Union along the lines identified in many blueprints adopted at the highest institutional level since 2012. In fact, the withdrawal of the United Kingdom from the Union compels the Union institutions and its remaining Member States to engage in important reforms to adapt the EU legal order to the reality of a Union of 27 Member States. Among others, some provisions of the Treaties will need to be amended, and new quasi-constitutional rules on the composition of the European Parliament and the financing of the Union will need to be adopted. Given the nature of these changes, the stakes will be high – and Union institutions and Member States will need to engage in far-reaching bargaining and negotiations. In this context, the constitutional proposals that supranational institutions and national government have brought forward during the euro-crisis and the celebrations for the 60th anniversary of the Rome Treaty acquire a new meaning – and may become part of a grand bargain. Hence Brexit could serve as the catalyst to achieve those constitutional reforms which many have called for to improve the effectiveness and legitimacy of the Union generally, and EMU specifically.

Needless to say, the prospect of a round of constitutional change in the Union should be handled with care. In fact, constitutional reforms in the Union meet several well-known difficulties – which I have discussed elsewhere.⁶⁵ Legal obstacles and political oppositions in a number of Member States could limit the possibility to engage in far-reaching revisions – and path-dependency is a strong feature of the life of all institutions. Yet, leaving aside the fact that during the last 25 years the Treaties have on average been amended every five years,⁶⁶ it seems clear that support for the status quo is diminishing. Moreover, new experiments with constitutional change outside the framework of EU law have recently been undertaken – precisely with the aim to neutralize possible veto points against reform. With the Fiscal Compact⁶⁷ and the European Stability Mechanism⁶⁸ a sub-group of Member States has deepened cooperation in the field of EMU, overcoming the unanimity rule that governs constitutional change in the Union.⁶⁹ If post-Brexit constitutional reform were to prove hopeless in the framework of the Union at 27, therefore, the possibility to resort to differentiated integration along these models may re-emerge as an option to establish a political union, particularly among the 19 euro area Member States.⁷⁰

In the end, therefore, Brexit offers an opportunity to reform the Union which should be seized. While multiple calls have been made during the euro-crisis and the celebrations of the 60th anniversary of the Rome Treaty to improve the EU

⁶⁵ See Fabbrini (2017).

⁶⁶ De Witte (2002).

⁶⁷ See [Treaty on Stability, Coordination and Governance in the Economic and Monetary Union](#), 2 March 2012.

⁶⁸ See [Treaty Establishing the European Stability Mechanism](#), 2 February 2012.

⁶⁹ See Closa (2013).

⁷⁰ See S. Fabbrini (2015).

institutional set-up, and enhance its fiscal capacity – no action has been taken so far. Yet, changing the EU system of government and its financial framework is precisely what the remaining Member States and Union institutions will need to do after the United Kingdom withdraws from the Union. Hence Brexit creates the space for a grand bargain and allows entrepreneurial policy-makers to push through reforms that are indispensable to tackle the Union’s effectiveness and legitimacy deficits. While Europe has somehow weathered the recent crises, the state of the Union is not strong. It is therefore time to complete the European Union. Or, to put it with the words as the President of the ECB, Mario Draghi, it is time to perfect the Union, “following through the consequences of the decision to create a genuine single market supported by a single currency.”⁷¹

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⁷¹ ECB President Mario Draghi, “Europe’s Pursuit of ‘A More Perfect Union’”, Speech at the Harvard Kennedy School of Government, 9 October 2013.

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Panel 4
Brexit – Looking outwards

Panel 4

Luis Romero Requena
European Commission

To what extent can existing treaties and trade agreements serve as role models for future EU-UK bilateral arrangements?

ECB Legal Conference, 4 September 2017



Treaties and trade agreements as role models for the future EU-UK bilateral arrangements

By Luis Romero Requena¹

If and to what extent can existing treaties and trade agreements serve as role models for the future EU-UK bilateral arrangements.

When I started preparing this presentation my reaction to the question was straightforward; I do not know if existing treaties and agreements could serve as role models for the future bilateral agreements. First, because there is not yet a clear indication of what “the framework for its future relationship with the Union” will be – the already famous sentence of Article 50(2) TEU – which the United Kingdom would like to have after its withdrawal. Second, because the main goal of the existing treaties with third countries is precisely a deeper economic integration or, at least, a more open trade, where the result in this case can only be lesser integration.

However, the question also shows that there is a better understanding of the consequences of the 2016 June referendum and of the subsequent notification the United Kingdom government issued on 29 March 2017.

The day before the referendum, I had the opportunity to explain to a group of colleagues the two possible scenarios:

- The simple one: the victory of the “remain”
- The complex one: the victory of the “leave” and its “uncharted waters” aspects.

I suddenly discovered that the expression “the Treaties shall cease to apply...” was not really understood. When I said that the meaning of this expression was that the United Kingdom will become a third country two years after the date of the notification, there was a lot of surprise in some faces.

Therefore, I find the question reassuring. The fact that the United Kingdom will become a third country is finally integrated. The discussions on the future framework have not yet started but the first negotiations on the arrangements for the withdrawal have already taken place.

It is worth noting that the authors of the Treaty considered it would be possible to negotiate the withdrawal agreement in less than two years. The reality though, is a little bit different. Five months after the notification, we have ahead of us only nineteen months for negotiating and deciding on the withdrawal agreement, for drafting and translating the legal text. In the same period of time, the agreement has

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to be approved by a qualified majority in the Council, by the European Parliament and, last but not least, by the United Kingdom.

Before any other consideration on the negotiation and its outcome, one has to bear in mind that nothing in Article 50 TEU could be seen as an obligation for the parties to reach an agreement, neither on the arrangements for the withdrawal, nor for a treaty defining the future relationship. The only real fact is that two years after the notification and unless the European Council by unanimity decides to extend this period, the United Kingdom becomes a third country.

Theoretically, the future agreement has to be the fruit of a double balance. The first one is the normal equilibrium between sovereignty and any international relations. The second one is the institutional balance between the “treaty making powers” and the constitutional constraints. Both are crucial.

In the present case the first one plays a decisive role on the United Kingdom’s side. By issuing the notification, the British government endorsed the result of the non-binding referendum. The key question, without a clear answer at this stage, concerns the link between the result of the referendum and the future EU-UK relationship. What are the red lines that the British authorities have to respect in the negotiation of the future treaty in order to be in line with the result of the referendum? In other words, would the result of the referendum be interpreted as allowing for a “soft Brexit” or would it be necessarily seen as leading to a “hard Brexit”?

It goes without saying, that different interpretations are possible because the referendum only addressed the issue of the withdrawal but not the future relationship. For some in the United Kingdom, the result of the referendum does not prevent a future agreement foreseeing the permanence of the United Kingdom in the internal market and the customs union. Others in the domestic British debate consider that a close link with the internal market will be a betrayal of the referendum result. I have read somewhere the following sentence as a summary of the latter: “The better an economic outcome is, the less it is politically acceptable.”

In any case, it seems clear that a majority of people have accepted that the United Kingdom as a third country can hardly maintain the internal market membership. The balance to be found is between sovereignty and the level of market access and not between sovereignty and internal market membership.

From the EU27 perspective and with the sensible exception of the free movement of persons, I have the impression that the first balance is less important. This is quite normal, since the Union and the 27 Member States were very satisfied with United Kingdom membership of the Union. We have to remember that concessions were made in February 2016 in view of the June referendum. The second balance, the one between “treaty making powers” and constitutional constraints is more important for the Union. The European project is a very complex and sophisticated construction based on principles and governed by law. The future agreement between the United Kingdom and the Union cannot be in breach of the Union rules and I am sure that all the institutions, and particularly the European Court of Justice, will be very vigilant. While an opinion of the European Court of Justice based on

Article 218(11) TFEU, on the compatibility of the withdrawal agreement with the Treaties, may appear less likely, by contrast, it is almost certain that the opinion of the Court will be requested in the case of the agreement on the future relationship.

Before considering the existing models, I would like to make a reference to the nature of the future agreement in terms of competences. The Union is based on the principle of conferral, any competence that has not been conferred on the Union, belongs to its Member States. If the agreement on the future relationship includes Member States' competences, its conclusion and entry into force will be much more difficult. As we have seen in the CETA case, the ratification process could be quite cumbersome.

In very general terms, the economic relations of the Union with third countries could be classified in five categories. However, not all of them have the same level of interest for this presentation.

I will start by excluding the default option, the eventual application of World Trade Organization (WTO) rules and the most favoured nation (MFN) clause. This option has been exhaustively considered in the previous panel. At the same time, I would like to remind you that, the "default option" is the one that will be applicable in case of no deal.

I think we can exclude also, as a model, the existing agreement with Turkey. Taken in isolation, this is quite far from the present analysis but, at the same time, the customs union is an element that could be used in order to reinforce some of the existing models.

The Swiss model has to be excluded because it is not working properly. This is not only my personal opinion. In 2010 the Council described the model of EU-Switzerland relations as: "... complex and unwieldy to manage and (it) has clearly reached its limits". The fact that the Union is negotiating new arrangements with Switzerland, particularly in order to reinforce the governance aspects is a good indication of its weaknesses.

In my opinion there are only two models to be considered: The European Economic Area (EEA) model and the Free Trade Agreement model. From the Union perspective, both models respect the legal / institutional constraints and are therefore compatible with the Treaties.

When analysing the balance between sovereignty and market access, it seems clear that the EEA model offers a deeper economic integration. However, it could be considered by some as incompatible with the results of the referendum. On the contrary, the Free Trade Agreement model, due to the fact that it implies much less integration, cannot be considered in breach of the political mandate deriving from the referendum. In reality the two models are completely different concepts. In principle, the Free Trade Agreement model consists mainly of a reciprocal reduction of tariff and non-tariff barriers to trade and does not imply significant changes in the law making sovereignty of the parties. Even if it is true that Free Trade Agreements are

becoming more and more sophisticated, in reality they can be considered as mere improvements of the default option, the MFN clause.

The EEA is quite a complex legal and institutional construction that grants three members of European Free Trade Association (EFTA) a very wide access to the EU internal market. Its initial design was considered by the European Court of Justice in its Opinion 1/91 as incompatible with the Community law and in conflict with the very foundations of the Community.

The EEA institutional set up is very complex because it is based on a two pillar structure. The institutions of the EU pillar, the European Court of Justice and the European Commission, are mirrored in the EEA pillar by two multilateral institutions, the EFTA Court and the EFTA Surveillance Authority. The system works because EU rules relevant for the EEA are integrated in the legal system of the three non-EU members of the EEA, and the EFTA Court monitors the uniform implementation of them including the case law of the European Court of Justice. The functioning of the EEA agreement is not completely satisfactory and there is an important backlog of EU law which is not yet integrated in the internal legal order of the non-EU EEA members.

Contrary to what has been said, it is not true that the United Kingdom, having left the Union, can remain a member of the EEA. What is legally possible for the United Kingdom, after leaving the Union, is to re-join the EEA as a non-EU member after having been accepted as a new member of the EFTA, following a very complex and risky procedure.

There are some important elements of the EEA model that seem at odds with ideas regularly defended by some in the British domestic debate.

On substance, and we have to bear this in mind, in the EEA model, access to the internal market implies also free movement of persons, as one of the four freedoms that constitute the very foundations of the European Union. Moreover, the non-EU EEA members made important annual contributions to the Union budget, including the "Financial mechanism" foreseen in Protocol 38 of the EEA treaty.

On the functioning of the system, it is worth noting that the non-EU members of the EEA are bound by EU law that has to be integrated in their internal legal order, even if they have no direct influence in the EU law making process. The EEA Treaty only grants them the right to participate in decision shaping, providing inputs at the early stages of the EU law making process. Finally, the uniform implementation of the internal market rules and the EEA Treaty are guaranteed by the EFTA Court following the ECJ case law.

Despite the rather integrated economic model, the EEA does not include a customs union. However, I believe it may be possible to complete an agreement based on the EEA role model with a customs union. However, we cannot forget that it is precisely because there is not a customs union, that the non-EU members of the EEA have their own trade agreements with third countries. Once a customs union is constituted this possibility is in principle no longer available.

Once the United Kingdom leaves the Union, the possibility of a Free Trade Agreement, exists at any moment. It will be less disruptive than the WTO rules and the MFN clause, but even if modelled on the very recent Free Trade Agreements entered into by the Union, it will be very far from the level of economic integration that exist today between the United Kingdom and the EU27 inside the internal market.

Before concluding, I would like to draw attention to the timing issue. I think it is simply not possible to have a Free Trade Agreement and even less possible to have a Treaty based on the EEA role model, in force the day after the withdrawal. This is not only due to the fact that experience shows that these texts are complex and difficult to agree, but also due to the procedures foreseen by EU Treaties having to be respected.

Conclusion

It is too early to know what the future relationship between the United Kingdom and the European Union will be after the withdrawal. Therefore it is not possible at this stage to say if the existing treaties and trade agreements will serve as role models. In any case, these treaties are already the expression of what it is legally possible and have essentially to be the reference for the future relationship.

Recognition of third country equivalence in EU financial law – an obstacle or a way forward for future EU-UK bilateral arrangements?

By Eilís Ferran¹

1 Equivalence or a bespoke solution based on international standards?

The prevailing view in the United Kingdom is that the current third country equivalence regime in European Union financial law will not work as a mechanism that effectively mitigates Brexit risks.² Many studies have identified a variety of shortcomings.³ However, to describe it as an obstacle goes too far. With justification, the European Commission notes that “Internationally, the Union equivalence framework is regarded as one of the most advanced and most used frameworks to defer to the systems and rules of other jurisdictions”.⁴ The current Union equivalence framework is not perfect but it is a tried and tested system and rich experience has been built up around it. Taking an optimistic view that glosses over the limited success of trade agreements in breaking down regulatory barriers (about which I have written elsewhere⁵), we can allow for the possibility of future EU-UK bilateral arrangements including a bespoke mutual recognition regime for financial services but we can also envisage this working alongside the Union third country equivalence framework and not duplicating in areas where the general Union framework makes adequate provision. It is also possible to channel some of the discussion of the shortcomings of the current Union position in the direction of reform of the equivalence framework as part of the “continuous work” that the Commission has acknowledged as being “necessary to enhance the overall framework in the interest of better effectiveness”.⁶ The prospect of Brexit has certainly been a catalyst for bold thinking on how the Union equivalence framework could evolve so as to better serve Union interests.⁷

Under its existing framework the Union will defer to third country financial regulation but only in tightly controlled circumstances based on fairly strict equivalence with

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² Edmonds (2017).

³ e.g., Ferran (2017a).

⁴ European Commission (2017).

⁵ Ferran (2017b).

⁶ European Commission (2017).

⁷ Reynolds (2017).

Union regulatory norms and confidence in the quality of supervision in the third country. The stringency of the review in any particular case is related to the systemic threat posed by the issue and country in question. The Union may impose conditions on deference to ensure that certain Union requirements will continue to apply, although the impact of this may, in turn, be softened by comparable compliance arrangements at the supervisory level. The Union equivalence regime for third countries can operate as a mechanism for the export of Union financial regulation: as the price for access or other concessions, the Union insists on the third country rules being close to its own and will examine the third country requirements closely to check that this is the case. So, in insisting on close equivalence to its norms, the Union sets the bar high and by applying a standard for regulatory parity that is enshrined in Union law and governed by Union processes with clear roles for each of the Union Institutions, it places the matter firmly within the purview of the European Court of Justice (the CJEU), which asserts a judicial monopoly with regard to the interpretation and application of Union law.

As the United Kingdom moves towards Brexit, attention has turned to the possibility of an alternative, potentially bespoke, approach in which the requisite level of regulatory parity could be set by reference to international standards rather than Union norms, the process of checking compatibility could become a less intensive exercise, and dedicated dispute resolution mechanisms rather than either side's domestic courts could provide judicial underpinning to protect legal certainty. A leading proponent of this model describes it as the "high road" that could provide a template for the rest of the world.⁸ Efficiency gains arising from not needing to repeat the peer reviews and other work done by international bodies to check country-by-country implementation of international standards are mentioned amid suggestions that the approach to checking comparability taken by these international bodies is superior to the Union approach because it avoids pedantry and is genuinely focused on outcomes. International standards tend to be less granular than domestic regulation and unlike the maximalist character of much modern Union financial regulation, they do not preclude regulatory gold-plating at the local level. These characteristics are also held out as attractive features that would leave room for dynamic systems to co-evolve in a manner that fits local circumstances yet remain comparable by reference to the chosen benchmark.

Clearly there are political and tactical reasons for the United Kingdom to favour a standard for regime comparison that is not closely tied to Union legal concepts and processes. However, it is not the purpose of this paper to attempt to grapple with the febrile politics of the UK-EU Brexit negotiations. Reflections on the analytical methods that can best support and inform decisions to defer to another financial regulatory regime both predate and go further than Brexit. For instance, in 2013 the International Swaps and Derivatives Association (ISDA) published a paper setting out a conceptual framework and substantive processes for inter-jurisdictional recognition of derivatives regulation through a principles-based substituted compliance methodology; this paper called for the benchmark principles to be

⁸ Carney (2017).

framed at an appropriate level of generality so as not to be tethered to jurisdiction-specific institutional features of legal systems and markets; and it specifically noted that standards of comparability should not be used as a tool to export regulations from one jurisdiction to another.⁹ To give just one other example, in 2015 the International Organization of Securities Commissions (IOSCO) published a major paper on cross-border regulation on that included reference to the scope for international standards to be used as the benchmark for cross-border reviews.¹⁰ Deference is important in the Brexit context but, as these examples show, it is also of much broader significance to the evolution of international financial regulation at a global level.

2 Why deference? And why not?

There are many reasons why one country may choose to defer to another country's system of financial regulation and/or supervision, including to remove barriers and thereby make the domestic market more attractive to foreign firms, to secure reciprocal market access concessions for their own firms, to facilitate diversification by domestic investors, to encourage the flow of capital between markets to spread and dampen risks, to provide incentives for other countries to raise their standards to a higher level, to soften the impact of domestic regulation that has extraterritorial application, to gain influence in international regulatory fora, and to better protect domestic savers, investors and other financial market actors from systemic harm arising from excessive regulatory arbitrage or other socially wasteful behaviour. Deference accords with the principle of international comity whereby national authorities seek to minimise frictions between their domestic interests and their relations with other countries, and considerations such as efficiency, practicality, courtesy and reciprocity confer policy legitimacy.

Deference in order to protect the domestic market from harm is key from a public interest perspective: whilst arrangements that make a country's markets more appealing to foreign firms may lead to economic gains that support the domestic economy, these are second order benefits only that should not be pursued in a way or to an extent that puts public safety at risk. This view is consistent with the rationale for the Union equivalence regime, which is firmly anchored to the objective of delivering a sound and secure prudential environment and not to the goal of liberalising international trade.¹¹ But the imperative to protect the public from harm is also an inhibiting factor on the use of deference since allowing a foreign actor into a market otherwise than on the basis of the full application of host state regulation and supervision could import new threats. The collapses of the Icelandic banks and of the Fortis Group still stand out as examples of the vulnerabilities that host States can face in crisis situations that result in home State national interests eclipsing all other considerations.

⁹ ISDA (2013).

¹⁰ IOSCO (2015).

¹¹ European Commission (2017).

For a host country to allow foreign actors to operate within its jurisdiction on different terms and conditions from those that it imposes on domestic firms or to escape the application of requirements that have extraterritorial application is a non-trivial decision and from a public safety perspective it is reassuring that public officials do not lightly sign off on the quality of a foreign regime, worry about the potential risks to market stability and the competitiveness of its domestic industry where the foreign regime does not contain the same elements as the domestic regime, and are concerned about future-proofing, in particular with regard to the risk of rapid and extensive deregulation within the foreign regime (an issue that has increased in saliency in the era of the Trump US presidency).

However, it is important to stress that deference is a flexible concept and that there are various ways to manage the risks that it presents. In theory a country could host foreign firms entirely on the basis on their home regime but accommodations that waive certain host country requirements or that allow compliance with home country requirements to satisfy applicable host country requirements are more likely. The scope and extent of deference in a particular case will reflect a risk-based analysis of the arguments for and against deference being the appropriate policy response in that context. The host country will likely reserve the right for its authorities to exercise certain supervisory and enforcement powers and allow for the review of the deference arrangements on a fairly regular basis. Memoranda of understanding, colleges of supervisors and resolution colleges, and co-operation agreements are all elements of the support structure that can be put in place to support ongoing supervision and in anticipation of potential failure.

The Commission's recent proposal to apply a sliding scale of Union regulation and supervision to third country central counterparties provides a good illustration of the way in which the flexibility of deference can be used to mould risk-based and proportionate responses across a variety of situations.¹² The proposal envisages three tiers of central counterparties to which different deference arrangements will apply: substantially systemically important third country central counterparties which will be required to establish in the Union (no deference); systemically important third country central counterparties which must (as now) be recognised by the European Securities and Markets Authority (ESMA) on the basis of an equivalence determination by the Commission but which will in future have to comply with certain EU requirements in addition to their home requirements, although in what the Commission dubs "a system of comparable compliance" ESMA may waive the EU requirement where it is satisfied that the corresponding third country rules and supervisory enforcement provide comparable outcomes; and low impact third country central counterparties that, as now, may be recognised by ESMA on the basis of an equivalence determination by the Commission but with certain targeted changes introduced to reinforce ESMA's position in its relationship with third country CCPs and their home supervisors. The tier into which a third country central

¹² Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) and amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third country CCPs COM(2017) 331.

counterparty falls will depend on (i) the nature, size and complexity of its business; (ii) the effect that the failure of, or a disruption to, the third country central counterparty would have on critical markets, financial institutions, or the broader financial system and on the financial stability of the Union; (iii) the third country central counterparty's clearing membership structure, and (iv) the third country's relationship, interdependencies, or other interactions with other financial market infrastructures.

3 The ground conditions for deference – how good does the match between the rules need to be?

Deference depends on consistency between regimes and robust processes for checking that this is the case. The Union is committed to the G20-endorsed approach whereby the capability of the regime in the third country to meet the objectives of the relevant Union regulation is assessed from a holistic perspective that looks at regulation as implemented as well as the position as it appears on paper. However, there is at least the perception that the technical work to inform Union equivalence determinations places (too) much emphasis on whether the third country has legally binding requirements that are complied with and are equivalent to Union requirements, and relies on line-by-line comparisons to identify similarities and differences.¹³ This practice prompts descriptions of the Union approach as being “granular” and “detailed”¹⁴, and these portrayals are not necessarily intended as praise.

There is a broad consensus across the financial regulatory community that what really matters to systemic safety and security is the effectiveness of rules in action. It is recognised that having the best rules in the world on paper counts for nothing if those requirements are not supported by adequate and effective supervision, enforcement and resolution arrangements. Indeed, the need for better ongoing supervision is at the heart of the Union's proposed revamp of the oversight of third country central counterparties. Following this line of reasoning it is possible to question just how much importance should be attached to the match between the rules. Does systemic safety require advanced regulatory convergence so that everyone is playing by broadly the same rules with only minor differences in the details? Is the degree of regulatory convergence even the right question to ask first – perhaps we should instead begin with supervisory convergence and consider the appropriate degree of regulatory convergence through the lens of what is needed to support effective cross-border supervision?

So, whilst the question whether the standard for regulatory parity between the United Kingdom and the Union in post-Brexit financial services should be Union norms or international standards has become highly politicised, we should seek to look beyond the politics. The more fundamental issue relates to the importance of

¹³ Marjosola (2016).

¹⁴ Bailey (2017).

matching rules to the evolution of an ecosystem of financial regulation that is better adapted to a global business sector.

4 Considering international standards as an alternative benchmark for regulatory parity

To consider the adoption of international standards in place of Union norms as the benchmark for regulatory parity would be a pathway either to a more streamlined Union equivalence process or for a bespoke UK-EU mutual recognition arrangement but it would be a radical departure for the Union. International standards feature in the verification processes that the Commission follows in deciding whether to sanction deference to a third country regime but compatibility with international standards is not determinative.¹⁵ Would placing more reliance on international standards be dangerous from a public interest perspective? This depends on whether a very close match between home and host rules is an indispensable requirement for deference to operate safely. Given that deference is a flexible concept and that public interest concerns can be managed in a variety of ways, including by granting partial deference and/or imposing conditions to limit its scope, the a priori need for rigid insistence on rules that match at a very detailed level is not obvious. From a functional perspective it might even be argued that what really matters is supervisory parity: where bilateral supervisory cooperation is particularly close and effective and there are robust arrangements for securing that closeness into the future, whether the fine details of rulebooks match may seem rather less important on the basis that one offsets the other to a certain extent. This echoes the point touched on earlier that perhaps the better question is not whether the rules match in some abstract sense but rather whether the rules match sufficiently to enable the safe sharing of the responsibilities for supervision with respect to the activity in question, taking due account of the broader benefits and threats to society inherent in that activity.

To make the point that there are different ways to discharge the responsibilities associated with protection of the public interest, let me refer here to UK practice with regard to international bank branching. The Prudential Regulation Authority (PRA) of the Bank of England is responsible for the decision whether to allow an international (currently non-EEA) bank to operate as a branch or to require the establishment of a local, UK-incorporated subsidiary. The standard for regulatory parity in this context is international standards and there is reference also to international assessment processes.¹⁶ However, evaluating the broad equivalence of the foreign prudential regulatory and supervisory regime, including arrangements for information sharing and confidentiality, against the benchmark of international standards and with reference to international assessment processes is just one part of the inquiry conducted by the PRA. The PRA will also take account of its own experiences in dealing with the foreign supervisor – that is, the reality of the foreign regime and its

¹⁵ Ferran (2017a).

¹⁶ Prudential Regulation Authority (2014).

effectiveness in practice, as opposed to how it appears on the books. Furthermore, branching into the United Kingdom is only allowed under limited conditions, in particular that new international branches should focus on wholesale banking and do so at a level that is not critical to the UK economy. The possibility of a new international branch undertaking retail banking activities beyond a minimum level is not ruled out entirely, but it is dependent on a very high level of assurance from the home country supervisor regarding resolution. Permission to branch into the United Kingdom does not relieve the third country bank of the requirement to be authorized by the PRA but the PRA will agree a split of prudential supervisory responsibilities with the home supervisor, in effect to share the responsibility for supervision. In addition foreign branches are subject to the conduct of business requirements of the UK Financial Conduct Authority.

To be clear, the point of this example is not to suggest that PRA practice is superior to Union equivalence processes but simply to highlight that there is a spectrum of possible approaches to deference. Using international standards as the benchmark for regulatory parity may look risky in isolation but when viewed as an element as a larger and multifaceted process, it may assume a different and, arguably, much less troubling character. Deference is a flexible instrument and there is always scope for less intense pre-entry checks to be counterbalanced by tight restrictions on entry and by enhanced oversight and intervention powers. One contextual consideration relating to the PRA example that is worth highlighting is that it involves deference at the supervisory level. Supervisory deference has at least the potential to operate in a more agile and adaptable way than full equivalence processes. A reference may be made here to the “comparable compliance” arrangements proposed to be introduced into EU financial regulation for systemically important third country central counterparties; this too will be a form of deference at the supervisory level and it is envisaged that it will be a proportionate system with simple procedures.¹⁷ Although this proposal has been controversial at the political level because of its association with Brexit-related competition to attract business from the City of London into Union financial market locations, from the standpoint of the evolution of a system of effective cross-border financial regulation, dual registration and shared supervision is a promising model in that it leads quite naturally to a focus on the quality of practical, on the ground, implementation and seems less likely to slide into legalistic line-by-line examination of the rules as they appear on paper.

5 Are international standards fit for purpose?

There is one rather significant practical difficulty with using compatibility with international standards as the determining standard for regulatory parity: depending on where you look, you will likely feel more (or less) comfortable with on relying on compatibility with international standards as the more (or less) definitive yardstick of regulatory parity and dispensing with more detailed head-to-head comparative evaluation of the respective domestic regulatory regimes. The complicating factor is

¹⁷ COM(2017) 331.

that international standards are not homogeneous. Some are very detailed and require little or less adaptation to become enforceable legal requirements; they are also demanding in terms of their substantive qualities. International financial reporting standards (IFRS) sit at this end of the spectrum. The Basel capital standards are also towards this end of the spectrum. Towards the other end sit, for example, the IOSCO Objectives and Principles of Securities Regulation, which are not granular in their content and which are deliberately drafted at a broad conceptual level of accommodate wide jurisdictional differences.

IOSCO has acknowledged that non-use of international standards as benchmarks for cross-border reviews may be linked to the fact that they are often insufficiently detailed.¹⁸ IOSCO has also been somewhat dismissive of the possibility of national regulators relying too much on international standardized assessments in their assessment of a foreign regime because “that would involve a regulator relying on an assessment whose quality it cannot verify”.¹⁹ Trusting an assessment conducted by a third party conducted by reference to standards that are (often) less granular than domestic requirements requires several leaps of faith. IOSCO has included developing the granularity or detail of IOSCO principles and standards to facilitate reliance on foreign regulatory regimes which are aligned with those principles and standards in a list of suggestions about how it potentially enhance engagement with member regulators and has identified this as being part of “the general direction of travel”; but references elsewhere to “the existing global regulatory architecture [being ...] not yet conducive, in many cases, to the more centralized and multilateral approach for regulating cross-border financial activity that is favored by many consultation respondents”, “the apparent disparity between the aspiration of many consultation respondents for a multilateral process centered on IOSCO, and ... the current reality of cross-border engagement” and “an international regulatory architecture which is not at present anchored in international public law” make it clear that it would be unwise to expect quick progress.²⁰

A further adverse consideration is that the Trump Presidency has raised questions about the future effectiveness of multilateral fora. Clearly there is a risk that if the United States were to disengage from international standard-setting processes, these fora could become little more than talking shops.

So, in a sense this paper has taken quite a long route to reach a rather modest conclusion: that in principle the case can be made for the use of international standards as the benchmark for regulatory parity but there is major impediment because of the limited supply of suitable standards. Even if the Union were to consider a possible relaxation of its insistence on close equivalence to Union norms as part of its review of its equivalence regime or in the context of some bespoke arrangement with the United Kingdom, the practical impact of doing so would likely be quite limited. Nevertheless targeted application of international standards and associated implementation methodologies in certain specific circumstances could

¹⁸ International Organization of Securities Commissions (2015).

¹⁹ *ibid.*

²⁰ *ibid.*

have a powerful impact. Take resolution arrangements, which are the most critical and potentially most vulnerable part of cross-border deference because in a crisis it is essential to know, and to have legal certainty around who is responsible and who pays. A suite of measures relating to resolution has been developed at the international level by the Financial Stability Board (FSB): the *Key Attributes of Effective Resolution Regimes for Financial Institutions* to set out the core elements that the FSB considers to be necessary for an effective resolution regime, and detailed guidance and a concrete methodology specifying the essential criteria to guide the assessment of the compliance of a jurisdiction's bank resolution frameworks with the standard. It is possible to envisage the *Key Attributes* package potentially assuming a key role in the conclusion of the bespoke international agreements with third countries regarding the means of cooperation between Union resolution authorities and the relevant third country authorities that are envisaged by Union law.²¹

6 The ground conditions for deference – maintaining effective supervisory cooperation between the United Kingdom and the Union

Union equivalence processes do, of course, already pay attention to the quality of implementation in the third country and do involve consideration of track records in supervision and enforcement. In addition, the conclusion of memoranda of understanding and other mechanisms to support ongoing supervisory cooperation are standard pre-conditions to the granting of equivalence determinations. In advocating an even stronger focus on supervision and less attention on the match between the rules, this paper is thus making the case for a shift of emphasis rather than radical change. Reliance on certain international standards as the benchmark for regulatory parity could help to facilitate that change of emphasis.

The United Kingdom has the advantage over other third countries of having been a full member of the Union's financial supervisory ecosystem. Following the logic of treating the effectiveness of practical implementation as the fulcrum, keeping the British supervisory (and resolution) authorities as close as possible to the Union ecosystem would be key to achieving a high level of deference between the United Kingdom and the Union. Options for achieving this include third country participation in the work of the European Supervisory Authorities, as permitted by their founding instruments, or bespoke arrangements that include binding dispute mechanisms and provide for legal certainty around recognition and enforcement of resolution procedures. There is too much uncertainty about the British negotiating position (for

²¹ 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, p. 190), Article 93; Proposal for a Regulation of the European Parliament and of the Council on a framework for the recovery and resolution of central counterparties and amending Regulations (EU) No 1095/2010, (EU) No 648/2012, and (EU) 2015/2365 (COM/2016/0856), Article 74.

example, we have already seen some watering down of the so-called red line around the role of the CJEU) to give a credible prediction about the chances of any such option proving to be politically acceptable.

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The implications of international trade law for the financial sector under future trade agreements between the Union and the United Kingdom

By Maria Chiara Malaguti¹

1 Introduction

Although the focus of legal scholars on Brexit seems to be, for the time being, mainly on the interpretation of European Union Treaties, and in particular Article 50 of the Treaty of the European Union (TEU), a number of scholarly studies do focus on consequences of the United Kingdom's withdrawal from the Union under international law. These concern, in particular, the effects of such withdrawal on existing treaties. Although such studies are still few, some consideration has already been given to the topic. What is still missing, to some extent, is consideration of the consequences arising from the application of international trade law to the expected future trade agreement(s) between the two future partners. A factual analysis is frequently made of existing models and their adequacy to address the present situation and the desires of the two parties – although this is, to a large extent, still unclear. However, very little consideration, if any, has been given to the constraints that conceptualization and existing general principles of international trade law impose on such agreement(s).

On the one hand, the United Kingdom seems to count on the specificity of the current situation – which certainly has no historical precedent – to partially depart from the application of trade law, and rather rely on the application of general principles of international law. Indeed, it tends to deal with its withdrawal from the Union and the future framework for its relationship with the Union as one single process. However, the Union has been extremely clear in affirming the autonomy of the two phases. First, the United Kingdom withdraws from the Union, and the Treaties cease to apply to it. Then, it becomes a trading partner of the Union. Even if these two phases might be negotiated jointly, from a legal standpoint they must be treated separately. Under this reconstruction, whatever trade agreement will be negotiated, this will have to be considered within the existing set of principles regulating international trade.

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2 In need of some clarification: “market access”, “passporting” and “equivalence”

Against this background, two general considerations should be first addressed before any debate on the future relationship between the Union and the United Kingdom can be considered in respect of the financial sector. In the financial sector international trade law, on the one hand, and prudential as well as financial stability regulation, on the other, coexist and partially overlap. Consequently, this generates some ambiguities, at least in terms of the reconstruction of the applicable legal categories:

- General standards for market access under international trade law do not exactly coincide with standards for access to the market under prudential/financial stability regulation. Broadly speaking, in the first case the reason for the standard is the avoidance of discrimination and the guarantee of a level playing field, whereas in the second case, any access standard is tailored to risk and finalised to ensure stability. This latter case is not directly focused on foreign entities (and their right not to be discriminated against, in favour of domestic entities), but on the services to be provided by any authorised entity, irrespective of its institutional nature or nationality. Consequently, the two sets of standards do not necessarily translate into the same rules, or produce the same consequences on the shape of the market. This has the consequence that, when focusing on regulated markets, as is the case for the financial sector, rules that currently apply in the Single Market to guarantee soundness and stability cannot be automatically duplicated in an international treaty following the logic of international trade law.
- In the same vein, “passporting” under Union law and the standard of “equivalence” used in Union legislation to permit the provision of services by a third country entity within the Union, do not represent a continuum: equivalence is not a quasi-passport. The Union passport can only be enjoyed within the context of the Union Single Market² and is not based exclusively on the existence of similar rules in the home and the host State. It is rather based on the fact that Member States share a complex set of common rules and institutions, which make legal orders comparable as a whole, and consequently integrated. Of utmost relevance, Member States can rely on a judicial system, with the European Court of Justice (ECJ) at its top, ensuring the uniform application of European law. Passporting can consequently not be simply exported outside the Union. Any *prima facie* similar concept, as that of “equivalence”, is based on different assumptions.³

Against such premise, which distinguishes between concepts that often overlap in the legal discourse, it is thus necessary to consider what kind of constraints

² As well as the EEA Agreement.

³ Commission Staff Working Document, EU equivalence decisions in financial services policy: an assessment (SWD), 27 February 2017. European Parliament, IPOL – EGOV Briefing, Third-country equivalence in EU banking legislation, PE587.369, 12 July 2017.

international trade law imposes on any future trade agreement between the Union and the United Kingdom. Following the current debate, although a common understanding is in fact far from being reached, the legal form that such agreement may most probably take is that of a Free Trade Agreement (FTA).⁴

3 Interaction of trade law, regulation and the integrity of the Single Market

Within this context, three sets of considerations need to be addressed: (i) the consequences of the general constraints coming from the current practice under international trade law applicable to the Union; (ii) the role of international regulatory standards in the financial sector within the dynamics of trade; and, (iii) the limits to any agreement, which are imposed by the need to preserve the integrity of the Single Market.

3.1 General constraints arising from the current practice under international trade law applicable to the Union

The General Agreement on Trade in Services (GATS) contains obligations applicable to services in general, whereas World Trade Organization (WTO) members' Schedules of Commitments include their specific market access and national treatment commitments in the financial sector.⁵ The schedules are integral parts of the Agreement. It is thus only by reference to a country's schedule that it can be seen to which service sectors and under what conditions the basic principles of the GATS apply within that country's jurisdiction.⁶ Moreover, an Annex to the GATS contains specific provisions applicable to trade in financial services. This includes prudential measures. In particular, as for regulation, the Annex permits a State to limit market access for prudential/stability reasons.⁷ Finally, according to the same Annex a member may recognise prudential measures of any other country in determining how to apply its access requirements.⁸ Briefly, GATS rules on financial services do distinguish between market access principles and regulatory measures for prudential supervision and financial stability. Although domestic regulatory systems can be reciprocally recognised by way of a treaty or unilaterally, as far as

⁴ See the contribution of Luis Romero Requena, entitled "Treaties and trade agreements as role models for the future EU-UK bilateral arrangements", in this book.

⁵ For the Union, GATS/SC/31 and further Supplements.

⁶ See also the Understanding on commitments in financial services.

⁷ "2(a) Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. (...)" Annex on Financial Services.

⁸ *ibid.*, "3(a) A Member may recognize prudential measures of any other country in determining how the Member's measures relating to financial services shall be applied. Such recognition, which may be achieved through harmonization or otherwise, may be based upon an agreement or arrangement with the country concerned or may be accorded autonomously."

the principle of discrimination is preserved in its essence, a State is free to determine how to articulate and implement such recognition.

Within that general context, in the last decade the Union has negotiated a substantial number of trade agreements, which go beyond GATS commitments and contain some interesting elements. In particular, features of recently signed FTAs, or FTAs whose negotiation are at a very advanced stage, can serve as benchmark to see how a possible new FTA could be shaped.⁹

According to a study of the European Parliament¹⁰, most recent FTAs signed by the Union present the following patterns:

1. a chapter (or a section thereof) on financial services is inserted with a carve out for prudential regulation;
2. a necessity test is established in order to apply such a carve out clause;
3. in the case of the Comprehensive Economic and Trade Agreement (CETA), guidance on how to implement such necessity test is agreed upon;
4. a chapter on investment is also included, covering also financial services, possibly with some specificities.¹¹

The study acknowledges that, with the exception of CETA (closer to the model of the North American Free Trade Agreement), the Union has taken the GATS, the Annex and the Understanding as a starting point for negotiations, and sought to develop new rules and commitments on that basis. However, in their structure and architecture, most agreements depart from the GATS in a number of ways. Rules on trade in financial services are primarily contained in a general chapter, which is then divided into separate sections for rules relating, among others, to (i) cross-border supply of services; (ii) establishment, commercial presence and rules on investment; (iii) temporary presence of natural persons for business; and (iv) regulatory frameworks. This contains in turn a specific sub-section on regulation in the financial services sector. Most relevant for our purposes, different rules apply to these different modes of supply, rather than having general obligations which apply to all modes of supply. By contrast, CETA contains a dedicated financial services chapter, with virtually all the rules relevant to trade and investment.¹²

⁹ The most recently signed FTA are: EU-Republic of Korea; EU-Central America; EU-Colombia/Peru; EU-South Africa; EU-Canada (Comprehensive Economic and Trade Agreement: CETA). FTA under negotiation are in particular: EU-Singapore; EU-Vietnam; EU-Japan; EU-Indonesia, EU-Mexico. See Commission, Overview of FTA and other Trade Negotiations – Updated September 2017.

¹⁰ Financial Services in EU Trade Agreements, IP/A/ECON/2014-08, November 2014.

¹¹ A number of rights are protected by investment law rules. These usually include also international systems for settlement of disputes (ISDS), as illustrated by Paul Nihoul in his contribution. If such a mechanism is reproduced also in a Union-UK FTA, at least three issues arise: in the first place, in the light of ECJ Opinion 2/15, the possible FTA would be a mixed agreement. This would mean that the treaty is potentially subject to ratification by Member States, as it was the case for CETA. In the second place, arbitration-like mechanisms might be refused by some Member States, allegedly preferring to recognise competence for these matters to national courts. Finally, the Commission is supporting the establishment of a multilateral international court (MIC) for international investment law. Should that approach pass, the issue would raise of competence by different *fora* on different parts of the FTA.

¹² Financial Services in EU Trade Agreements, above, para 2.2.2.

Moreover, all agreements provide a carve-out for prudential measures. While there is still a considerable margin of appreciation in the interpretation of this carve-out, the new generation FTAs specify that these include measures to maintain safety, soundness, integrity or financial responsibility, and include prohibitions of particular financial services or activities for prudential reasons, provided such prohibitions are applied on a non-discriminatory basis. CETA is even more innovative since, as stated, it provides guidance on the application of the prudential carve-out, as well as a “filter mechanism” which applies wherever investor-State proceedings are initiated in respect of prudential regulations.¹³

Under the described approach, the new generation FTAs (whatever specific model they follow), do facilitate the openness of markets by establishing recognition of prudential measures. However, this is not conceived as a specific market access tool. This is confirmed, among others, by the very fact that in the CETA, recognition of prudential measures is established by a separate provision (Article 13.5) from that on market access (Article 13.6). On the other hand, the language of Article 13.5, paragraph 2 of CETA proves the lack of any general application of the mechanism. It states: “*a Party according recognition of a prudential measure shall provide adequate opportunity to the other party to demonstrate that circumstances exist in which there are or will be equivalent regulation, oversight, implementation of regulation and, if appropriate, procedures concerning the sharing of information between the Parties*”. This provision clearly recognises that the method implies an individual evaluation of specific circumstances according to the regulations in place in a country, and of its qualitative equivalence to domestic regulation for prevention of risks.

On the other hand, it is undisputed that Union law applies the standard of equivalence differently, according to type of financial services, and does not even allow its application in certain cases. Moreover, the Commission has the power to refuse recognition of equivalence, as well as to withdraw it depending on the circumstances.

In this context, and following this logic, the Commission Guidelines of 27 February 2017¹⁴ assert that the right of States to apply the principle of equivalence is meant to work to the benefit of their own territories/markets. Equivalence is a tool pertaining to regulation established to protect the national market from systemic risk, not to facilitate market access.¹⁵ Equivalence is indeed not a quasi-passport, but a tool that finds its *raison d'être* in a different context, linked to the guarantee of stability, not of freedom of trade, although it can lead to such result and share the general objective to foster a level playing field and consequently facilitate movement of financial services across countries.

¹³ *ibid.*, para 2.4.3. See also Financial Services liberalization and TISA: implications for EU Free Trade Agreements, EP/EXPO/B/INTA/2016/09.

¹⁴ See Commission Staff Working Document, EU equivalence decisions in financial services policy: an assessment, 27 February 2017, SWG 2017, Fin. 102.

¹⁵ *ibid.* “*Equivalence is not a vehicle for liberalising international trade in financial services, but a key instrument to effectively manage cross-border activity of market players in a sound and secure prudential environment with third-country jurisdictions that adhere to, implement and enforce rigorously the same high standards of prudential rules as the EU*” (p. 5).

3.2 The role of international regulatory standards for financial services within the dynamics of trade

An articulated body of international regulatory standards exist as the result of international cooperation among various actors and under the aegis of the Financial Stability Board (FSB). One idea that is being developed would be to base the principle of equivalence to regulate access of financial entities between the Union and the United Kingdom, on such international standards.¹⁶ This would reduce deference to domestic regulatory systems and the discretion of authorities in granting or withdrawing recognition of equivalence. Leaving aside the above considerations on the inaccuracy of interpreting equivalence as a purely market access tool, it is undeniable that such an idea is extremely suggestive and in line with the very intent of international standards for prudential supervision and financial stability: to foster a level playing field at global level by encouraging coherent implementation of policies across sectors and jurisdictions.

However, there are open issues that would make this approach difficult in the current context. In the first place, international standards vary considerably, from very flexible to very stringent, from high-level to clearly articulated standards. Moreover, a distinction would need to be drawn according to segments of the market, for example between financial infrastructures, wholesale services and retail products, in light of the fact that risk varies according to the relevant activities. Finally, some standards are purposely of a high-level character, to leave States free to adjust them to their specific features. In particular, the new generation of regulatory standards in financial markets also include principles on financial inclusion, which have to be combined and balanced with those on financial stability. The balance of such principles varies according to the context of the relevant country. For this reason, international standards need to be high-level and flexible. Aside from any other considerations on the concrete reference to standards in the presence of such a variability and difference in approach, reducing the margins of autonomy of authorities might be inappropriate when a concrete evaluation of the interests at stake needs to be made according to circumstances. Flexibility is a fundamental component of oversight to mitigate risk; reducing this to refer directly to international standards as the primary source of right might somehow disrupt the system.

It is even more relevant to note that this would justify a change in approach, not just for UK entities willing to provide services in the Union and vice versa, but rather in the global governance of financial markets. To keep consistent with the rationale of international standards, such change in perspective would inherently require the elaboration of criteria for interpretation and measurement of equivalence shared at international level, not just agreed upon based on reciprocity, in an individual agreement. Moreover, in the light of the role of equivalence within the logic of international trade principles, it should not be the specificity of relationships between two partners, such as the Union and the United Kingdom, that justifies such an

¹⁶ See contribution of Eilís Ferran.

approach¹⁷, but rather readiness of the international community to take such a step. Assuming that the time is ripe for such a significant change, this could imply a complete reshuffling of principles on access to financial markets under trade law, leaving it to regulators and regulatory instruments to address the issue of market access. This is extremely interesting as a suggestion, but not to be addressed in the limited context of Brexit.

3.3 Limits to any agreement which are imposed by the need to preserve the integrity of the Single Market

Finally, the above considerations on equivalence relate to the issue of the integrity of the Single Market, which requires that a consistent and compact legal and institutional order are ensured, and requires that the principles laid down in the Treaty are not weakened. In particular, the banking union and the capital markets union require a high level of cooperation among (European and domestic) institutions and the overall consistency of legal orders.

Enhanced convergence of regulatory and supervisory practices, as well as articulated mechanisms such as the Single Supervisory Mechanism (SSM) and the consistent implementation of the single rulebook for financial services provide additional tools to ensure integrity. The Single Market requires institutional coordination in a manner that results in the issues of integration and integrity becoming connected to and of extreme relevance to trade agreements with whatever trade partner.

The withdrawal of the United Kingdom, as well as any subsequent agreement between the two parties, should not affect such integration and integrity, nor produce any fracture within the implementation of the four freedoms giving shape to the Single Market. While general standards of access under trade law must be provided for, the granting of access to entities from third countries cannot go beyond such general standards and negatively affect such integrity. Equivalence to guarantee the reduction of systemic risk for cross-border activities and international financial markets (exceeding the Union's jurisdiction) must go hand in hand with internal integrity.

4 Some brief conclusions

The above considerations should help to put any further discussion on the kind of trade agreement that might be undertaken between the Union and the United Kingdom (once the latter withdraws from the Union) into the more articulated context of international trade law. The trade agreement cannot escape the principles of international trade law. They serve the purpose of clarifying how complex the reality of the situation is and how any political statement on the matter cannot ignore the

¹⁷ However, it may be possible to duplicate this by way of agreement, because of existing clauses to that end in other treaties, such as CETA, which are in line with the Most Favoured Nation principle.

constraints that international trade law poses to the shape that a trade agreement between the two future partners will take.

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Quos deus vult perdere, prius dementat – Brexit and its aftermath

Keynote speech

By J.H.H. Weiler¹

1 Introduction

The original of the refrain in the title, in Sophocles' *Antigone* – τὸ κακὸν δοκεῖν ποτ' ἐσθλὸν τῷδ' ἔμμεν' ὅτι φρένας θεὸς ἄγει πρὸς ἅταν (evil appears as good in the minds of those who gods lead to destruction) – is actually more subtle for it places at least some of the responsibility for our self-destructive behaviour in the hands of us, mortal humans. And what is madness in the affairs of State? Here I will borrow from Carlo Cipolla's classic *Basic Rules of Human Stupidity*: A course of action is wise when it brings benefits to you as well as to others. It is malevolent but not irrational if it brings benefit to you and harm to others. It is plain and simply stupid when it causes harm to others as well as to yourself.

Pick any of the three versions above and, I would submit, it applies to Brexit and its aftermath.

2 The referendum

It is easiest to begin with the United Kingdom itself and not least to the person on whose shoulders fall most of the responsibility for the present tragicomedy – David Cameron.

It is hard to translate the Yiddish word Chutzpah. 'Cheek' doesn't quite capture it. 'What a cheek' is not the same as 'What Chutzpah'. Chutzpah involves a certain brazenness. 'What Chutzpah' is usually associated with a rubbing of the eyes or a shake of the head in disbelief or even a kind of perverse admiration. The classical example of Chutzpah is the son who kills his mother and father and then turns to the judge and pleads: Mercy, I'm an orphan!

Cameron has taken Chutzpah to new heights.

A good place to start would be in the final weeks of the campaign when Cameron's refrain was 'Brits don't quit!' Rub your eyes – this from the Brit who just months earlier had presented his 'either we get this and this and that or, well yes, we quit'. Takes some nerve, does it not? Of course to have any credibility in his pre-

¹ Dinner Speech on the occasion of the 2017 ECB Legal Conference on 4 September 2017.

referendum Brussels negotiations he would have to sell himself and his country as ready to quit.

You would think that in playing against the grain of 'Brits don't quit' there would have to be something huge at stake. You may just remember the weeks that became months when having announced the referendum and insisting that there would have to be some radical changes if the United Kingdom were to remain, the world and its sister were waiting for him to present his list of demands. You will certainly not have forgotten the disdainful disbelief from all and sundry when he finally presented his Potage of Lentils – that thin gruel of demands for which he was willing to gamble the future of the UK membership of the European Union and much more.

It was also an insult to one's political intelligence. As a ploy to address internal party politics – the real reason behind the whole unfortunate manoeuvre – did he really believe that even if his demands were met in full (and they mostly were) this would keep the wolves at bay? Even more damning in my view, it was clear that Cameron never grasped the truly serious problems of the European construct which, if one were to use (*quod non*) the 'nuclear option' of threatening to quit, could and perhaps should have been raised.

One issue in his list of demands did not appear trivial. So a word about the immigration item – no small measure of Chutzpah here too. Of course the Union had nothing whatsoever to do with the long-term rise in migrant numbers from non-EU countries. And not being part of Schengen, the United Kingdom did not have to face one of the trickiest aspects of the intra-Schengen dilemma. (Merkel, in a conversation with Renzi, is reputed to have praised the efficiency of the Italian railway system ...). But as one surely recalls, it was the decision of the United Kingdom, an excellent decision on many fronts, not to avail itself of a transitional period in accepting migrants from the 'new' member states. You open your gates, the (wonderful) Poles arrive, and *then* you squeal – "The Barbarians are here!? Mercy, I'm an orphan ..."

It does not end here. Having presented his thin gruel, it was not surprising that he essentially obtained that which he requested, since to their credit Juncker and the Union bent over backwards to accommodate his every wish, though how he was to sell this to the general electorate was anyone's guess. At this point, having earlier argued that if the United Kingdom did not receive its request it would quit, he now had to change his tune and predict brimstone and fire, ashes and embers were it actually to quit. But if this were the fate awaiting Brexit, how to explain his earlier negotiating stance in Brussels?

But there was more to come. Having lost the campaign, it became in short order clear not only that there was no well thought out road map for Brexit but that in fact there had been no cost-benefit analysis or serious risk assessment – not least the threat to the integrity of the United Kingdom itself – prior to engaging in the referendum folly.

To cap it all was his 'principled' resignation, leaving others to deal with the mess he created. In this last respect he of course is not alone in that shameful corner. And

what came later was just path dependent – a flailing United Kingdom (or should one say Little England?) still without a plan, a veritable strategy moving brazenly from the arrogant to the pathetic. In Italian one would say: Fa Tenerezza ...

Never in the annals of modern British politics have so many, suffered so much harm at the hands of so few.

3 Article 50

The draftsmen and women of Article 50 also merit the accolade of ‘mad’ or ‘stupid’ – take your pick.

Contrary to some common misconception, it is not the ‘right’ to secession that Article 50 granted: That would exist with or without Article 50 under general public international law. But with no rules and procedures it would undoubtedly be messy. Article 50 set a procedure which was designed to regulate the process. Yes, one knows that it was always considered a ‘nuclear option’ – a provision never intended to be used which thus explains some measure of vagueness or imprecision. But only some.

I accept the utility in negotiations of setting a timetable, even a timetable of which failure to respect would lead to catastrophic results – as an incentive to serious negotiations and prevention of interminable uncertainty.

But could anyone, even in the heydays of drafting the “Constitution” and then its reincarnation as the Treaty of Lisbon, imagine that two years (two years!) was a reasonable time to negotiate – even the principles alone – of the disentanglement of the United Kingdom (not Greenland, mind you) from the European Union, without causing serious mischief? What was in *their* minds? Quos deus vult perdere ...

Or, to give but one of many more possible examples, can anyone explain the logic behind the provisions which sensibly provide for approval of a final accord by majority but anything but sensibly insist on unanimity for a decision to extend the negotiations? As I just mentioned, I could regale you with plenty of examples from that masterpiece called Article 50. I am no longer sure whether the messiness of secession negotiations under the unregulated process of general public international law would not have been less harmful.

So why Article 50 at all if so carelessly drafted? The written record is murky and we have to resort to memoirs, and memories of the various protagonists of the Convention. Some argue that it was a compensatory device for the introduction of the so called *Passerelle* the “Constitution” and then Lisbon introduced. Seems like cracking a nut with a sledgehammer.

Others claim that since one was drafting a Constitution, it required such a provision which, after all did not exist in the preceding Treaties. The truth, I believe, is exactly the opposite. I know of no constitution which provides for a dismemberment of the State, just think Catalonia (and then cry – another instance of Quos deus vult

perdere ...?). Article 50 was inserted in order to remind all and sundry that in fact this was *not* a real Constitution that was being drafted, that in fact it was still a legal order rooted in its Schmittian moments in public international law.

4 The way forward

So finally, us, the European Union and our Member State governments. Of course, we know better than to be shooting at each other; but the post-23 June relationship between the United Kingdom and the European Union is woefully bellicose, and increasingly so. In tone and mood, diplomatic niceties are barely maintained and in content positions seem to be hardening. I am mostly concerned with attitudes and positions of and within the Union and its 27 remaining Member States. Handling Brexit cannot be dissociated from the handling of the broader challenges facing the Union. I will readily accept, as mentioned above, that the UK leadership bears considerable responsibility for the bellicosity and the escalating lawfare. Mad and stupid. But the inequality of arms so strikingly favours the Union that its attitude and policies can afford a certain magnanimous disregard of ongoing British provocations.

It is easy to understand European Union frustration with the United Kingdom. I want to list three – the first being an understandable human reaction. I recall Jean-Claude Juncker's *State of the Union of 2015* in which going the extra mile in preventing a Brexit was one of his top priorities. Any fair-minded observer would agree that the Union delivered on this commitment. Some of us even thought that the eventual compromise on free movement went beyond the boundaries of extant EU law.

The actual Brexit vote was thus greeted with understandable disappointment, to which a measure of bitterness and even anger were easy to detect in the myriad statements that followed. And this only exacerbated as it also became abundantly clear, breathtakingly clear, that the United Kingdom went into the referendum without any strategic – political and legal – plan in the event of, well, Brexit. One did not know what the Brits wanted ahead of the referendum and one still is not clear what they want in its wake. It has been ongoing and at times incoherent improvisation – adding further to the already existing frustration. We tend to reify governments and administrations just as we reify courts. But when all is said and done, there are always humans with emotions and ambitions and desires and the usual frailties of the human condition.

Still, setting aside this kind of emotional state as the basis for, or even influencing, a Brexit strategy, it is well overdue. If the interest of the kids is really in one's mind, it behooves any divorcing couple to get as quickly as possible beyond the anger stage. In approaching Brexit, the single consideration should be the overall interest of the Union and the underlying values of the European construct.

I take it as axiomatic that it is in the interest of the Union – economic, strategic (not least security) and even social – to have as amicable, open and cooperative a relationship with a post-Brexit United Kingdom. One cannot very justly express alarm and disapproval at the protectionist winds blowing from the White House and then

not accept that, even if outside the Union, it is in our interest to keep as open a marketplace with such an important contiguous economy as the United Kingdom. Nor can one fail to realize that with the end of the *Pax Americana*, how damaging it would be for Europe, when finally beginning to take its security responsibilities seriously, not to be able to count on a robust participation of the United Kingdom. And beyond the money/power matrices, the United Kingdom has to remain a firm ally in the defence of liberal democracy under attack. Not to mince words, a hostile Union will only further push the United Kingdom into an uneasy embrace with Trumpism.

What, then, from the Union's side – at the policy rather than the emotional level – seems to explain the bellicosity? There are two interconnected arguments which are repeated again and again in explaining and justifying the rhetoric of a 'hard' Brexit or 'Divorce before any negotiations' et cetera et cetera *ad nauseam* and *ad tedium*.

The first is that one cannot compromise the conceptual and practical coherence of the Single Market, of which free movement of workers is an indispensable and non-negotiable principle. (I consider as sad collateral damage the fact that the Brexit debate has returned the principle of free movement to its economic foundation – workers, factors of production in a common market – and away from its new citizenship grounding). And since the United Kingdom insists that it can no longer accept free movement, it cannot both have its cake and eat it. You cannot be in the Single Market without accepting its cardinal principles. (There is an important additional nuance to this argument, namely that by taking a tough line with the United Kingdom one is squelching any heretics who would like to see the dilution of free movement within the Union.)

The second – interconnected – reason for the tough rhetoric and the endless promises of a 'hard' Brexit is the 'discourage the others' argument. If the United Kingdom gets too cushy a deal – i.e. is not made to pay and to be seen to be paying a heavy price for Brexit – it might tempt other Member States to seek the same, thereby bringing about a weakening or even disintegration of the Union. The notion of some form of Associate Membership for the United Kingdom is thus rejected categorically.

I think the first argument is based on a misunderstanding and the second argument raises a profound issue that goes well beyond any Brexit strategy. It touches on what is sometimes thought of as the 'soul of the Union' – its very ontology – a clarification of which should at least provoke second thoughts as to the wisdom of the extant approach to Brexit.

It is clear that if the United Kingdom leaves the Union and rejects free movement it cannot be a full participant in the Single Market. And that, indeed, there can be no compromise on the fundamental freedoms of which movement is one. But, it is worth making, again and again, the obvious distinction between *being part of* the Single Market and *having access* to the Single Market.

For decades, even before it was called the Single Market, it has been European policy that granting access to the Single Market to partners all over the world was an important objective, beneficial both to the Union and to such trading partners. The

recent conclusion of CETA is just the last, if very visible, manifestation of such a policy. The Union has countless agreements of this nature – the common denominator of which is the granting of access to the Single Market not only without requiring free movement of workers, but specifically excluding such! In the case of developing countries the access has been at times on a non-reciprocal preferential basis, though with many partners (again using CETA as an example) it is on a fully reciprocal basis. It is true that for the most part the agreements relate to goods rather than services but the access is extensive nonetheless.

Why should the Union not announce, unilaterally, and as soon as possible, that it would be its desire that the United Kingdom have at a minimum an agreement granting it access to the Single Market on terms no less favourable than any of its existing reciprocal agreements with third parties?

I can see several distinct advantages of such a declaration. First it would change the existing damaging, bellicose atmosphere and mood, which are not auspicious for an amicable divorce. Second, it would not compromise any European interest from a commercial perspective. And third, it would allow that aspect of the negotiations to be handed over to the technocrats – the devil is in the details! – while allowing the more sensitive issues such as financial services, passporting and the like to be dealt with at the political level.

In the same vein, just about all Member States of the Union have bilateral investment treaties with third parties, which typically give extensive access to company directors, etc. Is it thinkable that the United Kingdom should not have similar privileges? Why should the same ‘most favoured’ principle not be extended as regards these privileges accorded to third parties?

Negotiating from a position of power, such gestures of good will by the Union would not compromise its interests; rather they would facilitate the negotiations by setting at least minimal targets to be achieved in the negotiations and send an important signal that the period of anger is over and functional pragmatism is back.

I also do not understand the negotiating philosophy of rejecting the parallel tracks – divorce and relationship. Imagine a real divorce. Is not our (EU) position similar to a would-be husband who says: “First agreement on the assets before we even begin to discuss custody of the kids?” Would any divorce lawyer representing the wife not reject that *ab initio*? (And yes, I have used here an old fashioned concept of the family in order to make my point).

What then of the ‘discourage the others’ argument? Here my views are decidedly iconoclastic but, I want to believe, at least merit a hearing.

The actual departure of the United Kingdom was not in my view the deepest harm inflicted by Brexit (thought of as a holistic set of events). The catastrophic damage to the Union was to grievously arrest the slow transformation of the European construct from a community of convenience (“concrete achievements leading to *de facto* solidarity”) to a community of fate. By community of fate (and thankfully Isaiah Berlin re-Koshered Herders’ concept so abused by National Socialism) I mean the notion

that whilst one can and should have deep divisions and conflicts within the Union as regards its policies, scope of action, methods of governance and the like, such divisions and conflicts have to be resolved within the framework of the Union, its Member States and their peoples being attached to each other indissolubly. The Exit option, a nod towards the residual sovereignty of the Member States (an indispensable nod, given that the very notion of a high integration among sovereign states is the double helix of the European construct that differentiates it from Federal States) was always to remain the arm you never use. Brexit discourse, spilling over from the United Kingdom debate to the whole of Europe, regressed the Union back to a contingent, ongoing project, the viability of which may be challenged at any moment, depending on a material balance of costs and benefits and the utility of which had to be proven again and again to its citizens. Unwittingly, in an almost panicky knee-jerk reaction, European discourse became one of 'we have to come up with projects that will prove to the peoples of Europe that it is in their interest to maintain the Union'. To remain. Even if successful in finding such projects, this is a self-defeating approach, because of its contingent, cost-benefit logic, on which the future of the Union is now to rest. As we saw in the British debate on Brexit and we see in current Euro-speak, this logic inevitably leads to the politics of fear. As the Brexit debate in Britain progressed it became increasingly one of 'who could scare their adversary' more effectively. The 'discourage the others' argument in the current post-Brexit approach belongs to the same genus – the politics of fear. Does one really want the future of European integration to rest on fear-driven support, scaring our peoples by setting up the United Kingdom as a reminder of the bad fate that awaits the heretics?

I cannot but think of millennial Christian doctrine – now abandoned – which held that the Jews should be kept as a miserable entity as a reminder of the fate of those who reject the Saviour. It was in fact a betrayal of Christian ideals and such politics of fear would likewise constitute a betrayal of European ideals

So, think now the unthinkable – an approach which would afford the United Kingdom as comfortable a status as possible, even a form of Associate Membership. It would still be a second class membership; whatever access the United Kingdom would have to, say, the Single Market, would be to a marketplace the rules of which would be determined by others. This is a self-inflicted damage that the United Kingdom will have to live with. It could be a nice solution to the ever more complex Turkish dossier. Turkey would never accept a second class Membership, but a status similar to the United Kingdom? Much more palatable.

Brexit is a watershed. So, I would argue, instead of trying to stick the finger in the dyke let us live the watershed. If an eventual United Kingdom status is appealing to this or that Member State, let it be. Those states would not in any event be helpful in a Union which needs some brave and decisive fixes to its structure and processes, not least the structure and processes of governance. For those who remain, most if not all, it will be a moment of willed re-commitment rather than scared, coerced, resentful and contingent inertia.

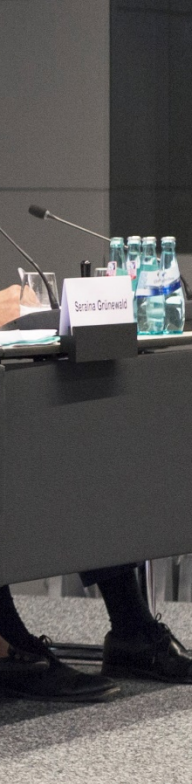
5 Conclusion

Dessert waits! So let us end this gloomy story with a precious Jewish joke. Our hero – let's call him Solomon – is desperately looking for parking. Should he not find a spot, he will miss a critical appointment. In desperation he turns his eyes to heaven and pledges that should God provide parking he will never again eat Jamón Ibérico, he will stop going to football matches on the Sabbath, etc. etc. Just as the last words leave his mouth, a large truck starts up and begins to move vacating the much coveted parking place. "God" shouts Solomon in delight. "Don't bother! I have found parking!"

Let us not rely on the Gods for help or alibis. Our destiny is in our hands.

Panel 5

Restructuring, resolution and insolvency
– shift of tasks from judicial to
administrative authorities



Restructuring, resolution and insolvency: the shifting of tasks from judicial to administrative authorities

By Roberto Ugena Torrejón¹

A new institutional framework for the management of banking crises has been established at European Union level. There have been also relevant developments in Member States which have set up administrative procedures to address the consequences of banking crises. Prior to delving into the current framework, it seems useful to give a brief reminder of where we were and what developments led us to where we are today.

There has been a clear understanding for some time that normal insolvency proceedings do not work well for banks. Moreover, there has been a growing realisation that specialised bank insolvency regimes at national level are not always adequate to manage the failure of banks in these times when capital and investments flow easily across national boundaries.

Being at the heart of an economy, banks are “special” in some respects. In particular, the liabilities of a bank differ greatly from those of a normal company. There are the retail depositors, individuals who may have a significant percentage of their overall wealth invested as deposits. Then there are the liabilities to other financial institutions such as other banks and institutional investors. In addition, there are complex contracts such as derivatives and swaps. If we want to broaden the scope and look at the asset side, too, the picture does not get any better. Among other reasons, this is because of the potentially high mismatch between the dates when the assets can be converted into cash and the maturities of the liabilities, not to mention the valuation problems connected with banks’ assets in times of crisis. The banking industry is very susceptible to fluctuations in confidence and faces the risk of bank runs, which can facilitate the outbreak of financial crises.

It is therefore not surprising that normal insolvency proceedings generally do not provide for tools to appropriately address bank failures by ensuring sufficiently speedy intervention and the continuity of critical functions, thereby preserving financial stability.

Because of such considerations, when faced with a failing institution in the era preceding the Bank Recovery and Resolution Directive (BRRD)², public authorities

¹ Deputy Director General Legal Services, European Central Bank.

² 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, p. 190).

have, in the past, often felt compelled to look for alternative solutions to insolvency. A solution that has been used very often, especially during the recent financial crisis, has been the government bail-out. In other words, an injection of public money to maintain the bank as a going concern for as long as necessary for the bank to weather the storm or to wind down the problematic assets in an orderly fashion.

While this system of bail-outs seems to have functioned relatively well with regard to maintaining financial stability, it may have increased moral hazard by incentivising excessive risk-taking by those perceived to be too big to fail and which were actually conducting business with the backing of an implicit guarantee from the state. Bail-outs have also undermined competition, sometimes propping up banks with flawed business models. Finally, the bail-out approach has, over time, put a significant strain on public finances and in some cases negatively affected the solvency of the sovereigns supporting the failing banks. This has often been referred to as the vicious circle between banks and sovereigns.

In view of all these problems, policymakers in different fora, but especially under the auspices of the Financial Stability Board, have been hard at work to identify an alternative approach – one that would cater for the special role of banks while avoiding the negative side-effects of the bail-out. It has been thought for some time that there should be another approach that would allow public authorities to shift the burden from the general taxpayers to the actual stakeholders of banks, notably the shareholders and creditors.

In January 2011 the European Commission launched its consultation on a possible European crisis management framework.³ Among other questions, this consultation sought views on a power to write down claims of shareholders and creditors. This later evolved into the bail-in tool under the proposal for the BRRD.

Anticipating the adoption of the BRRD, the European Commission's 2013 Banking Communication⁴ introduced, as a pre-requisite for any State aid to banks, adequate burden-sharing by those who invested in these banks.⁵ More specifically, the Commission considered that adequate burden-sharing would normally entail, after losses were first absorbed by equity, contributions by hybrid capital holders and subordinated debt holders.⁶

A comprehensive framework only came into being with the adoption and implementation of the BRRD in the Union. In essence, the BRRD has embraced the idea of imposing (part of) the losses on the relevant stakeholders of the bank by granting an administrative authority the power to bail in the shareholders and some of the creditors. While certain liabilities (such as secured liabilities, covered deposits and interbank liabilities with a maturity of less than seven days) are excluded from

³ European Commission (2011), *Technical details of a possible EU framework for bank recovery and resolution: working document of the services of the Directorate-General Internal Market and Services*.

⁴ Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ("Banking Communication") (OJ C 216, 30.7.2013, p. 1).

⁵ *ibid.*, paras. 15 and 40 et seq.

⁶ *ibid.*, para. 41.

bail-in, the majority of the creditors of a bank now face the prospect of a partial or full write-down or conversion of their claim should the bank fail.

This is a significant development with regard to fundamental rights and in particular property rights. The pre-defined insolvency procedures have been designed with a view to ensuring that the creditor may to a great extent anticipate the outcomes of the liquidation process and have a variety of tools to protect their rights in this process. In resolution, many of these pre-defined procedures have been replaced by fast-tracked decisions by the resolution authority, usually encompassing some non-negligible scope for discretion. Such discretionary decisions by the resolution authority are bound to affect the claims of the creditors of a failing bank. This speaks for the need for appropriate protections. Hence any prospective imposition of losses on the creditors of a bank may only be legitimate if it comes with the appropriate safeguards to protect individual rights. The BRRD framework acknowledges this and provides a number of safeguards, both procedural and substantive.

However, it is not an easy task to strike the right balance between the different interests involved in resolving banks. There seem to be some tensions in the framework established by the BRRD and the Single Resolution Mechanism Regulation,⁷ areas where conflicting objectives may possibly undermine its application. On the one hand, this framework is aimed at maintaining financial stability by preserving critical functions performed by the failing bank. On the other hand, the framework is meant to protect private interests – in particular the property rights of the shareholders and creditors – furnishing them with safeguards comparable to those in insolvency proceedings. But one could question whether these two angles are well balanced against each other.

For instance, one needs to consider that, according to the legal framework, the bank is not necessarily heard when the trigger for resolution is set (i.e. the bank is failing or likely to fail). Moreover the BRRD provides that the lodging of an appeal does not entail any automatic suspension of the effects of the resolution authorities' actions.⁸ Are the available safeguards then sufficient? Or, looking at the other side of the coin, are the limitations justified?

These tensions are also present when it comes to substantive safeguards. The no-creditor-worse-off principle has become the cornerstone aimed at ensuring a level of protection compatible with our fundamental rights. As the Court of Justice of the European Union has confirmed in the *Kotnik* judgment, burden-sharing measures are only legitimate when the losses for subordinated creditors in a resolution would not be higher than those in a prospective insolvency.⁹ However, since an intervention at an earlier point in time could increase the success of resolution actions, there might be an incentive to commence with the resolution of a bank at a point in time

⁷ 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).

⁸ See Article 85(4) of the BRRD.

⁹ Case C-526/14, *Tadej Kotnik and Others v Državni zbor Republike Slovenije*, ECLI:EU:C:2016:102, para. 78.

when insolvency would not necessarily have occurred and, perhaps more relevantly, at a point in time when there may be doubts that the insolvency scenario is the most plausible one. This dialectical tension may also appear in the determination of the extension of the bail-in to be applied to restore the bank to viability after other resolution actions are taken.

As should be evident by now, there are some difficult questions to be addressed that become even more complex when cross-border dimensions are taken into account¹⁰ – questions that we will have to reflect on as we gain further experience from the application of this new framework. We are lucky to have on this panel some distinguished speakers who will help us dive into and navigate our way through these complex issues. To begin with, Sabino Cassese will speak about the first dimension mentioned earlier: the gradual move from court-based insolvency proceedings for banks to administrative proceedings led by a supranational administrative authority. Next, David Ramos Muñoz will discuss the interplay between the insolvency hierarchy and the hierarchy of bail-in. Finally, Seraina Grünwald will share her thoughts on the legal challenges to the application of bail-in.

¹⁰ One should consider in particular the complexities of cross-border recognition of resolution actions, and their judicial review across Member States.

A new framework of administrative arrangements for the protection of individual rights

By Sabino Cassese¹

1 A new allocation of powers to redress bank failures

1.1 From the national level to the European level

The purpose of this paper is to analyse the new arrangements made at the European level to address the problem of the insolvency of financial institutions. I shall consider the public law implications of changes that have taken place in the law on the administration of bank resolution from the point of view of the new allocation of powers and (especially) of the safeguards for fundamental rights.

The European Union's Directive 2014/59² and Regulation 806/2014³ (BRRD and SRMR respectively) have produced a paradigm shift in three different directions. First, by devolving the power to tackle financial institutions' insolvency from national to European authorities. Second, by introducing a special regime for the resolution of financial institutions (and others), which is now no longer subject to the general legislation on insolvency. Third, by providing new out-of-court procedures, and therefore expanding the role of administrative authorities at the expense of civil courts.

I shall give a cursory examination of the first and second point, while I shall pay more attention to the third, which has several implications from the point of view of the safeguards for fundamental rights: indeed, it may be wondered whether fundamental rights, once in the hands of the judiciary, are left without any safeguards at all when the power to manage insolvency procedures is transferred to administrative authorities.

¹ Professor of Administrative Law and a former judge of the Constitutional Court of Italy. I wish to thank Edoardo Chiti, Maria Rita Circi, Mario Libertini and Chiara Zilioli for their comments on a previous version of this paper.

² 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).

³ 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).

The devolution of insolvency legislation from national to European authorities is clearly explained in Recitals 3, 4 and 9 of the BRRD. According to Recital 3, “Union financial markets are highly integrated and interconnected with many institutions operating extensively beyond national borders. The failure of a cross-border institution is likely to affect the stability of financial markets in the different Member States in which it operates”. Recital 4 states that “[t]here is currently no harmonisation of the procedures for resolving institutions at Union level”. According to Recital 9, “[t]he absence of common conditions, powers and processes for the resolution of institutions is likely to constitute a barrier to the smooth operation of the internal market and hinder cooperation between national authorities when dealing with failing cross-border groups of institutions”.

The reasons provided in the BRRD explain clearly the grounds of the transferral of legislative (and, in part, also administrative) power from the national to the European level: first, the failure of financial institutions is not only a national problem; second, there is a need to establish a common – and therefore uniform – set of rules. If the problem crosses national borders, then the solution too cannot remain in the hands of national governments alone.

1.2 From a general framework to a special framework

Previous regimes governing the insolvency of financial institutions essentially consisted in the application of general insolvency law, with many national variants. The reasons for taking this regime out of the general legislation on insolvency are clearly explained in Recital 4 of the BRRD: “the financial crisis has exposed the fact that general corporate insolvency procedures may not always be appropriate for institutions as they may not always ensure sufficient speed of intervention, the continuation of the critical functions of institutions and the preservation of financial stability”.

1.3 From the civil and judicial levels to the administrative level

The “administrativisation” of the regime on financial institutions’ insolvency is by far the most important feature of the new legal framework. The power to determine resolution is taken away from courts and conferred upon administrative authorities, to which a new space has now opened; “[t]he role of traditional bankruptcy and the bankruptcy court has therefore been marginalized”⁴.

According to Recital 15 of the BRRD, “[i]n order to ensure the required speed of action, to guarantee independence from economic actors and to avoid conflicts of interest, Member States should appoint public administrative authorities or authorities entrusted with public administrative powers to perform the functions and tasks in relation to resolution pursuant to this Directive”.

⁴ Haentjens (2016), p. 13 (8).

According to Union authorities, involving courts in restructuring financial institutions may raise costs, discourage restructuring and increase the workload of courts⁵.

2 A structural change

2.1 National governments alone cannot tackle bank failures

This new arrangement of powers at the European level raises many questions: does the function of allocating administrative and judicial power no longer pertain to the national governments? On which grounds is the new *ad hoc* resolution regime for financial institutions based? Can property/creditors' rights be subject only to courts, or are administrative authorities also entitled to govern these rights through administrative procedures?

A single and uniform resolution mechanism is part of what has been called “the new supranationalism”⁶: indeed, “supranational institutions have seen their discretionary powers significantly enhanced”. According to Recital 120 of the SRMR, “[t]he SRM brings together the Board, the Council, the Commission and the resolution authorities of the participating Member States”. A central role in the Mechanism is played by the Board, which is “*responsible for the effective and consistent functioning of the Single Resolution Mechanism*” (SRMR, Article 7.1). The Board has a power to coordinate: national resolution authorities inform the Board, which approves the resolution plans; and the national authorities coordinate with the Board (SRMR, Article 7.3). The Board also comprises a member representing each national resolution authority (SRMR, Article 43.1) and can use a Fund (SRMR, Article 67).

The unitary architecture of the resolution mechanism is strengthened by the horizontal links among resolution authorities, as the BRRD requires cooperation among resolution authorities within supervisory and resolution colleges, with a monitoring and mediation role of the European Banking Authority (BRRD Recital 17, Article 3.4 and 9).

Finally, the purpose of the new regime is – as noted above – to harmonize the procedures for resolving institutions at the Union level, to submit them to the same principles and to provide them with the same set of tools (BRRD Recital 4 and 5)⁷.

⁵ European Commission (2016).

For a general overview of the main trends in this area see Haentjens and Wessels (2016), who focus on three important changes: a “shift [...] from individual to public interest, from judicial to government authorities control and from European convergence to European harmonisation and unification.”

⁶ Dehousse (2015).

⁷ The Proposal of a Directive on preventive restructuring is an additional measure having the purpose of reducing the most significant barriers to the free flow of capital stemming from the differences in Member States' restructuring and insolvency frameworks (Recital 3).

On the SRM and SRB, see Del Gatto (2016).

2.2 National legal systems have experienced a plurality of insolvency regimes

The *ad hoc* legal framework of insolvency introduced in 2014 at the European level is part of a more general trend towards a plurality of insolvency regimes and a specialized insolvency mechanism for financial institutions.

There is a common trend towards introducing insolvency rules for special cases, in order to establish preventive measures (pre-insolvency), act as quickly as possible, and safeguard the failing institution: see the measures established in Germany (1994/1999), Belgium (1997), United Kingdom (2000 and 2002) Spain (2003), France (2005). As for Italy, new regulations, often issued on an *ad hoc* basis, were introduced in 1979, 1988, 1999, 2003, 2005, 2007, 2006 and 2008.

For financial institutions, there is a special reason for an *ad hoc* legal framework: that mentioned by the BRRD, or the need for speedy reaction to crises of financial institutions in order to avoid deposit flight.

2.3 The de-judicialization of insolvency procedures: judicial systems, being reactive and not proactive, are not prepared to manage pre-insolvency procedures

The BRRD states that “[t]he resolution authority shall be a public administrative authority or authorities entrusted with public administrative powers” (Article 3.2; Article 3.3 lists the organizations that can act as a national resolution authority, and none of these organizations is a court).

It should be noticed that the drafters of the BRRD did consider the problem of “considerably interfer[ing] with the constitutional and administrative systems of the Member States” (BRRD, Recital 15). However, this was only to exclude the BRRD’s capacity to establish which national administrative body should act as the resolution authority (and subsequently leave free hand to the Member States), and not to let national governments decide whether to empower the administrative or the judicial branch to act as the resolution authority.

It may be interesting to note that the Proposal of a Directive on preventive restructuring frameworks⁸ – which has a general scope but excludes financial institutions (Article 1.2) – does not choose the judicial or the administrative branch, as it mentions neither which national authority is entrusted with the insolvency powers nor “a judicial or administrative authority” (Articles 4.3, 5.2, 8.1, 24.1; see also Recital 18), leaving the ultimate choice to the national governments.

⁸ Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU.

It may also be interesting to notice that in the BRRD, courts are mentioned only three times, while in the general insolvency regime (848/2015)⁹, which does not apply to financial institutions, courts (defined by Article 1.2(6) as a “judicial body empowered to open proceedings, to confirm such opening, or take decisions in the course of such proceedings”) are mentioned 120 times.

The de-judicialization of Union resolution procedures for financial institutions matches a general trend: “the modernized bank insolvency regimes enacted around the world as a consequence of the global financial crisis have resulted in bankruptcy courts having had to cede their place to government authorities and administrative law courts”¹⁰. “Current bank insolvency law must be found in administrative law statutes, and the role of the bankruptcy judge is taken over by government authorities who act on the basis of those administrative law statutes”¹¹.

In fact, some of the special insolvency arrangements introduced in Italy and elsewhere (mentioned above) have experienced this transition from judicial to administrative authorities. Therefore, the new European insolvency framework for the insolvency of financial institutions is not entirely new, because it has already been experienced at the national level.

Are there structural reasons for this “flight from justice” in the financial institution insolvency regime? Before answering this question, it is necessary to recall that the reason for the judiciary’s role as protagonist in insolvency procedures is twofold. On one hand, courts were conceived as the main safeguard of property and creditors’ rights. On the other, courts were considered the only authority entitled to punish failed entrepreneurs.

Both reasons led legislators to rely on judges for insolvency procedures, including for decisions that are substantially administrative in nature, which – in civil law systems at least – are called decisions of voluntary jurisdiction or of non-contentious jurisdiction, because they are taken by courts even though they are not judicial but, rather, administrative in nature.

There are three reasons for this important reallocation of functions (from judicial to administrative bodies, with important implications for the jurisdiction of courts empowered to conduct judicial review).

First, judicial systems are incompatible with a single, uniform and hierarchical system as is the Single Resolution Mechanism. Courts can use foreign law, develop common principles, interpret legal norms according to common standards, converge on these in order to act as bridge-builders, establish a dialogue, from time to time reach agreements on their procedures, refer cases to one other, and form networks (and build integrated epistemic communities, such as the European Judicial Network (EJN); Eurojust; the European Judicial Network for civil and commercial matters, the

⁹ Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (OJ L 141, 5.6.2015, p. 19-72).

¹⁰ Haentjens (2016), p. 10.

¹¹ *ibid.*, p. 1.

Council of Europe's Consultative Council of European Judges; the Conference of European Constitutional Courts; the International Association of Supreme of Supreme Administrative Jurisdictions, Associations of the Councils of States and Supreme Administrative Jurisdictions of the European Union). However, they cannot coordinate their actions, cooperate, or be submitted to superior directives. In other words, courts cannot become part of a hierarchical supranational system, because they are inherently isolated monads.

Second, courts are reactive (they act upon request of a party) and not proactive, while modernized resolution procedures require preventive measures to avoid insolvency. Commission Recommendation 2014/135/EU¹² on a new approach to business failure and insolvency emphasizes preventive restructuring frameworks, facilitation of negotiations on restructuring plans, restructuring plans, protection for new financing and "Second Chance" – all activities for which courts are not well equipped. Indeed, these also require technical expertise and a knowledge of complex financial and economic problems, if not political evaluations.

Third, courts are not prepared to tackle insolvency problems that – as in the financial sector – have a systemic nature: indeed, the failure of one financial institution can bring to the insolvency of other financial institutions (as banks sell money *and* trust, or confidence in the reliability of the system). To deal with systemic failures or danger of systemic failures requires a consideration of general, political and administrative problems that are foreign to judicial culture and mentality.

These observations do not mean that courts cannot be part of an integrated, partly national and partly supranational judicial system, as happens in the Union. However, within such a system they act as reviewing bodies, through referrals from lower courts to higher courts (therefore *ex post*), while in insolvency procedures, courts act mainly in an administrative capacity.

3 Does the new system adequately safeguard individual rights?

3.1 Is the legal basis adequate?

Does the new arrangement, which moves insolvency procedures from the realm of civil-judicial authorities into that of administrative bodies, guarantee fundamental rights? Does administrative law provide adequate safeguards to creditors' rights, or is there a danger of "minimization of the role of private creditors and commercial law in favour of a preeminent role for government authorities and administrative law"¹³?

¹² Commission Recommendation 2014/135/EU of 12 March 2014 on a new approach to business failure and insolvency (OJ L 74, 14.3.2014, p. 65-70). See also Regulation 848/2015.

¹³ Haentjens (2016), p. 10.

Let me start by observing that in no country is there a clear-cut separation between judicial and administrative functions. The dividing line between judicial and administrative tasks is blurred and does not follow rigid criteria. Even in countries characterized by judicial dualism, such as France and Italy, the dividing line between civil and administrative courts may be different: for example, in France, property rights fall within the jurisdiction of civil courts, while in Italy, they are within the jurisdiction of administrative courts. Therefore, it does not suffice to observe that judicial procedures have been replaced by out-of-court, administrative, procedures, to reach the conclusion that fundamental rights (like property rights and creditors' rights) are not safeguarded.

It is necessary to ascertain the following: (i) if there is an adequate legal basis for administrative interventions; (ii) if the administrative authority in charge of regulating insolvency is sufficiently independent; (iii) if private parties affected by the decision are provided with adequate procedural safeguards; (iv) if administrative remedies are available to parties affected by the decision; and (v) if they can activate judicial review of the administrative decision, once it has been taken.

Let me now consider each one of these safeguards, in the case of financial institution insolvency, starting with the legal basis.

The BRRD, at Recital 13, states that “[t]he use of resolution tools and powers provided for in this Directive may disrupt the rights of shareholders and creditors. In particular, the power of the authorities to transfer the shares or all or part of the assets of an institution to a private purchaser without the consent of shareholders affects the property rights of shareholders. In addition, the power to decide which liabilities to transfer out of a failing institution based upon the objectives of ensuring the continuity of services and avoiding adverse effects on financial stability may affect the equal treatment of creditors. Accordingly, resolution action should be taken only where necessary in the public interest and any interference with rights of shareholders and creditors which results from resolution action should be compatible with the Charter of Fundamental Rights of the European Union (the Charter). In particular, where creditors within the same class are treated differently in the context of resolution action, such distinctions should be justified in the public interest and proportionate to the risks being addressed and should be neither directly nor indirectly discriminatory on the grounds of nationality”.

On this basis, the BRRD, while empowering European and national administrative authorities to govern the resolution of financial institutions, establishes principles and constrains resolution powers within strict and detailed procedural rules, based on a “dialogue” with the affected “institutions”.

Consider, for example, Article 32.1 of the BRRD on “conditions of resolution” (“Member States shall ensure that resolution authorities shall take a resolution action in relation to an institution referred to in point (a) of Article 1(1) only if the resolution authority considers that all of the following conditions are met”) and on the proportionality required for the measures taken by the administrative authority by Articles 32.4 and 32.5.

Another example is the transparency requirement for the sale of business tools (Article 39.2(a)).

The BRRD and the SRMR on the resolution of financial institutions are much more detailed than many national insolvency rules. This choice compensates for the de-judicialization. An *ex post* safeguard (placing judges in command of insolvency procedures) is replaced by an *ex ante* guarantee (establishing, in legislative instruments, powers and their limits).

It may be concluded that European legislative instruments, mainly the BRRD, have introduced adequate limits to confine administrative authorities' power, providing strict guidelines that administrative authorities with the power to govern financial institutions insolvency must follow, thereby avoiding arbitrary decisions.

3.2 Are administrative authorities independent?

A second safeguard for fundamental rights stems from the independence of administrative authorities. But are the authorities governing financial institution insolvency independent?

According to Article 1 of the SRMR, “[t]his Regulation establishes uniform rules and a uniform procedure for the resolution of the entities referred to in Article 2 that are established in the participating Member States referred to in Article 4. Those uniform rules and that uniform procedure shall be applied by the Single Resolution Board established in accordance with Article 42 (the ‘Board’), together with the Council and the Commission and the national resolution authorities within the framework of the single resolution mechanism (‘SRM’) established by this Regulation. The SRM shall be supported by a single resolution fund (‘the Fund’).”

Article 42.1 of the SRMR provides that “[t]he Board shall be a Union agency with a specific structure corresponding to its tasks. It shall have legal personality”.

Article 43.1 provides that “[t]he Board shall be composed of the Chair appointed in accordance with Article 56; four further full-time members appointed in accordance with Article 56; a member appointed by each participating Member State, representing their national resolution authorities”. Article 45.1 establishes that “[t]he Board shall be accountable to the European Parliament, the Council, and the Commission for the implementation of this Regulation [...]”. Article 47.1 establishes that “[w]hen performing the tasks conferred on them by this Regulation, the Board and the national resolution authorities shall act independently and in the general interest”.

As for the national resolution authorities, Article 3.3 of the BRRD states that “[r]esolution authorities may be national central banks, competent ministries or other public administrative authorities or authorities entrusted with public administrative powers.[...] Adequate structural arrangements shall be in place to ensure operational independence and avoid conflicts of interest between the functions of supervision

pursuant to Regulation (EU) No 575/2013¹⁴ and Directive 2013/36/EU¹⁵ or the other functions of the relevant authority and the functions of resolution authorities pursuant to this Directive, without prejudice to the exchange of information and cooperation obligations as required by paragraph 4. In particular, Member States shall ensure that, within the competent authorities, national central banks, competent ministries or other authorities there is operational independence between the resolution function and the supervisory or other functions of the relevant authority”.

This complex structure belongs to the family of European self-contained composite organizations called common or single regulatory frameworks. These are composed of national and supranational bodies with a common task and an obligation to cooperate and exchange information (see Articles 30 and 31 of the SRMR). They co-manage, although supranational (and mixed) bodies have functional supremacy¹⁶. In the case of the Resolution Board, there is also a Single Resolution Fund (see Articles 67 ff. of the SRMR), a financial instrument that cannot be attached to the judiciary.

The complex system of regulatory institutions, the “mechanism” as a whole, the “Board”, and the national branches do not enjoy the same degree of independence of a court. Independence is not guaranteed by the composition of the bodies, at the European and national levels, nor is it functionally prescribed at the national level (however, when national governments choose central banks, the structural nature of these independent regulatory agencies plays a role similar to that missing requirement).

3.3 Are there procedural safeguards?

A third way to safeguard fundamental rights against administrative authority power is to provide the affected parties with *ex ante* procedural guarantees, such as the “notice and comment” right provided by the US Administrative Procedure Act of 1946. Does European *ad hoc* legislation provide information, a right to hearing, and a duty to take reasoned decisions?

Article 34.1(i) of the BRRD states that “resolution action is taken in accordance with the safeguards in this Directive”. Substantive safeguards are listed in general terms in Articles 73-80, while “procedural obligations” are listed in Articles 81-84. Articles 82 and 83 emphasize the information to be provided to the financial institution under resolution, while there is no provision for the “comment” part of the procedure. This does not exclude special consultation procedures (for example, the information and consultation of employees: Recitals 35 and 48 and Article 34.5 BRRD), assistance

¹⁴ 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. 1-337).

¹⁵ 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. 338-436).

¹⁶ Cassese (2003), p. 110.

and cooperation (for example, for resolution plans, Articles 10.5 and 11.1 BRRD); the power to require the financial institution under resolution to take alternative measures (to remove impediments to resolvability: Article 17.4 BRRD; to exercise the write down or conversion power: Articles 62.3 and 4 BRRD).

To measure the degree of protection enjoyed by fundamental rights, these safeguards provided for the affected institutions should be compared to the general rules established by Union law, mainly Article 11 of the Treaty on European Union and Article 17 of the Charter.

The first provides that “[t]he institutions shall, by appropriate means, give citizens and representative associations the opportunity to make known and publicly exchange their views in all areas of Union action. The institutions shall maintain an open, transparent and regular dialogue with representative associations and civil society. The European Commission shall carry out broad consultations with parties concerned in order to ensure that the Union’s actions are coherent and transparent”.

According to Article 17 of the Charter, “[e]veryone has the right to own, use, dispose of and bequeath his or her lawfully acquired possessions. No one may be deprived of his or her possessions, except in the public interest and in the cases and under the conditions provided for by law, subject to fair compensation being paid in good time for their loss. The use of property may be regulated by law in so far as is necessary for the general interest”.

A comparison of the procedural safeguards provided in the new administrative framework for the resolution of financial institutions and the general rules on deliberative democracy (that is, participatory rights) in the Union leads to the conclusion that the new arrangements for financial institution insolvency are unsatisfactory. They establish strict conditions for the exercise of public authority – therefore satisfying the requirement of an adequate legal basis – but do not allow for a public exchange of views – and therefore do not satisfy the requirements of deliberative or participatory democracy. Nor does it provide sufficient safeguards for holders of property rights, as depositors and bond-holders, in terms of compensation.

3.4 Can private parties activate administrative remedies?

Very often, national governments provide administrative remedies to citizens, remedies that can be sought before judicial review or as an alternative means of redress for illegal decisions.

Union legislation provides a similar procedure in the area of financial institution resolution. Recital 88 of the BRRD states that: “[i]n accordance with Article 47 of the Charter, the parties concerned have a right to due process and to an effective remedy against the measures affecting them. Therefore, the decisions taken by the resolution authorities should be subject to a right of appeal”. Article 85 of BRRD provides that: “Member States shall provide in national law for a right of appeal against a decision to take a crisis prevention measure or a decision to exercise any

power, other than a crisis management measure, under this Directive. Member States shall ensure that all persons affected by a decision to take a crisis management measure, have the right to appeal against that decision. Member States shall ensure that the review is expeditious and that national courts use the complex economic assessments of the facts carried out by the resolution authority as a basis for their own assessment. The right to appeal referred to in paragraph 3 shall be subject to the following provisions: the lodging of an appeal shall not entail any automatic suspension of the effects of the challenged decision; the decision of the resolution authority shall be immediately enforceable and it shall give rise to a rebuttable presumption that a suspension of its enforcement would be against the public interest. Where it is necessary to protect the interests of third parties acting in good faith who have acquired shares, other instruments of ownership, assets, rights or liabilities of an institution under resolution by virtue of the use of resolution tools or exercise of resolution powers by a resolution authority, the annulment of a decision of a resolution authority shall not affect any subsequent administrative acts or transactions concluded by the resolution authority concerned which were based on the annulled decision. In that case, remedies for a wrongful decision or action by the resolution authorities shall be limited to compensation for the loss suffered by the applicant as a result of the decision or act”.

Beyond these general provisions, the BRRD contains *ad hoc* norms on appeals against decisions to require addressing deficiencies or impediments to recovery plans (Article 6.7), exercise of the power to address or remove impediments to resolvability (Article 17.6(c)), valuation for the resolution, to be appealed only in conjunction with the decision (Recital 51 and Article 36.13), write down of capital instruments (Article 60.2(b)), transfer of shares, assets, rights or liabilities (Article 66.6(a)), and administrative penalties (Article 112.1).

Both the general rule on appeals (see the limitations in Article 85.3) and this list require clarification: is the appeal system general or are appeals admissible only against those specific decisions that are mentioned in the Directive¹⁷?

3.5 Is there a mechanism for judicial review?

European legislation provides *ex ante* and *ex post* judicial review.

Article 85.1 BRRD provides that: “Member States may require that a decision to take a crisis prevention measure or a crisis management measure is subject to ex-ante judicial approval, provided that in respect of a decision to take a crisis management measure, according to national law, the procedure relating to the application for approval and the court’s consideration are expeditious”.

This is the price paid by Union law to the still-prevailing national procedural arrangements for insolvency, in which the judiciary plays an important role.

¹⁷ Ireland, Cyprus and Spain have introduced legislation that provides either for ombudsmen or arbitration mechanisms.

Another *ad hoc* power that European legislation recognizes to the judiciary acting *ex ante* is the power to enforce inspection.

According to Recital 93 of the SRMR, “[i]n order to perform its tasks effectively, the Board should have appropriate investigatory powers. It should be able to require all necessary information either through the national resolution authorities, or directly, after informing them, and to conduct investigations and on-site inspections, where appropriate in cooperation with national competent authorities, making full use of all information available to the ECB and the national competent authorities. In the context of resolution, on-site inspections should be available for the Board to ensure that decisions are taken on the basis of fully accurate information and to monitor implementation by national authorities effectively”. Therefore, Article 36.1 provides that “the Board may, in accordance with Article 37 and subject to prior notification to the national resolution authorities and the relevant national competent authorities concerned, and, where appropriate, in cooperation with them, conduct all necessary on-site inspections at the business premises of the natural or legal persons referred to in Article 34(1). Where the proper conduct and efficiency of the inspection so require, the Board may carry out the on-site inspection without prior announcement to those legal persons”. However, Article 37.1 then provides that “[i]f an on-site inspection provided for in Article 36(1) and (2) or the assistance provided for in Article 36(5) requires authorisation by a judicial authority in accordance with national rules, such authorisation shall be applied for”. Such national judicial powers are subject to European law restraints because, according to Article 37.2, “the national judicial authority shall control that the decision of the Board is authentic and that the coercive measures envisaged are neither arbitrary nor excessive, taking into account the subject matter of the inspection. In its control of the proportionality of the coercive measures, the national judicial authority may ask the Board for detailed explanations, in particular relating to the grounds the Board has for suspecting that an infringement of the decisions referred to in Article 29 has taken place, the seriousness of the suspected infringement and the nature of the involvement of the person subject to the coercive measures. However, the national judicial authority shall not review the necessity for the inspection or demand to be provided with the information on the Board’s file. The lawfulness of the Board’s decision shall be subject to review only by the Court of Justice”.

Recital 120 SRMR states that “[t]he Court of Justice has jurisdiction to review the legality of decisions adopted by the Board, the Council and the Commission, in accordance with Article 263 TFEU, as well as for determining their non-contractual liability. Furthermore, the Court of Justice has, in accordance with Article 267 TFEU, competence to give preliminary rulings upon request of national judicial authorities on the validity and interpretation of acts of the institutions, bodies or agencies of the Union. National judicial authorities should be competent, in accordance with their national law, to review the legality of decisions adopted by the resolution authorities of the participating Member States in the exercise of the powers conferred on them by this Regulation, as well as to determine their non-contractual liability”.

Article 86 SRMR provides that “[p]roceedings may be brought before the Court of Justice in accordance with Article 263 TFEU contesting a decision taken by the

Appeal Panel or, where there is no right of appeal to the Appeal Panel, by the Board. (2) Member States and the Union institutions, as well as any natural or legal person, may institute proceedings before the Court of Justice against decisions of the Board, in accordance with Article 263 TFEU. (3) In the event that the Board has an obligation to act and fails to take a decision, proceedings for failure to act may be brought before the Court of Justice in accordance with Article 265 TFEU. (4) The Board shall take the necessary measures to comply with the judgment of the Court of Justice”.

As for the national level, Recital 89 of the BRRD states the following: “[c]risis management measures taken by national resolution authorities may require complex economic assessments and a large margin of discretion. The national resolution authorities are specifically equipped with the expertise needed for making those assessments and for determining the appropriate use of the margin of discretion. Therefore, it is important to ensure that the complex economic assessments made by national resolution authorities in that context are used as a basis by national courts when reviewing the crisis management measures concerned. However, the complex nature of those assessments should not prevent national courts from examining whether the evidence relied on by the resolution authority is factually accurate, reliable and consistent, whether that evidence contains all relevant information which should be taken into account in order to assess a complex situation and whether it is capable of substantiating the conclusions drawn therefrom”.

Recital 92 of the BRRD states that: “[g]iven that crisis management measures may be required to be taken urgently due to serious financial stability risks in the Member State and the Union, any procedure under national law relating to the application for ex-ante judicial approval of a crisis management measure and the court’s consideration of such an application should be swift. Given the requirement for a crisis management measure to be taken urgently, the court should give its decision within 24 hours and Member States should ensure that the relevant authority can take its decision immediately after the court has given its approval. This is without prejudice to the right that interested parties might have in making an application to the court to set aside the decision for a limited period after the resolution authority has taken the crisis management measure”.

Article 85 BRRD provides that: “(2) Member States shall provide in national law for a right of appeal against a decision to take a crisis prevention measure or a decision to exercise any power, other than a crisis management measure, under this Directive. (3) Member States shall ensure that all persons affected by a decision to take a crisis management measure, have the right to appeal against that decision. Member States shall ensure that the review is expeditious and that national courts use the complex economic assessments of the facts carried out by the resolution authority as a basis for their own assessment. (4) The right to appeal referred to in paragraph 3 shall be subject to the following provisions: the lodging of an appeal shall not entail any automatic suspension of the effects of the challenged decision; the decision of the resolution authority shall be immediately enforceable and it shall give rise to a rebuttable presumption that a suspension of its enforcement would be

against the public interest. Where it is necessary to protect the interests of third parties acting in good faith who have acquired shares, other instruments of ownership, assets, rights or liabilities of an institution under resolution by virtue of the use of resolution tools or exercise of resolution powers by a resolution authority, the annulment of a decision of a resolution authority shall not affect any subsequent administrative acts or transactions concluded by the resolution authority concerned which were based on the annulled decision. In that case, remedies for a wrongful decision or action by the resolution authorities shall be limited to compensation for the loss suffered by the applicant as a result of the decision or act”.

When powers are conferred upon composite national and European administrative bodies, there is a recurring problem: that of the competent judge. If decisions are taken following a complex procedure, in which national and European authorities concur, is it entitled to review the decision of the national court or the European court¹⁸? The case law is oriented toward recognizing that the jurisdiction is for the European court, if European authorities took the challenged decision, even though it was prepared in collaboration with national authorities. However, this trend remains open to discussion, as demonstrated in Judgment 01805/2017, recently handed down by the Italian Council of State, Sixth Section, which requested the CJEU for a preliminary ruling on the issue.

The provisions of the BRRD have attracted strong criticism because they restrict judicial review: the appeal for review does not automatically suspend the effects of the challenged decision; summary proceedings must be initiated to achieve temporary *ex post* suspension; if a Member State has opted into the possibility of *ex ante* judicial control, the appeal for review must be adjudicated upon within 24 hours of the appealed decision; and reviewing courts must use the assessment made by national resolution authorities.

One jurist has concluded that “national resolution authorities and the SRB have been granted wide-ranging powers to remove impediments to a bank’s resolvability, and the BRRD and SRM Regulation have justly opened the resolution authority’s resolvability decisions to appeal. However, such an appeal is severely restricted. First, the complexity of the procedural structure impedes the affected bank’s judicial

¹⁸ Property rights safeguards have been examined by the Court of Justice of the European Union (CJEU) in two cases regarding banking law. In the first case, Case C-526/14, *Kotnik and others v Državni zbor Republike Slovenije*, ECLI:EU:C:2016:570, the Court decided that “(71) the burden-sharing by the shareholders and the subordinated creditors is no more than a criterion governing the Commission’s authorisation of State aid granted to banks that show a significant capital shortfall, the result being that aid can be limited to the minimum necessary and that the recipient of that aid will contribute appropriately to the costs of restructuring”. Therefore, “(78) the burden-sharing measures on which the grant of State aid in favour of a bank showing a shortfall is dependent cannot cause any detriment to the right to property of subordinated creditors that those creditors would not have suffered within insolvency proceedings that followed such aid not being granted”.

In the second case, Joined cases C-8/15 P to C-10/15 P, *Ledra Advertising Ltd and Others v European Commission and European Central Bank* (ECB), ECLI:EU:C:2016:701, the CJEU has decided that “In view of the objective of ensuring the stability of the banking system in the euro area, and having regard to the imminent risk of financial losses to which depositors with the two banks concerned would have been exposed if the latter had failed, such measures do not constitute a disproportionate and intolerable interference impairing the very substance of the appellants’ right to property. Consequently, they cannot be regarded as unjustified restrictions on that right”.

On property rights safeguards and the CJEU jurisprudence, see Raganelli (2016), p. 439-459.

protection. Second, judicial redress is limited to appeals *ex post*. Third, when considering a case in which the CJEU is requested to review an SRB resolvability decision on the ground of proportionality, it has been seen that virtually any resolution authority's decision will pass the broad suitability and proportionality test. On the other hand, the court will be confronted with complex economic assessments, which the court will not redo itself. The court will probably only assess closely whether the relevant guidelines and RTS have been complied with, and whether the resolvability decision has been adequately reasoned¹⁹.

What can be observed, in conclusion? It cannot be said that the right to a judge implies a right for private parties to be subject to administration by judges, and therefore a duty for European and national legal orders to allocate insolvency power to the judicial branch necessarily. Access to justice only means that there is a right to obtain judicial review of decisions taken by other bodies. However, some of the restrictions deriving from the due process of law before courts, established by European legislation, may raise problems of constitutionality, because they introduce limitations upon the judicial power to ascertain facts.

A final observation regards the implicit results of the new arrangements for the insolvency of financial institutions. In judicially dualist countries (that is, where there are separate civil and administrative courts, such as France or Italy), access to justice for appeals against decisions taken by administrative authorities implies an important shift from civil to administrative judges, because judges are called upon to review administrative decisions. By entitling administrative authorities (and not courts) to govern the insolvency of financial institutions, European legislation has implicitly taken judicial review out of the hands of civil courts, and placing it within the jurisdiction of administrative courts, the only courts competent to review administrative decisions.

It is well-known that the dividing line between the jurisdiction of civil courts and that of administrative courts has been always a subject of discussion, and that legislation and judge-made law (for example by the Tribunal des conflits in France and the Corte di Cassazione in Italy) have been often called upon to settle jurisdictional tensions between the two branches of the judiciary. This time, a great shift of competence from the civil to the administrative has occurred by stealth.

4 What can be done to improve the safeguards for individual rights?

There is a lesson to be learned from these new arrangements: administrative law is more flexible because it can adapt to supranational institutions and respond to the requirements of speed and expertise more than judicial systems and their procedural

¹⁹ Haentjens (2016), p. 16. It may be interesting to consider how national authorities implement, by means of national legislation, the limitations established by European legislation on both administrative procedure and judicial review. For the Italian legislation, see Article 60.2 and Articles 26 and 95 of Legislative Decree 180/2015.

rules. Moreover, from the time of the enactment of the American Administrative Procedure Act (1946), administrative systems around the world have been able to develop internal procedural arrangements that mimic judicial proceedings, place independent hearing offices in charge of the procedure (today, in the US, called the administrative judge), open space to debate with the interested parties, give them an opportunity to make their voices heard, impose an obligation to explain (give reasons) on the concerned authority. Briefly, administrative systems have adopted quasi-judicial proceedings.

This explains the worldwide trend of flight from courts and from judicial proceedings. This does not mean, however, that they are entirely excluded, as – on the contrary – they always have the final word.

Compound (or composite) organizations such as those introduced in many European areas require such flexibility, as they are necessarily dualist: partly European, partly national.

Once insolvency procedures are brought outside of the courts, put in the hands of administrative authorities, and placed under the aegis of administrative law, it is wrong to try to find more space for judicial intervention. These are necessarily *ex post* and, therefore, necessarily arrive too late.

It is better to try to improve administrative independence and administrative justice.

This means, first, to ensure that at the national and European levels, administrative authorities are strong enough to resist “capture” on part of the regulated. Initially, financial regulators developed as instruments of self-regulation of the financial community, and became slowly independent from the regulated industry. Despite these developments, financial regulators are still part of an *ad hoc*, self-contained and sectorial system of regulation, and are therefore subject to dangers of “capture”.

This means, in the second place, that it is necessary to give interested parties a voice before administrative authorities and to enhance contentious but administrative procedures through transparency, openness and impartiality. Proposals of amendments to the BRRD and the SRMR (COM (2016)852²⁰ and 853²¹; COM (2016)851²²) do not consider such problems.

Another necessary improvement is to expand the area of rights that are safeguarded by administrative (and subsequently judicial) remedies. The Explanatory Memorandum to the Proposal for a Directive on preventive restructuring

²⁰ Proposal for a Directive of the European Parliament and of the amending Directive 2014/59/EU on loss-absorbing and recapitalisation capacity of credit institutions and investment firms and amending Directive 98/26/EC, Directive 2002/47/EC, Directive 2012/30/EU, Directive 2011/35/EU, Directive 2005/56/EC, Directive 2004/25/EC and Directive 2007/36/EC.

²¹ Proposal for a Directive of the European Parliament and of the Council on amending Directive 2014/59/EU of the European Parliament and of the Council as regards the ranking of unsecured debt instruments in insolvency hierarchy.

²² Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 806/2014 as regards loss-absorbing and Recapitalisation Capacity for credit institutions and investment firms.

frameworks²³, Second Chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures, for example, takes into account only rights that are guaranteed by the Charter. Is this an appropriate choice? Should, instead, European law not also consider rights that are guaranteed by constitutional traditions common to the Member States (Article 6 of the Treaty on European Union)?

A final question is the following: does the ECB “Draft guidance to banks on non-performing loans” (September 2016) leave enough room to the interested parties to make their voices heard in the administrative procedures designed, to allow for their participation?

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²³ Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU.

Bank resolution and insolvency ranking and priorities

By David Ramos Muñoz¹

1 Introduction

What happens when you put together two of the quintessential examples of national interest in domestic economic legislation, and try to establish a dialogue between them? Is such thing truly possible, or even desirable? The second question can be answered, in our case, with an emphatic “yes”. Bank resolution may have been one of the more momentous changes introduced after the 2007-2009 financial crisis, but for its changes to last, they need to find accommodation with the now less fashionable, but more venerable, insolvency laws.

Nowhere is the need for dialogue more acutely felt than in relation with insolvency priorities. Of the multiple rules introduced by the Directive 2014/59/EU on Bank Recovery and Resolution² (Bank Recovery and Resolution Directive, or BRRD) only a handful are loss-allocation provisions, dealing directly with the consequences of resolution for holders of equity and debt instruments. These are the provisions regulating resolution tools. Of those, none are more momentous than the provisions on bail-in,³ since bail-in is no mere resolution tool. It is the only tool that can be applied without putting the entity in resolution,⁴ and it has come to represent the main change in policy resulting from the crisis. If the crisis lessons can be encapsulated by the aphorism that banks cannot be “too-big-to-fail”, bail-in tries to be the antidote to that: ensure that the funds to rescue a bank come from the bank shareholders and creditors, and you can let any bank fail, plus its failure will not result in tragic consequences for the financial system, and the taxpayer ... or so the theory goes.

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² 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, p. 190).

³ Articles 43, 44 and 59 BRRD.

⁴ Article 59 BRRD.

Theories, however, are “stylised”, or, simply put, elegant and neat. Practice, on the other hand, has a habit of being complex, messy and unexpected. Yet if bail-in is to work, it must urgently confront practice, and this requires finding a way in which the loss-allocation provisions of bank resolution, which are an expression of bank resolution’s policies, can dialogue with the provisions that set forth the cascade of losses under domestic insolvency laws. Making such comprehensive analysis would be the work of a treatise. Here the aim is much more modest, as the structure of this paper shows. A first section establishes what are the possible frictions between bank resolution and insolvency priorities at the level of policy, how the coexistence between the two is structured at the level of rules, and what problems can we anticipate (2). Then, another section uses a layer-by-layer approach to analyse some of those problem scenarios, first, in light of bank resolution provisions and insolvency laws, and cases; second, in light of European Union legislative initiatives to sidestep the problem by creating a layer of “easy-to-bail-in” debt, such as MREL; and, third, in light of the need of recognition of bail-in, and resolution measures, on a cross-border basis (3). Another section concludes (4).

2 Bank resolution and insolvency priorities: frictions in policy and accommodation in rules

Prudence advises that, if you see two trains headed towards each other, you should get away. When those trains are abstract, however, the prudent course of action is to tackle the possible train wreck head on, the only peril being intellectual frustration if the problem proves too intractable. So the question is, are insolvency law and bank resolution irreconcilable? The answer is, clearly, “no”. However, even if they share an important core, it is also much that pulls them apart, in terms of policy as will be seen by looking, first, at international insolvency best practice (2.1), and then at bank resolution (2.2). Having outlined the similarities and divergences in policy, we will discuss the attempts by resolution rules to accommodate insolvency law, and the difficulties that may be anticipated (2.3).

2.1 Policy considerations on insolvency and insolvency hierarchy

The field of insolvency law has been the subject of major international initiatives to identify and promote best practices. Given the seamless interaction between the law of credit and security and the law of insolvency, and their joint, and critical, influence, in fostering access to credit, and economic development, it is unsurprising for international efforts to have developed under the aegis of both the United Nations and the World Bank. The World Bank’s efforts have focused on the principles for effective Insolvency and Creditor/Debtor Regimes,⁵ which were originally developed in 2001 as part of international efforts to provide sound solutions to the problems arisen with the (Latin American, Asian, and Russian) crises of the 90s, and were

⁵ World Bank, [The World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes](#), Washington, 2016.

revised in 2005, 2011 and 2015. The United Nations, through its Commission on International Trade Law (UNCITRAL) began its contribution to the field in 1997, with the Model Law on Cross-Border Insolvency, to which a Guide to Enactment and Interpretation was added in 2013,⁶ and increased its output with its 2004 Legislative Guide on Insolvency Law,⁷ which was expanded in 2010 with its now-called Part Three for groups,⁸ and in 2013, with Part IV on Directors' obligations on the period approaching insolvency.⁹

The mutual influence between UN and World Bank efforts was made quite explicit in 2011, when the Bank's principles were modified to incorporate the UNCITRAL Guide's updates.¹⁰ Since then, it has only been deepened, resulting in the Insolvency and Creditor Rights Standard (ICR), formed by the Bank's Principles and the UNCITRAL Guide.¹¹ The ICR has received the endorsement of the Financial Stability Board (FSB) as a key standard for sound financial systems,¹² whose implementation should be prioritised.

Given the importance of insolvency ranking and priorities they figure prominently in the ICR, both in the World Bank Principles and the UNCITRAL Legislative Guide.¹³ In this regard, the best practices identified in these texts are (i) the need for insolvency law to uphold the priorities of claims established prior to insolvency under commercial or other laws to protect legitimate expectations and encourage predictability;¹⁴ (ii) the need to uphold the priority of secured creditors over their collateral;¹⁵ (iii) the need to prioritise the payment of claims related to the costs and expenses of administration;¹⁶ (iv) the need to promote the *pari passu* distribution of proceeds once secured creditors and insolvency expenses have been satisfied, which also means trying to limit the number of priority classes to a minimum;¹⁷ and (v) the need to, on the one hand, not give precedence, as a general rule, to public interests, and, on the other hand, bear in mind the importance of workers to the enterprise when giving them priority status.¹⁸

Even if its details may vary, at a simplified level the picture is relatively straightforward: creditor protection and fairness towards creditors seem to be the preponderant principles, which mean that creditors should be treated equally, absent

⁶ [UNCITRAL Model Law on Cross-Border Insolvency \(1997\) with Guide to Enactment and Interpretation \(2013\)](#) United Nations New York 2014.

⁷ [UNCITRAL Legislative Guide on Insolvency Law \(Parts I and II\)](#).

⁸ [UNCITRAL Legislative Guide on Insolvency Law. Part three: Treatment of Enterprise groups in insolvency](#).

⁹ [UNCITRAL Legislative Guide on Insolvency Law. Part four: Directors' obligations on the period approaching insolvency](#).

¹⁰ With new principles C16 and C17, regarding enterprise groups.

¹¹ [Creditor Rights Standard \(ICR\)](#).

¹² See [Insolvency and Creditor Rights Standard](#).

¹³ World Bank Principles Principle C12; UNCITRAL Legislative Guide, Part II, Chapter V, paras. 51-81.

¹⁴ World Bank Principles Principle C12.1; UNCITRAL Legislative Guide, Part II, Chapter V, paras. 51-81.

¹⁵ World Bank Principles Principle C12.2; UNCITRAL Recommendations No 188, Recommendations No 191.

¹⁶ World Bank Principles Principle C12.3; UNCITRAL recommendations No 189.

¹⁷ *ibid.*, No 187.

¹⁸ World Bank Principles Principle C12.3-12.4; UNCITRAL Recommendations.

a clear justification. These goals need to accommodate the protection of legitimate expectations of creditors relying on specific priorities, and the role of certain categories of creditors. Yet, all in all, the interests protected are private, and the public interest enjoys secondary importance, as shown by the fact that the priority of government liabilities tends to be seen with suspicion.

2.2 Policy considerations on bank resolution and the bail-in tool

The BRRD is part of the package of major financial reforms that followed the 2007-2009 crisis. It has been inspired by the debates conducted at a global level on the need for specific frameworks for the resolution of banks and major financial institutions. The crisis led to the inevitable reckoning that insolvency laws were inadequate to deal with bank crises. The mechanisms were too cumbersome, and courts were not specialised enough to ensure the swift handling of the assets, and avoid of spill-over and contagion.¹⁹ The problem is at the heart of insolvency law, which prioritises dealing with failed debtors, and protecting creditors,²⁰ without paying attention to the specific function of banks, i.e. their ability to generate money-like liabilities (which requires the protection of depositors) or general interests (e.g. preservation of financial stability).

Some of the answers to these problems were already available in the jurisdictions that already had a specialised mechanism in place, notably the United States.²¹ Thus, when Union rules were finally enacted, in the form the BRRD, these were largely consistent with the traditional approach of US rules. This is the case with regard to the appointment of specific resolution authorities to carry resolution proceedings forward²² (a role that, in the United States, is since long vested in the Federal Deposit Insurance Corporation (FDIC)). It is also the case of specific resolution tools, such as the sale of business, or the “bad bank”.²³

Nevertheless, on other issues the existing background was insufficient for the challenges confronting major financial institutions, and the Union legislature was forced to innovate. This was the case with regard to major international banking groups. The collapse of Lehman Brothers made abundantly clear that large financial institutions did not necessarily rely on the boundaries of legal personality, and many of their functions were managed on a centralised level.²⁴ Thus, the group, not the entity, was the correct unit to fit resolution measures. In addition to this, large financial groups straddled international borders, and used the mobility of financial assets to maximise the value of their funding and asset structure. This meant that, absent an adequate cross-border coordination of resolution action, these additional complexities could well make the introduction of the new tools come to nothing. As

¹⁹ Hüpkes (2011), p. 114.

²⁰ Jackson (1986), p. 7.

²¹ FDIC, “[The First Fifty Years. A History of the FDIC 1933-1983](#)”, Washington: Federal Deposit Insurance Corporation, 1984, pp. 84 et seq.

²² Articles 3, 61, 63-72, 81-84 BRRD.

²³ Articles 37-42 BRRD. See also [FDIC Resolutions Handbook](#), chapter 4.

²⁴ [Valukas Report](#) Vol. 5 Section III B. Avoidance Actions, p. 1549.

such, the BRRD included a great number of rules concerning banking groups,²⁵ and a coordination structure based on the idea of “colleges” of authorities (in this case, resolution authorities) to facilitate the proper forum for swift and flexible decision-making in coordination.²⁶

These ideas were taken one step further for the euro area. In this regard, the BRRD has been adopted in parallel with the process to achieve the banking union, which was set in motion when the 2007-2009 financial crisis mutated in the euro area into a sovereign debt crisis in 2010, which successively engulfed the economies of Greece, Ireland or Portugal, and then threatened the finances of Spain, Italy, and France. To sever the link between weak banks and weak public finances²⁷ Union policymakers proposed several mechanisms that would ensure that at least the major banking institutions in the euro area would be subject not only to a harmonised, but also centralised, system of supervision, with the Single Supervisory Mechanism (SSM),²⁸ resolution, with the Single Resolution Mechanism (SRM),²⁹ and deposit insurance.³⁰ The SRM enacted a much more centralised governance and administration of resolution action in the hands of the Single Resolution Board (SRB)³¹ and the Single Resolution Fund (SRF),³² but relied, for substantive purposes, on the framework of rules established by BRRD.

Thus, unlike insolvency law, which has a policy oriented towards the protection of the private interests of the parties involved, resolution clearly reflects macro-systemic concerns, and therefore involves more public considerations. This is expressly noted in the BRRD provisions, which identify a series of resolution “objectives”, which help to shape resolution authorities’ mandate,³³ and thereby provide a finalistic perspective to the interpretation of BRRD rules. These are: *(a) to ensure the continuity of critical functions; (b) to avoid a significant adverse effect on the financial system, in particular by preventing contagion, including to market infrastructures, and by maintaining market discipline; (c) to protect public funds by minimising reliance on extraordinary public financial support; (d) to protect depositors covered by Directive 2014/49/EU and investors covered by Directive 97/9/EC; (e) to protect client funds*

²⁵ Articles 7-8, 12-13, 16, 18, 19-26, 30.

²⁶ Articles 88-89 BRRD.

²⁷ Moloney (2014), p. 1622.

²⁸ See 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) ([SSM Regulation](#), or [SSMR](#)).

²⁹ 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) ([SRM Regulation](#), or [SRMR](#)).

³⁰ Article 1 SRMR; Intergovernmental Agreement on the Transfer and Mutualisation of Contributions to the Single Resolution Fund 8457/14 Brussels 14 May 2014. See also Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (the Deposit Guarantee Scheme Directive, or DGS Directive).

³¹ Articles 42-56 SRMR.

³² Articles 67-79 SRMR.

³³ Article 31(1) BRRD states that: “When applying the resolution tools and exercising the resolution powers, resolution authorities shall have regard to the resolution objectives, and choose the tools and powers that best achieve the objectives that are relevant in the circumstances of the case”. Article 34(1) BRRD.

and client assets,³⁴ as well as the integrative ones of minimizing resolution costs and avoiding destruction of value.³⁵ Thus, it is not as if resolution goals are fully incompatible with insolvency policies, but the latter will only be espoused by resolution if they fall within the categories of (i) financial stability preservation, (ii) taxpayer protection, and (iii) protection of specific classes or creditors, such as depositors, clients with funds or assets, and those necessary to ensure the continuity of critical functions. Other stakeholders in the bank are clearly left outside, to be protected by the overly broad consideration of avoiding unnecessary destruction of value. Thus, even from the statement of its goals, resolution introduces a clear distinction between “clients, depositors and operational creditors” and “other creditors”.

This is confirmed by the BRRD rules that state resolution “principles”, which supplement resolution goals.³⁶ These are more numerous, and cover a wider variety of areas, from management replacement to the liability of the persons responsible for the resolution.³⁷ However, there is a clear emphasis on burden-sharing, i.e. the need that the costs of resolution are not fully borne by the taxpayer, but by bank shareholders and creditors, with the need to protect depositors, to treat creditors equitably, and to limit their losses to those that would have been suffered under insolvency.³⁸

Thus, a key to understand bank resolution is that, in addition to enhanced cross-border group-level coordination, the current framework tries to address the problem of moral hazard.³⁹ The idea that emerged after the financial crisis was that the rules in place created an incentive for groups to be bigger, more complex and more interconnected, since this nearly ensured that they would receive public funding in times of financial distress. The only way to limit the problem of moral hazard was to ensure that holders of debt and equity instruments in the failed institution suffered

³⁴ Article 34(2) BRRD.

³⁵ Article 34(2) 2nd para. BRRD.

³⁶ A more philosophical consideration would be to discuss whether, and to what extent, resolution “objectives” differ from resolution “principles”, or they have the same interpretative nature, i.e. whether they shape the authorities’ mandate, and help interpret the legal provisions in the same way, or have different uses. For a general discussion of “goals” and “principles” as opposed to rules, and their distinction, see Dworkin (1977) p. 28.

³⁷ Article 34(1) BRRD states: “Member States shall ensure that, when applying the resolution tools and exercising the resolution powers, resolution authorities take all appropriate measures to ensure that the resolution action is taken in accordance with the following principles: (a) the shareholders of the institution under resolution bear first losses; (b) creditors of the institution under resolution bear losses after the shareholders in accordance with the order of priority of their claims under normal insolvency proceedings, save as expressly provided otherwise in this Directive; (c) management body and senior management of the institution under resolution are replaced, except in those cases when the retention of the management body and senior management, in whole or in part, as appropriate to the circumstances, is considered to be necessary for the achievement of the resolution objectives; (d) management body and senior management of the institution under resolution shall provide all necessary assistance for the achievement of the resolution objectives; (e) natural and legal persons are made liable, subject to Member State law, under civil or criminal law for their responsibility for the failure of the institution; (f) except where otherwise provided in this Directive, creditors of the same class are treated in an equitable manner; (g) no creditor shall incur greater losses than would have been incurred if the institution or entity referred to in point (b), (c) or (d) of Article 1(1) had been wound up under normal insolvency proceedings in accordance with the safeguards in Articles 73 to 75; (h) covered deposits are fully protected; and (i) resolution action is taken in accordance with the safeguards in this Directive.”

³⁸ Article 34(1)(a), (b), (f), (g) BRRD.

³⁹ De Weijts (2013), pp. 207-215.

the consequences of their lack of monitoring. The first institutional emphasis on burden-sharing came from the European Commission, which used its powers to approve state-aids to the financial sector under Article 107 of the TFEU⁴⁰ to issue guidelines insisted on the need that holders of equity and junior debt in a failed institution shared in the losses in order for the public funds not to be considered an illegal State aid.⁴¹

As efforts to achieve a common Union resolution framework were set in motion, lawmakers found a more suitable setting for this policy goal in BRRD rules on bail-in, which constituted one of the more important initiatives of Union resolution rules to avoid the use of public resources to rescue financial institutions (bail-out).⁴² This provided the first stable institutional setting for burden-sharing, and set forth a relationship of complementarity between bail-in and resolution funding, which, in this way, acted as communicating vessels: bail-in would act as the primary mechanism for loss absorption and recovery, and resolution funding to cover the gaps left.⁴³

It is important to bear in mind that, when we talk about “bail-in” we refer to two similar, albeit different, powers, under BRRD rules:⁴⁴ one is the “bail-in tool”, which can be used when all the conditions for resolution are fulfilled;⁴⁵ and the other are the write-down and conversion powers, which can be applied together with the resolution tool (in case the conditions for resolution are fulfilled) but also independently,⁴⁶ in cases where, if the powers are not used, the entity will no longer be viable.⁴⁷

Thus, bail-in is not only a mere resolution tool. It is the tool to ensure that losses are allocated properly among bank shareholders and creditors, rather than the taxpayer, without breaching any of the other principles, i.e. preventing contagion the continuity of critical functions or financial stability in general, ensuring equitable treatment, and protecting the specific classes of creditors. This offers an interesting balance, whereby burden-sharing considerations inspire the provisions, and are, in turn, inspired by the overall resolution objectives, whereas creditor protection considerations act as a check to such burden-sharing. Although this is not fully incompatible with insolvency law, a clear picture emerges, and one where the preferences in resolution rules are clear, and differ from those under insolvency law in some critical respects.

⁴⁰ Article 107 TFEU declares State aids illegal unless they are included within the exceptions under section (3), whose letter (b) authorises such State aid to “remedy a serious disturbance in the economy of a Member State”.

⁴¹ Communication from the Commission of 30 July 2013 on the application from 1 August 2013 of State aid rules to support measures in favour of Banks in the context of the financial crisis (OJ 2013, C 216/1).

⁴² Sommer (2014), pp. 207-228.

⁴³ See, e.g., Recitals (73) and (74) and Articles 37(10), 44 (4)–(12) BRRD.

⁴⁴ Wojcik (2016), p. 106.

⁴⁵ Articles 37(3) and 43-55 BRRD.

⁴⁶ Articles 37(2) and 59-62 BRRD.

⁴⁷ Article 59(3)(b)-(d) and (4) BRRD.

The above considerations are relevant to set the policy background where the ensuing discussion will take place. Hard cases, i.e. cases where the letter of the rules fails to provide a full answer, are bound to occur in the framework of the BRRD. Many of those cases will require the interpreter to search for the meaning of a specific provision, which requires considering its purpose and finality.⁴⁸ This will require a careful weighing of the different principles and policies at stake, which can be a tricky balancing act. In cross-border cases this will require weighing the interest of different legal systems. Yet, even within the “four corners” of a legal system, one still needs to consider the interaction between the principles underpinning national insolvency laws, and those embedded in resolution rules themselves. Naturally, this would not happen in the presence of a perfect accommodation between the two set of rules. As it will be seen, however, such accommodation is far from perfect.

2.3 Bank resolution. A rules-based accommodation in the presence of tension between policies: what could possibly go wrong?

The approach used by Union rules to try and reconcile the demands of insolvency law with those of bank resolution is rules-based, and a quick glance at its provisions reveals how difficult it is to achieve a balance between competing demands. First of all, resolution rules *rely* on insolvency rules to determine the waterfall of payments. Article 48 BRRD (*sequence of write down and conversion*) establishes that the sequence of write – down and conversion (bail-in) is (a) Common Equity Tier 1 Capital; (b) additional Tier 1 capital; (c) Tier 2 capital instruments; (d) subordinated debt that is not Tier 2 debt *in accordance with the hierarchy of claims in normal insolvency proceedings*; and (e) the rest of *eligible liabilities in accordance with the hierarchy of claims in normal insolvency proceedings*. The question of what is meant by “normal insolvency proceedings” must be answered by reference to Article 2(1) (47) BRRD, which provides that:

“normal insolvency proceedings” means collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator or an administrator normally applicable to institutions under national law and either specific to those institutions or generally applicable to any natural or legal person;”

This may give rise to some interpretative difficulties, though they are surmountable. Resolution authorities need to determine which proceedings would *hypothetically* apply, an issue that has become more difficult in an increasingly crowded field, where traditional winding-up proceedings are accompanied by reorganisation proceedings, voluntary arrangements, debt workouts and restructurings. Still, if, rather than on *insolvency proceedings* in the abstract, resolution authorities consider the *hierarchy of claims* in those proceedings, that tends to fixed, generally under the

⁴⁸ See, e.g. Case C-125/10 *Merck Sharp & Dohme Corporation v Deutsches Patent- und Markenamt*, ECLI:EU:C:2011:812, para 29. Such “hard cases” can be characterised as “pivotal cases”, which are distinguished from “borderline cases”, where there is disagreement as to the application to the specific case, but agreement as to the principles/policies involved. See Dworkin (1986), pp. 41-43.

rules on liquidation and winding up.⁴⁹ The only problem may arise in cases where ranking and priorities differ between reorganisation proceedings and liquidation proceedings,⁵⁰ although those cases should be rare.⁵¹

Thus, resolution rules try to accommodate the coexistence between them and insolvency hierarchy rules by deferring to those rules. That deference, however, is formal, and subject to important caveats. First, Article 48 BRRD itself stipulates an actual sequence for bail-in, including CET1 instruments, capital instruments, Tier 1 and Tier 2, and only then does it rely on insolvency law for purposes of subordinated debt instruments, and ordinary debt instruments beyond the realm of Tier 2.⁵² Domestic insolvency law may thus determine the priority of liabilities arising from debt instruments, but not equity instruments.

In second place, the rules introduce an *insolvency* priority for “eligible deposits”, which are those deposits covered by the deposit guarantee scheme,⁵³ basically retail deposits, and deposit guarantee schemes subrogating on the rights of those deposits.⁵⁴ In addition to this, the rules also introduce another priority for two types of non-eligible deposits, such as (i) deposits for natural persons and small and medium-sized enterprises (SMEs) exceeding the coverage levels of the Deposit Guarantee

⁴⁹ This is the case in England, Germany, or Spain. See Hamish Anderson; Charlotte Cooke; Louise Gullifer “National Report for England”; Christoph G Paulus; Matthias Berberich “National Report for Germany” Ignacio Tirado “National Report for Spain” and Annina H person; Marie Karlsson-Tuula “National Report for Sweden” in Faber; Vermunt; Kilborn; Richter; Tirado (2016), pp. 225, 289, 529, 556. The case is the same in most EU jurisdictions.

⁵⁰ This is the case in France. See articles L. 622-17 (reorganisation), and L. 641-13 (liquidation) of the French Commercial Code. The differences are “slight”, however. See Gilles Cuniberti; Isabelle Rueda “National Report for France” in Faber; Vermunt; Kilborn; Richter; Tirado (2016), p. 259.

⁵¹ Furthermore, the ranking in reorganisation proceedings is rarely applied, as it is only relevant in cases where the business is sold as a going concern. *Ibid.* However, that scenario should be more “normal” in *bank resolution, where the bail* – in tool may often be used in conjunction with the sale of business, bridge institution or asset separation tools. See Article 37(3) BRRD. Fortunately, French resolution rules make an *express* reference to “liquidation” proceedings for these purposes. See Article L. 613-55-5 no I 4th and 5th of the French Financial and Monetary Code, which refers to “liquidation proceedings” under Book VI of the Commercial Code.

⁵² *Member States shall ensure that, when applying the bail-in tool, resolution authorities exercise the write down and conversion powers, subject to any exclusions under Article 44(2) and (3), meeting the following requirements: (a) Common Equity Tier 1 items are reduced in accordance with point (a) of Article 60(1); (b) if, and only if, the total reduction pursuant to point (a) is less than the sum of the amounts referred to in points (b) and (c) of Article 47(3), authorities reduce the principal amount of Additional Tier 1 instruments to the extent required and to the extent of their capacity; (c) if, and only if, the total reduction pursuant to points (a) and (b) is less than the sum of the amounts referred to in points (b) and (c) of Article 47(3), authorities reduce the principal amount of Tier 2 instruments to the extent required and to the extent of their capacity; (d) if, and only if, the total reduction of shares or other instruments of ownership and relevant capital instruments pursuant to points (a), (b) and (c) is less than the sum of the amounts referred to in points (b) and (c) of Article 47(3), authorities reduce to the extent required the principal amount of subordinated debt that is not Additional Tier 1 or Tier 2 capital in accordance with the hierarchy of claims in normal insolvency proceedings, in conjunction with the write down pursuant to points (a), (b) and (c) to produce the sum of the amounts referred to in points (b) and (c) of Article 47(3); (e) if, and only if, the total reduction of shares or other instruments of ownership, relevant capital instruments and eligible liabilities pursuant to points (a) to (d) of this paragraph is less than the sum of the amounts referred to in points (b) and (d) of Article 47(3), authorities reduce to the extent required the principal amount of, or outstanding amount payable in respect of, the rest of eligible liabilities in accordance with the hierarchy of claims in normal insolvency proceedings, including the ranking of deposits provided for in Article 108, pursuant to Article 44, in conjunction with the write down pursuant to points (a), (b), (c) and (d) of this paragraph to produce the sum of the amounts referred to in points (b) and (c) of Article 47(3).*

⁵³ Article 108(b)(i) BRRD refers to “covered deposits”, which are defined under Article 2(1) BRRD as “covered deposits as defined in point (5) of Article 2(1) of the DGS Directive.”

⁵⁴ Article 108(b)(ii) BRRD.

Schemes (DGS),⁵⁵ and (ii) deposits that would be eligible if they were not made through branches located outside the Union of institutions established within the Union.⁵⁶ Those two shall enjoy priority over ordinary liabilities, but be subordinated to eligible deposits and DGS subrogating in their position.

In third place, and perhaps more crucially, BRRD rules exclude some instruments from bail-in.⁵⁷ Article 44 (scope of the bail-in tool), provides in its no (2) that: “*Resolution authorities shall not exercise the write down or conversion powers in relation to the following liabilities whether they are governed by the law of a Member State or of a third country*”, followed by a long list of instruments.⁵⁸

A quick glance at these carve-outs shows that they are justified by policies similar to those justifying domestic insolvency priorities, e.g. BRRD rules exclude from bail-in creditors that are normally protected by security interests or property rights, and those usually considered preferential creditors under national insolvency provisions. Yet there are also significant differences, e.g. the exclusion of deposits and “operational” liabilities, including trade creditors or less-than-7-days-maturity debts. This shows that a specific goal of the rules is to ensure that resolution does not short-circuit day-to-day management and operations.

This effectively alters the priority rules under domestic insolvency laws. If, for example, a specific liability enjoys priority, but is still subject to insolvency law’s waterfall, while it is completely excluded from bail-in under bank resolution rules, it is relevant whether resolution or insolvency is chosen. The domestic insolvency system, based on a logic of “up-or-down” in the hierarchy, is accompanied by a parallel system, based on a logic of “in-or-out”. This gives rise to a different set of incentives, since a creditor with a protected liability has a greater incentive to focus on obtaining the exclusion under Article 44, than on pleading a “preferred” status, which would still not exclude the liability from bail-in.

3 The battleground scenarios. A layers-based approach

Bank resolution rules pretend to respect insolvency law, but introduce important modifications, and a whole parallel system, based on the exclusion of certain liabilities from bail-in. This can give rise to important interpretative problems. The

⁵⁵ Article 108(a)(i) BRRD, with reference to DGS Directive.

⁵⁶ Article 108(a)(ii) BRRD.

⁵⁷ Article 2(1)(71) BRRD states that: “*eligible liabilities’ means the liabilities and capital instruments that do not qualify as Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments of an institution or entity referred to in point (b), (c) or (d) of Article 1(1) that are not excluded from the scope of the bail-in tool by virtue of Article 44(2)*”.

⁵⁸ This includes covered deposits, secured liabilities, liability arising out of holding of client assets or money under a fund (UCITS or AIFs), provided the client is protected under insolvency law, liabilities arising out of fiduciary relationships where the entity in resolution acts as the fiduciary, liabilities with a maturity of less than 7 days, liabilities to employees in relation to accrued salaries pension benefits or other fixed remuneration (except the variable component not regulated by collective bargaining agreement), liabilities to commercial or trade creditors providing goods or services that are critical to the entity’s daily operations, tax and social security liabilities, provided they are preferred under the applicable law, and deposit guarantee schemes arising from contributions due in accordance with the Directive on Deposit Guarantee Schemes. The text is repeated in Article 27(3) of SRM Regulation.

discussion of those problems is here structured in layers of complexity. Thus, the first point discusses some notable examples where the bail-in exclusions could give rise to interpretative issues on their own (3.1.) The second discusses the specific legislative intervention of loss-absorbency requirements, consisting in creating a layer of debt that can be easily bailed-in, the issues it gives rise to, and its recent evolution (3.2.) Finally, the third point considers the problem in the context of the cross-border recognition of resolution action (3.3.)

3.1 Layer 1. Frictions before specific legislative intervention: some examples

The challenges for the new provisions in practice become patent as one begins to think in actual scenarios, where a mere taxonomical difficulty can result in the bail-in of vast pools of liabilities, to the surprise of their holders, who could reasonably expect those liabilities to be bail-in-proof. Despite the diversity of banks' funding structures can give rise to numerous examples more complex than the ones envisaged here, a mere critical overview of the categories of liabilities excluded from bail-in suffices to raise thorny issues. This is the case with clients' money and securities (3.1.1), or intra-group funding (3.1.2).

3.1.1 Problems with clients' money and securities

Article 44(2)(c) BRRD states that bail-in powers shall not be exercised over: “*any liability that arises by virtue of the holding by the institution or entity [...] of client assets or client money*” (the underlining is ours). This is understandable, since writing down clients' money or assets would be tantamount to appropriating assets that are not the bank's own. Having said that, the provisions do not clarify the conditions to trigger the application of this provision. The solution is clear for those cases where clients' assets and money that are duly segregated from the bank's own assets and money. Yet the first question is what happens when the bank has failed to segregate the money or assets.

The question is far from hypothetical, as shown by the Lehman Brothers (*Client Money*) saga of court cases,⁵⁹ where the problem was that, under existing regulatory rules, Lehman could choose to segregate clients' funds immediately upon receipt, or use an “alternative approach”, under which it would put the money in house accounts, then segregate it, and run daily reconciliations to ensure that every clients' money was deposited in client accounts. As anyone can imagine, reconciliations took increasingly a longer period as the situation of financial distress worsened, with the result that the gap between the moneys that should have been deposited, and those

⁵⁹ *In the matter of Lehman Brothers International Europe*, [2009] EWHC 3228 (Ch); [2010] EWCA Civ 917; and [2012] UKSC 6.

that were effectively deposited was called a “failure on a truly spectacular scale” by Briggs J.⁶⁰

The case shows that the difficulties in some cases may not arise from the text of the current provision, but from its interpretation, because even if knowing what to do with client assets and money is clear, knowing what is “client assets and money” is less so. To determine that, resolution authorities would have to answer a series of questions, such as (i) does the law provide protection to the clients based on the segregation that should have taken place, or the segregation (or lack thereof) that actually took place? (ii) should one decide on the basis of the law applicable to the custody relationship, on insolvency law, or on an autonomous interpretation of Article 44(2)(c) BRRD? In principle, Article 44(2)(c) only excludes the liabilities from bail-in “provided that such a client is protected under the applicable insolvency law”, which means that the interpretation of BRRD must rely on insolvency law. However, in most cases insolvency law will not have decided on this issue, since cases like the Lehman Brothers saga are rare, which means that resolution authorities would be deciding on a hypothetical protection under insolvency law.

Any interpretative approach chosen by resolution authorities would have immediate remedial consequences. The decision whether to protect the moneys that should have been segregated, as a result of applying common law fiduciary doctrines, like ‘constructive trust’,⁶¹ could create a schism of principle with civil law countries, which may have stricter rules on “property”. Furthermore, another decision would be needed over whether the protection under property or trust law suffices to exclude the liability from bail-in. The problem has a far from obvious answer. Protection under property or trust law only establishes a prima facie claim by the owner or beneficiary over an unidentified pool.⁶² If clients are excluded from bail-in on the basis of the moneys or assets that should have been segregated, it will be difficult to know how much of those liabilities are excluded, which means that a greater pool of assets will need to be carved-out to ensure that, once the claims are duly established, every client gets her money, which means that ordinary creditors will take a greater hit.

In addition to this, an issue may also arise in cases where clients have allowed the re-use of their assets or money as collateral for the bank’s transactions. Practice like collateral re-use and re-hypothecation have been identified as sources of systemic risk,⁶³ but they are difficult to control without causing important liquidity bottlenecks,

⁶⁰ *In the matter of Lehman Brothers International Europe*, [2009] EWHC 3228 (Ch).

⁶¹ *In the matter of Lehman Brothers International Europe*, [2009] EWHC 3228 (Ch); [2010] EWCA Civ 917; and [2012] UKSC 6.

⁶² Indeed, in the Lehman Brothers cases protection under the law of trusts was relatively settled in the first instance. The main issues that made all the way up to the Supreme Court had to do with the applicability of the specific (and quick) procedure envisaged in regulatory rules for restituting moneys to the clients. Tracing requires the beneficiary to identify “his” property, which is extremely difficult to do in case of money assets commingled in different accounts. See the explanation *In the matter of Lehman Brothers International Europe*, [2009] EWHC 3228 (Ch) at 172 et seq. In other words, if clients simply had had a constructive trust, whereas the specific procedure envisaged in regulatory rules, which consisted in the forming of a Client Money Pool (CMP) to be promptly restituted, was reserved only for clients whose moneys were effectively segregated, there would be a clear difference in treatment. Thus, the Court of Appeal and the Supreme Court considered that the CMP should encompass all clients, regardless of whether their moneys had been effectively segregated. See *In the matter of Lehman Brothers International Europe*, [2010] EWCA Civ 917; and [2012] UKSC 6.

⁶³ Solana (2017).

and the rules merely require disclosure to clients by financial intermediaries.⁶⁴ However, those rules do not clarify whether clients would enjoy protection. Under the law of property, the collateral that is re-used may cease to be the property of the collateral giver, but there may still be uncertainty about whether this would be protected.⁶⁵

The problem may be worse if the bank has the money or assets of financial counterparties. That money may be the ownership of third parties, and, as such, would be subject to a special priority upon insolvency. However, bail-in provisions are different, and only exclude liabilities resulting from “*client* assets or client money” (Article 44(2)(c) BRRD), then “secured liabilities” (Article 44(2)(b) BRRD), and “any liability that arises by virtue of a fiduciary relationship” (Article 44(2)(d) BRRD). Technically, liabilities resulting from a non-client third party’s ownership over assets held by the bank are not excluded from bail-in, even though they should rank highest under insolvency rules. Resolution authorities would need to re-characterise an ownership right as either a “secured” right, or a “fiduciary” relationship, which would arguably be a contrived interpretation of the letter of the provisions.

3.1.2 Problems with group-level management of liquidity and instruments

If the case of money and instruments of clients and counterparties is uncertain, it becomes worse when we touch upon the management of liquidity and instruments on an intra-group basis. Internal liquidity management can be a source of risk. The examiner’s report on the *Lehman Brothers* bankruptcy shows that the sky is the limit when it comes to the complexity of the features of intra-group funding and liquidity management structures.⁶⁶ The uncertainty surrounding the rights and obligations arising from such structures may thus be counterproductive by increasing risk. However, bank group structures can be used to have an efficient allocation of liquidity, and facilitate the mobilisation of resources on relatively short notice.⁶⁷ A surplus in liquidity, or collateral that may be used to raise liquidity, may be quickly re-allocated across the group, and facilitate its overall stability, as well as the exploitation of business opportunities.

This ability to mobilise resources, however, can be curtailed if supervisors insist that bank assets should be ring-fenced in their own jurisdiction, following current regulatory rules and practice.⁶⁸ The immobilisation of resources can also be a consequence of resolution rules that create a disincentive for intra-group management of liquidity and instruments. This could be the consequence of applying

⁶⁴ See, e.g. Articles 13-15 Regulation 2015/2365 of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012 (the Securities Financing Transactions, or SFT Regulation).

⁶⁵ Article 5 of Directive 2002/47/EC on Financial Collateral Arrangements (OJ L 168, 27.6.2002, p. 43) (the Financial Collateral Directive, or FCD) regulates the “right to use” of the collateral, but provides no rule as to the position of the party whose collateral is used by the collateral taker.

⁶⁶ Valukas (2009).

⁶⁷ Basel Committee on Banking Supervision (BCBS) Report on intra-group support measures, February 2012, p. 1.

⁶⁸ Gambacorta, van Rixtel and Schiaffi (2017) p. 8.

bail-in rules. Those rules exclude from bail-in the liabilities resulting from *clients'* money and assets. This posed an interpretative difficulty with counterparties, but in the case of group entities the liabilities would be clearly included within bail-in, as clearly falling outside the concept of “client” money or assets. In addition, short-term liabilities are excluded from bail-in, to avoid introducing a disincentive to granting liquidity access to the bank, just when it needs it the most, but this is “excluding entities that are part of the same group”.⁶⁹

The possibilities left would be the exclusion of any liability “that arises by virtue of a fiduciary relationship” between the bank and a beneficiary, “provided that such a beneficiary is protected under the applicable insolvency or civil law” (Article 44(2)(d) BRRD), and “secured liabilities” (Article 44(2)(b) BRRD). A first difficulty in the former case would arise with the concept of “fiduciary relationship”, i.e. whether it would include, say, any relationship of custody, or where one party holds something for the benefit of another, or would require specific coverage, and whether, in such case, parties in common law jurisdictions would stand to benefit more from the provision than those in civil law ones.⁷⁰ A second difficulty would arise with the concept of “applicable insolvency law or civil law”. It is unclear whether this provision requires resolution authorities to simply look at the insolvency law otherwise applicable, and see whether the fiduciary relationship *would be* protective if the bank were declared insolvent, or whether it suffices that the authorities see that the fiduciary arrangement is protected by, say, a retention right, even if that right would not grant a restitution remedy, or any other protection upon the debtor’s insolvency.

The problem with the latter is that the bail-in provision does not clearly state what is the interplay between it and the insolvency law otherwise applicable. Again, the question is not abstract. In another case of the *Lehman Brothers* saga the problem arose because one of the companies within the group held a security interest, which the parties called “lien”, over the instruments of other group companies.⁷¹ This “lien” was part of the intra-group structure for the management of liquidity and instruments. However, a “lien” is security that requires physical possession, and the right could not be it, no matter what the parties said, so the High Court had to re-characterise it. In a ruling that may have surprised some, the court found that the right could not be characterised as a “Financial Collateral Arrangement” (FCA), of those covered by the

⁶⁹ Article 44(2)(e) BRRD.

⁷⁰ E.g. since “fiduciary” is a term arising from trust law, the question is whether arrangements in civil law countries would benefit from it.

⁷¹ The clause, initially developed for client custody agreements read as follows: “*The Client agrees that the Custodian shall have a general lien on all other Property held by it under this Agreement until the satisfaction of all liabilities and obligations of the Client (whether actual or contingent) owed to the Custodian or any Lehman Brothers entity under any other arrangement entered into with any Person in the Lehman Brothers organisation. In the event of failure by the Client to discharge any of such liabilities and obligations when due, such non-performance remaining un-remedied for a period of 3 days after notification by the Custodian to the Client the Custodian shall be entitled to sell, in a commercially reasonable manner after notice to the Client, or otherwise realise any such Property and to apply any moneys from time to time deposited with it under this Agreement and the proceeds of such sale or realisation in the satisfaction of such liabilities and obligations; for the purpose of such application the Custodian may purchase with any moneys standing to the credit of any account such other currencies and at such rate(s) of exchange as may be necessary to effect such application.*” *In the matter of Lehman Brothers International Europe*, [2012] EWHC 2997 (Ch) at 32.

FCD because the security taker lacked the requisite control over the collateral.⁷² The right was characterised as a floating charge,⁷³ without FCD protection, meaning a security right with a protection that is significantly weaker.⁷⁴ This gives an idea of the nature of the problems that may arise in practice.

The problem is compounded by the fact that some States subordinate intra-group debt, as it is the case in Spain or Germany.⁷⁵ Such subordination provisions used to be a sort of anti-avoidance technique to prevent shareholders from disguising equity financing as debt to get a more beneficial insolvency treatment. However, the difficulty of separating avoidance cases from those that were not has led to mechanical provisions that can automatically rank debt held by shareholders (Germany), or by related (group) entities as subordinated. This can severely impact intra-group liquidity management because it also affects operational liabilities, including short-term debt.

3.2 Layer 2. Frictions arising after specific legislative intervention: TLAC/MREL rules, and the lack of harmonisation of loss-absorbing debt

The problems outlined above illustrate that creating a “parallel” system whereby liabilities are “in” or “out”, on top of the system of ranking and priorities under national insolvency law, where liabilities are “up” or “down” does not rule out controversy, only transforms it. Thus, it is not surprising that EU resolution rules have attempted another strategy to sidestep the problem via legislative intervention. This is through the concept of Minimum Requirements for capital and Eligible Liabilities (MREL).⁷⁶ MREL is the EU attempt to ensure compliance with the global standard on Total Loss-Absorbency Capacity (TLAC) sponsored by the Financial Stability Board (FSB), which tries to ensure that Globally Systemically Important Banks (G-SIBs) have, in addition to a sufficient cushion of capital under Basel prudential rules, a cushion of debt that can be written down or converted if the entity is put into resolution in a way

⁷² The Directive introduces a requirement of “possession or control” that needed to be satisfied. his requirement was not satisfied in the instant case, given, in the accounts Lehman Brothers International Europe (LBIE) held for Lehman Brothers Finance (LBF) as custodian, LBF retained uncontrolled rights of recall and disposal. See *In the matter of Lehman Brothers International Europe*, [2012] EWHC 2997 (Ch) at 147.

⁷³ *ibid*, at 70.

⁷⁴ Floating charges rank below preferential creditors, including not only those with a fixed security, but also creditors for winding-up/administration expenses, pension contributions, or wages. See, e.g. s. 176ZA (winding-up expenses); Schedule B1 para. 99(3) (administration expenses); and s. 175(2)(b) in relation to s. 386 and Schedule 6 paras. 8-9 Insolvency Act 1986. The resulting ranking upon insolvency was thus stated by Lord Neuberger in *Re Nortel GmbH* [2014] AC 209 (SC) at [39]. The order set out in that decision is (1) creditors with a fixed security; (2) expenses of insolvency proceedings; (3) preferential creditors; (4) floating charge creditors; (5) unsecured probable debts; (6) statutory interests in probable debts; (7) deferred, unsecured, probable debts; (8) non-provable liabilities; (9) shareholders’ return on capital and (10) shareholders’ distribution of surplus.

⁷⁵ Section § 39(1) 5th, (4) and (5) (see also Section § 135) German Insolvency Statute; and Articles 92 5th and 93 Spanish Insolvency Act.

⁷⁶ Article 45 BRRD.

that ensures the recapitalisation of the entity at levels that allow it to continue its operations as a regulated bank.⁷⁷

This has an immediate bearing on our issue: TLAC/MREL debt is created to be bailed-in if bail-in is the resolution strategy chosen by the bank in its resolution plan, and bail-in will primarily take place over TLAC/MREL debt. Still, the concept significantly changes the picture because, even though every TLAC/MREL must be bail-ineable, not every bail-ineable debt can qualify as TLAC/MREL. Rather, debt can only be TLAC/MREL eligible when it does not pose the same daunting problems that we have just discussed in the prior section with regard to other types of debt, since otherwise the recapitalisation attempts would be thwarted by the complexity of the bail-in process. MREL rules try to accomplish that by setting some criteria in advance to facilitate the bail-in of the debt.

Thus, the debt instrument: (a) must be issued and fully paid up; (b) must not be owed to, secured by or guaranteed by the institution itself; (c) its purchase must not be funded directly or indirectly by the institution; (d) must have a remaining maturity of at least one year; (e) must not arise from a derivative; (f) must not arise from a deposit with preferential insolvency treatment.⁷⁸ These requirements are similar to those envisaged under international standards for TLAC,⁷⁹ and try to leave “operational” debt outside bail-in, in a way that avoids the disruption of the bank’s activities.

However, unlike the TLAC standard, MREL rules do not require for MREL debt to be subordinated to non-MREL debt.⁸⁰ This means that non-MREL operational debt that ranks *pari passu* with MREL debt, such as derivatives or non-covered deposits, could still be bailed-in together with MREL debt, so that disruption would not be avoided. In second place, EU rules on MREL do not provide any roadmap for Member States on how to implement MREL, i.e. it does not give a concrete picture of how MREL debt should look like.

This choice in favour of an open definition of the requirement, which may be fulfilled in different ways depending on the country or the institution, has given rise to a variety of approaches. Countries like Spain have opted for a strategy of “contractual subordination”, whereby MREL requirements can be fulfilled by issuing debt subject to an express subordination clause.⁸¹ Countries like Germany or Italy, have opted instead for a strategy of “statutory subordination”. In Germany, for example, senior unsecured bonds have been statutorily subordinated to operational liabilities, like deposits or derivatives.⁸² In Italy, subordination only has taken place vis-à-vis all

⁷⁷ Abascal; Garcia (2016).

⁷⁸ Article 45(4) BRRD.

⁷⁹ Abascal; Garcia (2016).

⁸⁰ Article 45 BRRD.

⁸¹ See Articles 48(1)(d) and (3) and Additional Provision 14th of the Spanish Act 11/2015 on the Recovery and Resolution of Credit Institutions and Investment Firms.

⁸² Section § 46f(5) et seq. of the German Banking Act (*Kreditwesengesetz*, or KWG), and Section § 97(1) 3rd para. of the German Act on Recovery and Resolution, as introduced by the Resolution Mechanism Act (*Abwicklungsmechanismusgesetz*, AbwMechG) of November 2015.

types of deposits,⁸³ i.e. besides those excluded from bail-in, and those granted statutory preference in insolvency by BRRD rules.⁸⁴ France has chosen a mixed approach, by creating a specific type of “Tier 3” debt, which, in the insolvency ranking, is subordinated to operational debt, provided it includes a specific reference in its contract documentation indicating its “non-preferred” status.⁸⁵

The variety of approaches can give rise to difficulties in cross-border cases mixing different legal regimes. One problem may arise if Tier 3 debt is issued subject to French law, by a bank subject to German insolvency law. Since German insolvency law subordinates *all* senior unsecured bonds to operational liabilities without making any distinction, the question is whether Tier 3 debt should be bailed-in before ordinary debt. A similar problem may arise if debt is issued subject to a subordination clause, under Spanish law, but by a bank subject to French insolvency law, which gives the same treatment of “Tier 3” debt to any debt subject to the laws of another country, but deemed “equivalent” to Tier 3 debt.⁸⁶ The question, in this case, is whether debt subject to a subordination clause would be deemed equivalent to Tier 3 French debt, or not.

The problem may be even more acute if the laws of non-EU countries are involved, e.g. the laws of New York. If a bank subject to German insolvency law has ordinary bonds standing, and issues Tier 3 debt subject to French law, or subordinated debt subject to Spanish law, together with ordinary debt subject to New York law, it would be extremely difficult to determine the treatment of New York debt *vis-à-vis* ordinary bonds, and Tier 3 or subordinated bonds.

All these problem scenarios do not even touch the most intractable issue of all, which concerns intra-group debt. In the previous description of MREL we have omitted one fundamental detail, which is that MREL debt requirements must fit the resolution strategy of the banking group.⁸⁷ When we move from a resolution strategy for a single entity to a group strategy, and this involves the bail-in of debt, it is not only necessary that the “external” debt, held by third parties, can be bailed-in without problems. Even more important is the previous step, where the losses of operational subsidiaries must be “up streamed” to the parent company that will absorb them. The parent company will only bail-in the external debt when the losses of its subsidiaries are excessive, but before that those losses must have been absorbed by the parent, which will be accomplished through “internal MREL”, or debt issued by the subsidiaries, and held by the parent company, which must also be bailed-in.

Different banking groups may call for different resolution strategies, and a debate has arisen on whether a Single-Point-of-Entry Strategy (SPoE) is preferable, and

⁸³ Article 91 of the Legislative Decree No 385 of 1 September 1993, Consolidated Law of Banking (TUB).

⁸⁴ Article 108 BRRD.

⁸⁵ Article L 613-30-3 French Financial and Monetary Code.

⁸⁶ *ibid.*

⁸⁷ *EBA Report on the Implementation and Design of the MREL Framework*. Final Report EBA-Op-2016-21 14 December 2016, p. 9. In fact, this is the main reason why MREL requirements are individualised for each group, unlike TLAC requirements, which are common across the board for all G-SIIBs.

should be promoted by resolution authorities,⁸⁸ or a Multiple-Points-of-Entry (MPoE) may sometimes be desirable, and resolution rules and authorities should remain neutral. The conclusion on this, however, does not affect the conclusion that resolution rules need to consider the specialties of “internal MREL”. Currently, debt cannot be bailed-in unless the entity is placed into resolution,⁸⁹ and pre-resolution bail-in is only allowed for capital, not debt.⁹⁰ Up-streaming of losses from an operating subsidiary to a parent company (which may be the holding company, under SPoE, or an intermediate company, under MPoE) is, thus, extremely difficult unless the subsidiary is placed in resolution, which would be inconsistent with the resolution strategy.

Therefore, it is not surprising that the EU legislature has proposed reforms shortly after their enactment,⁹¹ in the broader context of a banking package that, among other things, implements the TLAC standard.⁹² Newly proposed resolution rules include rules directed at “external” MREL, such as a newly drafted Article 108 BRRD, which introduces a new type of senior, unsecured, non-preferred debt, which will be subordinated to other types of ordinary senior debt, in the insolvency hierarchy, but preferred to subordinated debt, following the French Tier-3 approach.⁹³ New rules would also address the problem of “internal MREL”, by including a requirement for banks that form part of a banking group to issue debt that will be held by their parent companies, is subordinated to all types of ordinary debt, and does not trigger a change of control of the company in case it is subject to bail-in.⁹⁴ Finally, to facilitate the upstreaming of losses towards the parent company without having to put the operating subsidiary into resolution, which would jeopardise the group strategy, newly proposed provisions make it possible to bail-in debt independently of

⁸⁸ See, e.g. Gordon; Ringe (2015).

⁸⁹ Article 43 BRRD.

⁹⁰ Article 59 BRRD.

⁹¹ Commission Proposal for a Directive on amending Directive 2014/59/EU of the European Parliament and of the Council as regards the ranking of unsecured debt instruments in insolvency hierarchy. Brussels, 23.11.2016 COM(2016) 853 final 2016/0363 (COD) (Proposal on Insolvency Hierarchy); and Proposal for a Directive amending Directive 2014/59/EU on loss-absorbing and recapitalization capacity of credit institutions and investment firms and amending Directive 98/26/EC, Directive 2002/47/EC, Directive 2012/30/EU, Directive 2011/35/EU, Directive 2005/56/EC, Directive 2004/25/EC and Directive 2007/36/EC Brussels, 23.11.2016 COM(2016) 852 final 2016/0362 (COD) (Proposal on BRRD Reform for Loss-Absorbency).

⁹² See Commission Proposal for a Regulation amending Regulation (EU) No 806/2014 as regards loss-absorbing and Recapitalisation Capacity for credit institutions and investment firms. Brussels, 23.11.2016 COM(2016) 851 final 2016/0361 (COD) (Proposal on SRM Reform on Loss-Absorbency); and the Proposal for a Regulation amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements and amending Regulation (EU) No 648/2012 Brussels, 23.11.2016 COM(2016) 850 final 2016/0360 (COD) (the CRR Reform Proposal).

⁹³ New Article 108 BRRD under the Proposal on Insolvency Hierarchy. In order to be classified as such type of liability, the debt must have a contractual maturity of 1 year or more, no derivative features, and the relevant contractual documentation related to the issuance must explicitly refer to insolvency ranking. In other words, EU rules propose to adopt the French approach, based on the creation of a new kind of Tier-3 debt, as the blueprint of harmonization of MREL debt at an EU level.

⁹⁴ New Article 12h(3) SRM Regulation under the Proposal on SRM Reform on Loss-Absorbency, and new Article 72a CRR under the CRR Reform Proposal.

resolution action, in cases where the company will not be viable unless it is made subject to bail-in, a possibility that before was only available for capital instruments.⁹⁵

The reform will be a step towards greater clarity and uniformity, and should be welcome, although it is still unclear whether States will abandon the MREL-compliance strategies inconsistent with the EU approach, e.g. statutory subordination strategies, and whether market players will take the opportunity to sort out their external and intra-group finances. Problems could arise if these efforts are not present, but also, less avoidably, in cases where a group strategy to up-stream losses is thwarted by the subordination of operation debt, e.g. loans or derivatives, also held by the parent. These problems are not caused by the reform, but show that a much greater effort is needed to clarify the relative standing of bank debt.

Finally, the reforms do not, and cannot, solve the problem of debt subject to the laws of third countries. If a bank subject to the laws of an EU jurisdiction issues bonds subject to the laws of New York, it remains extremely difficult to state for sure that such debt will be subject to bail-in at the critical point where it is needed, and therefore there is insufficient clarity about its MREL eligibility.⁹⁶ The reasons for this will be explored in the next section.

3.3 Layer 3. Cross-border recognition

Any rules on bank resolution that did not duly address the cross-border scenario would be grossly inadequate, bordering on naive. Yet at the same time raising the issue of cross-border recognition increases the uncertainty of the analysis, by posing intractable taxonomical issues. At a domestic level, i.e. when the laws of a single country apply to both insolvency and resolution, the problem is one of interpretation of the provisions. At an international level, however, one can no longer rely on insolvency and resolution to operate without disruption. Insolvency is a court-administered procedure, and even if courts are an expression of a State's power, their independence facilitates cross-border cooperation based on relatively neutral rules. At least this has been the result of long efforts directed at harmonizing Private International Law rules on cross-border insolvency. In the tension between "territorial" and "universalist" approaches, the move has been decisive, albeit incomplete, towards the latter, with the UNCITRAL Model Law on Cross-Border Insolvency as the first example of "modified universalism",⁹⁷ with the possibility to recognise insolvency proceedings in a foreign country as "main proceedings", balanced with the possibility of "secondary proceedings"⁹⁸ as a means to protect creditors within a country's own territory. Within the EU the Insolvency Regulation,

⁹⁵ See newly proposed Article 59 by the Proposal on BRRD Reform for Loss-Absorbency.

⁹⁶ As a result, the SRB has so far held a policy of not counting third-country debt as MREL-eligible. See SRB MREL: approach taken in 2016 and next steps p. 21.

⁹⁷ Trautman; Westbrook; Gaillard (1993), p. 573; Fincke (2008), p. 43.

⁹⁸ Article 17(1) (recognition) and 17(2)(a) (recognition as main proceeding) and (b) (recognition as foreign non main proceedings) in relation with Article 2(b) (foreign main proceedings) (c) (foreign "non main proceedings") and (f) (definition of "establishment") of the UNCITRAL Model Law.

inspired by the Model Law, preserves this basic scheme,⁹⁹ while the Directive on the Reorganisation and Winding Up of Credit Institutions (Winding Up Directive) goes beyond that, by not contemplating secondary proceedings.¹⁰⁰

Resolution disrupts this consensus, however, from the moment that an administrative authority, which is a clearer expression of a State's power, tries to project that power beyond its natural borders. The international system is simply not prepared for that, and there is no obvious path between the multilateralism of cross-border insolvency rules, and the unilateralism that characterises administrative action. The alternatives are (1) to introduce new rules that establish a new system for the cross-border recognition of resolution action; (2) to introduce new rules that rely on the logic of insolvency rules, while supplementing them; (3) to rely on *ad hoc* cooperative solutions that respect the States' act unilaterally; or (4) to rely on naked unilateral solutions that do not consider the cross-border dimension.

Number (4) is potentially the worst possibility, and, in a context where finance is so interconnected, the one that States wish to avoid, but otherwise remains the default alternative. It depends on the level of trust and integration between States whether the solutions fall closer to (1), (2) or (3). Currently the system is not mature enough to entertain solutions falling under category (1), such as an International Treaty on Cross-Border Resolution.¹⁰¹ Furthermore, even that separate and relatively self-contained system would have to explain the relationship of resolution action and insolvency rules, at least in what regards insolvency priorities, in order to not be bogged down by claims based on fundamental rights.

Within the Union, the countries that have adopted the euro, and other EU countries that choose to become part of the Single Supervisory and Resolution Mechanisms, enjoy a "centralised" resolution system,¹⁰² under the SRM, where relevant decisions are adopted by the SRB.¹⁰³ However, the centralisation of this system is more operational than legal, since the SRB decisions still have to be implemented by National Resolution Authorities (NRAs).¹⁰⁴ Furthermore, with regard to the cross-border recognition of resolution decisions, these are subject to the same regime that is present for all (euro and non-euro) EU Member States under BRRD rules, which provide for the mutual recognition of resolution decisions by the NRA located in one EU country, in every other EU country.¹⁰⁵

The aim of the specific rules is clear, i.e. to ensure quick recognition without exceptions. Thus, the problems may arise less from the contents of those rules than from the reluctance of national authorities or courts to accept that they need to give effect to the decisions of authorities from other countries without asking questions.

⁹⁹ Article 3(2) Regulation 2015/848 on Insolvency Proceedings (EU Insolvency Regulation).

¹⁰⁰ Recital (16) Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the Reorganisation and Winding Up of Credit Institutions (Winding Up Directive).

¹⁰¹ See, e.g. Lipsky (2010).

¹⁰² See the classification in Lehmann (2017), p. 120.

¹⁰³ Article 21 SRM Regulation.

¹⁰⁴ Articles 21(11) and 29 SRM Regulation.

¹⁰⁵ Article 66 BRRD.

There have already been some examples of this in Germany and Great Britain. In Germany the example is the case of *Hypo Alpe Adria*. The case was complex, because it was an Austrian bank that was nationalised, its assets transferred to a special institution, which then was put into resolution, and the decision to impose a moratorium on certain liabilities was adopted via legislation, and not by a resolution authority.¹⁰⁶ With this setting in mind, some creditors in Germany challenged the decision before German courts, which refused recognition to the decision.

The decision on the moratorium itself was arbitrary, as it drew a distinction between different creditors who stood in an equivalent position, without clearly justifying it: indeed, it was invalidated by the Austrian Constitutional Court, which annulled it because it was contrary to the principle of non-discrimination.¹⁰⁷ Having said that, the decision by the German Court did not set a happy precedent for cross-border resolution within the EU. It refused recognition on the basis that the action was outside the scope of the BRRD because (i) the measure was not intended to recapitalise, but to liquidate a bank; and (ii) the measures were adopted by means of a legislative act, rather than through the act of a resolution authority.¹⁰⁸ It is difficult to explain its approach other than as reluctance to enforce foreign resolution decisions, or as an indirect way to reject a decision that was wrong on the substance. In particular, it is hard to see why an act of parliament should be granted “weaker” recognition than an action by resolution authorities.¹⁰⁹

A similar reluctance can be seen in the decision by the English High Court in the *Goldman Sachs v Novo Banco* case.¹¹⁰ This concerned the resolution strategy for Banco Espírito Santo, which consisted in the transfer of the good bits of the bank’s business to a new entity (Novo Banco) leaving much of the bad assets behind. One of the facilities left behind, however, had been subscribed with Oak Finance Corp, and it allegedly resulted in substantial claims in favor of Goldman Sachs. Banco de Portugal, as the administrative authority deciding on the resolution, had been equivocal about which liabilities would be transferred to Novo Banco in its 3 August 2014 decision, where it created Novo Banco, and then clarified, in a 22 December 2014 decision that the Oak Finance facility had not been transferred.

Goldman Sachs decided to test the resolve of resolution authorities, pleading that, since the facility was subject to English law, the High Court should be competent to decide over whether the facility had, or not, been transferred to Novo Banco, as alleged by Goldman Sachs. The decision was not, technically speaking, an outstanding one. The court discussed the regulation on jurisdiction and

¹⁰⁶ [BayernLB v Hypo Alpe Adria](#) (HETA case) Regional Court, Munich I, Judgment of 8 May 2015, BeckRS 2015, 15096.

¹⁰⁷ Austrian Constitutional Court, Decision of 3 July 2015, ECLI:AT:VFGH:2015:G239.2014.

¹⁰⁸ [BayernLB v Hypo Alpe Adria](#) (HETA case) Regional Court, Munich I, Judgment of 8 May 2015, BeckRS 2015, 15096.

¹⁰⁹ See Lehmann (2017), p. 133.

¹¹⁰ [2015] EWHC 2371 (Comm).

recognition,¹¹¹ finding that the agreement fell within its scope. Then, the court considered BRRD provisions, which grant cross-border recognition to resolution action, such as the “transfer of shares, other instruments of ownership, or assets, rights or liabilities” including “liabilities under the law of a Member State other than the State of the resolution authority”.¹¹² The court found that the concept of “transfer” under the BRRD provision did not include the decision “not to transfer” the Goldman Sachs facility,¹¹³ and therefore, this was not subject to recognition.

Anyone familiar with BRRD provisions would be quite surprised to hear that a resolution authority can decide to transfer some assets and liabilities to a bridge bank, and this will be subject to cross-border recognition, but then it cannot classify, qualify or amend its decision, because that falls with the courts of another country. Apparently, the UK Court of Appeal deciding in second instance must have harboured similar concerns, because it revoked the decision of the High Court.¹¹⁴ The Court of Appeal relied on the general principle underpinning Article 3 of the Winding Up Directive (which it referred to as the “Reorganisation Directive”), which establishes that “*measures taken by the authorities of the home Member State are recognised and applied by all other Member States and given the effect they would have under the law of the home Member State*”.¹¹⁵ The court also relied on the Directive, and on the CJEU judgment of *Kotnik* to find that the “reorganisation” measures referred to under the Directive, as subject to mutual recognition should be interpreted broadly, and encompass the measures adopted by resolution authorities.¹¹⁶

The case was granted permission to appeal to the Supreme Court.¹¹⁷ In our view, the decision by the Court of Appeal decision was correct. Still, it would not be just not to acknowledge the weaker spots still present in *Novo Banco*’s case. One is the fact that the succession of the August decision by the December decision betrayed a degree of improvisation that could look arbitrary, and was compounded by a lack of clarity about the nature and legal effects of the sequence. One can argue that, if the BRRD’s intent is to give effect to the decision of resolution authorities as under their own law, that should also include the power to clarify, qualify, or amend, those decisions. However, the authorities did an act that is not expressly contemplated by the BRRD, and, by discussing different grounds, i.e. whether it was a clarification decision, a decision to amend, or a decision to re-transfer, *Novo Banco* and the

¹¹¹ *ibid.*, 75-106. See Regulation No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (often called Brussels I Regulation, and called the ‘Judgments Regulation’ by the High Court in the decision).

¹¹² Article 66 BRRD.

¹¹³ [2015] EWHC 2371 (Comm) at 94-96, 100-103.

¹¹⁴ *Guardians of New Zealand Superannuation Fund & Ors v Novo Banco, S.A.* [2016] EWCA Civ 1092.

¹¹⁵ *ibid.*, 24.

¹¹⁶ The court relied on Case C-526/14, *Kotnik and Others v Državni zbor Republike Slovenije*, ECLI:EU:C:2016:570, where the court held, in paragraph 105, that: “the reorganisation measures taken by the administrative or judicial authorities of the home Member State, that is, the Member State in which a credit institution has been authorised, must have, in all the other Member States, the effects which the law of the home Member State confers on them.” See *Guardians of New Zealand Superannuation Fund & Ors v Novo Banco, S.A.* [2016] EWCA Civ 1092 at 24.

¹¹⁷ [Permission to appeal to the Supreme Court.](#)

courts opened the floor to the kind of semantic discussion where the plaintiffs had more to gain.

A second problem is caused by the fact that the BRRD amended the Winding Up Directive to classify resolution action as “reorganisation measures”, in order to subject them to the system of mutual recognition.¹¹⁸ It would probably be wrong for the courts of the jurisdiction where recognition is sought to second-guess the decision of resolution authorities, or the Directive itself, by deciding whether the specific resolution measures adopted are, or not “reorganisation measures”. However, by using the expedient of classifying resolution measures as reorganisation measures, instead of simply stating that they will be subject to the same recognition as, the EU legislature has opened the door to a conceptual discussion that may delay critical decisions.¹¹⁹

These decisions show that trust between courts and authorities of different countries needs to be strengthened, perhaps by increasing the channels of communication between the authorities adopting and the authorities enforcing the decisions. They also show that, in a scenario where everyone is looking, resolution authorities should try to improvise less, and clarify more the grounds on which they adopt their decisions. Transparency should be a priority if decisions on loss-allocation are to be smoothly enforced across borders.

This brings us to the context outside the EU, where there are no clear legal grounds on which resolution authorities may rely to enforce bail-in measures. The greatest step forward towards mutual recognition has been the adoption of the UNCITRAL Model Law on Cross-Border Insolvency by a large number of countries.¹²⁰ The domestic provisions that have implemented the Model Law have already resulted in an extensive body of case law, where foreign proceedings have been recognised as “main proceedings” or “secondary proceedings”, for financial companies,¹²¹ and even banks.¹²²

¹¹⁸ Article 2 (*Definitions*) of the Winding Up Directive states that: “‘reorganisation measures’ shall mean measures which are intended to preserve or restore the financial situation of a credit institution or an investment firm as defined in Article 4(1), point (2) of Regulation (EU) No 575/2013 and which could affect third parties” pre-existing rights, including measures involving the possibility of a suspension of payments, suspension of enforcement measures or reduction of claims; those measures include the application of the resolution tools and the exercise of resolution powers provided for in Directive 2014/59/EU.”

¹¹⁹ The Court of Appeal did not help in this case, by extensively discussing this point, and acknowledging that its decision was founded on a “broad” interpretation of the concept of “reorganisation measures”. See *Guardians of New Zealand Superannuation Fund & Ors v Novo Banco, S.A.* [2016] EWCA Civ 1092 at 24-25. This may provide the perfect excuse for a Supreme Court finding that a “narrower” interpretation is preferred. Both approaches would probably miss the point, if we consider that the idea of Article 2 is not to provide a functional characterisation of resolution actions, but rather to ensure that they benefit from the system of mutual recognition under the Directive, to the extent that BRRD rules do not provide a more specific solution.

¹²⁰ See [UNCITRAL Model Law on Cross-Border Insolvency](#).

¹²¹ *Ackers v Saad Investments Company Limited (in official liquidation)* [2010] FCA 1221; *In re: Gerova Financial Group, Ltd.*, 482 B.R. 86 (Bankr. S.D.N.Y. 2012).

¹²² *In re The International Banking Corporation B.S.C.* 439 B.R. 614 (SDNY 2012); *Re JSC BTA Bank No 10-10638 (JMP)* (Bankr. SDNY 23 August 2010).

Still, it is far from clear that resolution action can be subject to the Model Law system, and some voices suggest the opposite.¹²³ The Model Law adopts a conceptual approach, where only “insolvency proceedings” are subject to recognition,¹²⁴ and these only fit the definition in case the debtors’ affairs are “subject to control or supervision by a foreign court”.¹²⁵ The rules provide no alternative route for procedures that are administered by independent administrative authorities.

If resolution action falls outside the scope of the UNCITRAL Model Law there is no clarity about the grounds on which recognition could be sought. Given the complexity of the multiple combinations, we will discuss some scenarios based on US law. If, say, a resolution authority in the EU decides on a transfer of assets to a bridge bank, which shall not be available for the claims of the creditors of the entity in resolution, including creditors in the United States, US laws are conceived to protect domestic depositors.¹²⁶ There would be no clear legal channels to grant recognition to the action of the EU authority.¹²⁷ One alternative in that case would be to put the entity into insolvency proceedings, to secure that recognition, but then the insolvency court would lack the tools and expertise to adopt an adequate decision in an adequate amount of time.

In light of this, it is important to consider how far resolution authorities inside the EU could take unilateral action when that impacts liabilities subject to third-country laws. An intriguing reference is contained under Article 66 BRRD, which grants recognition to decisions over the transfer of assets and liabilities (Article 66 (2) and (3) BRRD) and to bail-in decisions (Article 66 (4) BRRD). This, according to the provision, means that when the resolution authority of Member State A, adopts a bail-in decision, Member State B needs to ensure that the amounts of the instruments or liabilities are duly reduced or converted as indicated in the decision not only when the instruments or liabilities are governed by the laws of Member State B,¹²⁸ but also when the liabilities are owed to creditors “located in Member State B”.¹²⁹

What exactly is the meaning of that provision? It is logical to interpret that, if, say, a bank in Spain has issued Tier-3 liabilities subject to, say, French law, the rules require French resolution authorities to cooperate in the enforcement of a bail-in decision adopted by the Spanish resolution authority. If some of those liabilities are held by, say, residents in Italy, the provision can be interpreted to mean that not only French authorities need to ensure that the debts are duly reduced or written-down, Italian authorities cannot raise any challenges to the implementation of that decision. However, the provision’s unqualified requirement can be taken to mean that if, say, the liabilities issued by the Spanish bank are subject to New York law, and some of

¹²³ Lee (2014), p. 297. See also Gleeson (2015), p. 118.

¹²⁴ Articles 2 and 17 UNCITRAL Model Law.

¹²⁵ Article 2(a) UNCITRAL Model Law.

¹²⁶ This happens under the conservatorship or receivership provisions of the Federal Deposit Insurance Act (FDIA). See Lee (2014), p. 298.

¹²⁷ The possibility to appoint a conservator, instead of a receiver, would allow more operational flexibility to recognise the actions of foreign authorities, since a conservator is not invested with the title to the assets. See Lee (2014), p. 300.

¹²⁸ Article 66(4)(a) BRRD.

¹²⁹ Article 66(4)(b) BRRD.

the liabilities are held by French or Italian residents, US authorities and courts do not have to grant recognition under Article 66 BRRD, but French and Italian authorities are, and, in our example, they would in theory be obliged to reduce the amounts of the debt issued by the Spanish bank vis-à-vis the creditors located within their respective jurisdictions. This would result in both a breach of international commitments, in this case towards the United States, and of the non-discrimination principle, which would require treating bondholders resident in France or Italy in the same way as holders of the same bonds are treated in other jurisdictions.

One possibility could be to interpret the provision as including a qualification whereby the duty of State B to grant recognition applies “provided that this is not contrary to the laws of the country that governs the instruments or liabilities”. However, there is no express basis for such teleological reduction. These interpretative difficulties¹³⁰ can cast a shadow of doubt over the actual scope of application of the recognition of bail-in decisions, and cause frictions upon implementation.

Thus, another possibility would be to exercise the bail-in tool without putting the entity in resolution.¹³¹ Then, the bail-in decision might be achieved, and even enforced in the United States, without triggering a receivership procedure, and EU authorities could rely on US authorities’ forbearance in deciding whether to start, or not, the proceeding.¹³² However, under the current legal framework, while the proposed amendments to BRRD are adopted, it is only possible to bail-in equity capital, and not debt, without putting the entity in resolution.¹³³ If a decision to bail-in debt is adopted within a resolution procedure, US authorities may find it more difficult to exercise their discretion to *not* resort to the US procedure.

A third possibility would be to rely on the mechanisms for international cooperation set forth in Articles 93 and following of BRRD. These include the possibility of agreements with third countries (Article 93), the recognition and enforcement of third-country resolution proceedings (Article 94), and the cooperation with third-country resolution authorities (Article 97, including the exchange of confidential information). However, no agreements with third countries have been concluded, to provide a firmer legal basis for recognition. Article 94 is a good addition, by providing a sound legal basis for the unilateral recognition by Member States’ resolution authorities or the SRB of resolution action in third countries, but the provision must be read together with the caveats under Article 95, which regulates the *right to refuse recognition of third-country resolution proceedings*, including causes such as “adverse effects on financial stability”,¹³⁴ or “material fiscal implications”,¹³⁵ the need of “independent resolution action” to achieve resolution objectives,¹³⁶ the discriminatory treatment of EU depositors vis-à-vis the third-country depositors,¹³⁷ or

¹³⁰ See Lehmann (2017) for an excellent discussion of the issues.

¹³¹ Article 59 BRRD.

¹³² Lee (2014), p. 301. This would mean relying on US authorities’ forbearance.

¹³³ Article 59(1) BRRD.

¹³⁴ Article 95(a) BRRD.

¹³⁵ Article 95(d) BRRD.

¹³⁶ Article 95(b) BRRD.

¹³⁷ Article 95(c) BRRD.

the fact that the recognition or enforcement would be contrary to national law.¹³⁸ In light of the breadth of these clauses, it is not possible to anticipate how resolution authorities in the EU will react to the actions of authorities in third countries, and even less whether authorities in third countries will reciprocate.

A fourth possibility also envisaged in BRRD provisions is to require entities subject to EU resolution rules to issue their debt, even their debt subject to the laws of third countries, subject to clauses that provide for the contractual recognition of bail-in.¹³⁹ The requirement was developed by EBA Regulatory Technical Standards (RTS),¹⁴⁰ which were implemented through a Commission Delegated Regulation.¹⁴¹ The market has responded by developing some standard documentation. This includes the International Swap Deals Association (ISDA) Protocols,¹⁴² which have been adhered to by major institutions,¹⁴³ and add to the organisation's major efforts to help financial entities comply with resolution action, which began with the ISDA resolution stay protocol.¹⁴⁴ It also includes the model clauses by the Loan Market Association (LMA),¹⁴⁵ or the Association for Financial Markets in Europe (AFME).¹⁴⁶ Still, important concerns remain, since introducing a clause for the contractual recognition of bail-in may be impossible or extremely difficult in some cases, which led the UK Prudential Regulation Authority (PRA) to issue an "impracticability" supervisory statement.¹⁴⁷ This included a duty for the entities to make an assessment of the instances where it would not be practicable to include a clause for recognition of bail-in, which include cases where it is illegal to introduce such term, cases where the entity has been notified by the authorities of the third country that it will not allow such introduction, or cases where the liabilities are governed by protocols, or standard terms imposed by virtue of the entity's membership to an organisation,

¹³⁸ Article 95(e) BRRD.

¹³⁹ Article 55(1) BRRD provides that: "Member States shall require institutions and entities referred to in points (b), (c) and (d) of Article 1(1) to include a contractual term by which the creditor or party to the agreement creating the liability recognises that liability may be subject to the write-down and conversion powers and agrees to be bound by any reduction of the principal or outstanding amount due, conversion or cancellation that is effected by the exercise of those powers by a resolution authority, provided that such liability is: (a) not excluded under Article 44(2); (b) not a deposit referred to in point (a) of Article 108; (c) governed by the law of a third country; and (d) issued or entered into after the date on which a Member State applies the provisions adopted in order to transpose this Section".

¹⁴⁰ EBA Draft Regulatory Technical Standards on the contractual recognition of write-down and conversion powers under Article 55(3) of Directive 2014/59/EU. EBA/RTS/2015/06, 3 July 2015.

¹⁴¹ Articles 42-44 of the Commission Delegated Regulation 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges.

¹⁴² [ISDA 2016 Bail-In Article 55 Protocol](#) (Dutch/ French/ German/ Irish/ Italian/ Luxembourg/ Spanish/ UK entity-in-resolution version). This was supplemented by the more recent [ISDA 2017 Bail-in Article 55 BRRD Protocol](#) (Austrian/Belgian/Danish/Swedish entity-in-resolution version).

¹⁴³ See, e.g. the [list of parties adhering to the 2016 Protocol](#).

¹⁴⁴ See [ISDA 2015 Resolution Stay Protocol](#).

¹⁴⁵ [Model clauses by the Loan Market Association](#).

¹⁴⁶ AFME Model clauses for the contractual recognition of bail-in under Article 55 BRRD, 1 August 2016.

¹⁴⁷ PRA, *The contractual recognition of bail-in: impracticability*, Supervisory Statement SS7/16, June 2016.

which the entity has no ability to amend.¹⁴⁸ Furthermore, even in cases where there has been no formal notification, there remains the uncertainty about whether the contents of the clause will be enforced under the laws of a third country, i.e. whether judicial or other authorities will accept giving effect to the decision of an administrative authority of another country.

This leaves a final possibility, which would consist in combining the mechanisms under Article 93 and following (agreements with third countries) with those under Article 87 and following (cross-border group resolution) in a way that achieves more inclusive resolution colleges. Membership rules would only need a slight amendment,¹⁴⁹ since third country resolution authorities can already participate in EU resolution colleges as observers.¹⁵⁰ If the law or practice recognises third-country resolution authorities the same status of EU resolution authorities, including for purposes of information exchange,¹⁵¹ and they are part of the multilateral decision-making process over resolution measures, it may be easier for them to put exercise their resolution powers in support of those decisions.

This type of “procedure based” solution may simplify the picture, which looks too complicated if we insist solely upon “rules based” solutions. The system of the UNCITRAL Model Law on Cross-Border Insolvency has been a rare achievement, and one that is based on courts’ independence and ability to cooperate across borders. Extrapolating the logic to a system based on the projection of powers by administrative authorities may be a non-starter for reasons of sovereignty, but also of lack of trust. If, on the other hand, resolution-based procedures are inclusive, it would be easier to then rely on their individual resolution powers in support of group-level resolution measures, because they will not be exercising their powers to recognise or enforce foreign resolution measures. Rather, they will be unilaterally exercising those powers to enforce “their own” decision, only this will be adopted in a cross-border, multilateral forum.

The difficulty for this type of solution, based on the ability to overcome resolution authorities’ reluctance to put their individual powers at the service of multi-party decisions, may come from the ability of third parties to challenge those decisions under their domestic law. If, say, United States holders of bonds, feel unduly aggrieved by a decision on bail-in to be enforced across borders, they could allege that the group’s assets in the United States are sufficient to satisfy their liabilities, and that, by enforcing bail-in equally for EU and US holders, US authorities are not giving adequate protection to their rights. The answer would depend on how far US

¹⁴⁸ *ibid.* p. 3. This could include, e.g. letters of credit governed by the Uniform Customs and Practices UCP-600.

¹⁴⁹ Article 88(2) BRRD.

¹⁵⁰ Article 88(3) BRRD. Also, European resolution colleges, envisaged under Article 89 for cases where a non-EU parent company has subsidiaries and/or significant branches in different EU countries can be waived if other groups or colleges under Article 88 “*perform the same functions and carry out the same tasks specified in this Article and comply with all the conditions and procedures, including those covering membership and participation in European resolution colleges, established in this Article and in Article 90*”. Presumably, this should encompass the colleges including authorities from third countries.

¹⁵¹ Article 90 covers this matter between resolution authorities, with express reference to third-country resolution authorities under paragraphs (2) and (3).

courts would be ready to protect the discretion of their resolution authorities, when this discretion may be exercised in a way that benefits investors in other countries (EU countries in this case), considering that the purpose and finality of US rules is to protect US depositors and investors.

4 Conclusions

The subject addressed here is too complex and uncertain to try to provide comprehensive solutions. Yet across the exercise of analysis, comparison, and discussion of hypothetical scenarios some clear patterns emerge, which will be summarised here.

First, resolution rules and insolvency law can be partially aligned, because they share some common goals, e.g. protection and fair treatment of creditors. However, full alignment is not possible from the moment that, while those goals constitute the basic fabric underpinning insolvency law, in resolution, they constitute more the countervailing weight to avoid excesses by resolution authorities, which are guided by goals that pursue more public interest goals, such as macro stability, minimisation of taxpayer loss, or the imposition of market discipline. In the field that may give rise to greater friction, i.e. the interaction between bail-in and insolvency ranking, resolution rules try to accommodate insolvency law formally, while, in reality, they provide a long list of exclusions from bail-in, which in practice replace insolvency's "up-or-down" ranking, with an "exclusion-based", or "in-or-out" system. The concepts underpinning that list, however, are bound to leave gaps, and, given that the complexity of banks' funding makes it impossible to anticipate all possible scenarios, it is unclear whether those gaps should be filled with insolvency or resolution principles. That constitutes the main source of trouble at an interpretative level.

Second, as some of the hypothetical scenarios discussed here illustrate, the gaps left by the exclusions from bail-in under resolution rules, plus the peculiarities of some insolvency laws, most notably the subordination provisions for intra-group debt, can wreak havoc, at worst, or cause much uncertainty, at best, over the relative status of liabilities that may be needed to shore up a bank's operations, and enhance its clients' and counterparties' trust on its ability to carry on. Thus, it is not surprising that resolution rules have not only sought to set aside insolvency ranking and priorities under insolvency laws, but also to carve out operational liabilities, by identifying a specific layer of TLAC/MREL debt destined to absorb losses.

In third place, the attempt to sidestep the issue by requiring a layer of debt that renders moot the discussion over "priorities" or "exclusions", has exposed the tension between diversity and efficiency. If the major goal is to enhance certainty, by creating a loss-absorbing layer of debt, this can only work if such layer of debt is easily recognisable in the market, which is not possible if different countries adopt different strategies to comply with TLAC/MREL requirements. Likewise, group structures need to ensure that losses can be up-streamed from subsidiary to parent, which must then apply bail-in over its "external" liabilities, which may be rendered difficult by excessively complex group structures. Yet at the same time, efficiency is

fostered by innovation, and this may be stiffened if banks must rely on a uniform group structure (to facilitate a Single-Point-of-Entry (SPoE) strategy) and a uniform structure for their liabilities. Furthermore, “resolvability” may be used as an excuse by resolution and supervisory authorities to ring-fence assets in their own jurisdiction, and hinder capital flows.

In fourth place, these harmonisation efforts are undertaken under the assumption that they should facilitate the adoption of resolution measures. However, one of the major obstacles for such measures, i.e. their recognition on a cross-border basis, has less to do with the uniformity of debt or group structures, and more with the existence, or absence, of an adequate framework for such recognition. In this regard, all the advantages of a specific system, like resolution, governed by special rules and authorities, turn into disadvantages when we consider it on a cross-border basis, because all the benefits of the cross-border recognition of insolvency proceedings are lost the moment the special proceeding lacks enough court supervision, and may be seen with mistrust by other resolution authorities. This gap can be, and has been, filled in an intra-EU setting with special rules that strengthen recognition, but even there mistrust still pervades some judicial decisions, where the principles underpinning resolution rules leave their place to formal textualism. Moving outside the EU we can only expect open territorialism to be the default setting, absent an unlikely application of cross-border insolvency regimes as background principles. Bridging the gap requires enlisting market efforts, with standardised clauses for the contractual recognition of bail-in, but also governance, or procedural efforts, whereby decision-making structures, like resolution colleges, are adapted to the reality of the structures of banking groups.

Churchill said, when referring to Russia, that “it is a riddle wrapped in a mystery, inside an enigma; but perhaps there is a key. That key is [...] national interest”. In a very different context, this analysis has shown that, when it comes to the interaction between bank resolution and insolvency priorities, the extraordinary complexity of the problem, even when we break it down in layers, make it impossible to anticipate what the future will bring. However, complexity, at least excessive complexity, can, and does, become the refuge of naked national interest. Thus, clarifying the problem scenarios, the possible avenues forward, and the governance mechanisms that can enhance trust in the actions of resolution authorities across the border, should be the priority of academic lawyers discussing the topic. Only then, may authorities and courts realise that, in this context, the international interest is the best chance to further the national interest.

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Legal challenges of bail-in

By Seraina Grünewald¹

1 History and rationale of bail-in

The history of bail-in is short but eventful. In a 2010 article in *The Economist*,² Credit Suisse investment bankers Callelo and Ervin set out a powerful third option to the preceding government bail-outs on the one hand and systemic financial collapse (Lehman) on the other: a forced recapitalisation of failing banks from within. The authors referred to their proposed mechanism as “bail-in”. They argued that authorities should “be given the legal authority to dictate the terms of recapitalisation, subject to an agreed framework.” Based on this authority, failing banks would be restructured in a speedy, regulator-imposed process, using private capital instead of public money.

The Financial Stability Board (FSB) took the idea up, and bail-in became a core element of its Key Attributes of Effective Resolution Regimes for Financial Institutions.³ The international standard recommends that resolution authorities be given statutory powers to write down equity and uninsured/unsecured creditor claims and/or convert into equity uninsured/unsecured creditor claims to the extent necessary to absorb the bank’s losses. Likewise, bail-in became the “innovative centrepiece”⁴ of the European Union’s new resolution framework. The Bank Recovery and Resolution Directive (BRRD)⁵ and Regulation on the Single Resolution Mechanism (SRMR)⁶ are based on the notion that the costs of a banking crisis must be first and primarily borne by shareholders and creditors and, in certain circumstances, the banking system as a whole.⁷ The shift towards privately-funded bank resolution not only followed the international trend, it also became an actual

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² Callelo and Ervin (2010).

³ FSB (2014), paras. 3.5 and 3.6. The original version of the FSB’s Key Attributes dates of 2011.

⁴ Wojcik (2016), p. 95.

⁵ 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, p. 190).

⁶ 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).

⁷ The protection of public funds became one objective of the BRRD/SRMR (Article 31(2)(c) BRRD, Article 14(2)(c) SRMR).

“game changer”⁸ in the negotiations on banking union, as it alleviated Member States’ fears of heightened fiscal transfers.

Notwithstanding its steep rise, bail-in remains among the most contested elements of new resolution frameworks and the debate on the scope and reasonability of its application continues, both in the Union and internationally. The concerns are at least partially rooted in the intrusive nature of bail-in. In resolution, authorities determine when which creditor must bear which amount of a bank’s losses. They do so based on the principles and objective elements set out in the law, but often with a large interpretative latitude and margin of discretion. As case law and established practices have yet to develop, the resulting challenges are manifold – some clearly legal, some of a more political nature.

This contribution discusses two key legal safeguards of the BRRD that are designed to avoid violations of shareholders’ and creditors’ right to property by bail-in and to guarantee a fair and consistent outcome. The analysis takes up some of the challenges highlighted by recent cases of bank failures involving bail-in in one way or another. It proceeds as follows: Paragraph 2 outlines that bail-in comes in two manifestations: bail-in under the resolution framework of the BRRD/SRMR and burden-sharing under State aid approval proceedings. Paragraph 3 discusses the key features of bail-in that distinguish it from insolvency proceedings and render it a practice that interferes with the right to property as enshrined in the Charter of Fundamental Rights (CFR)⁹ and the European Convention on Human Rights (ECHR). The legal challenges associated with the public interest test and “no-creditor-worse-off-than-under-normal-insolvency-proceedings” (NCWO) test of the BRRD are explored in Paragraphs 4 and 5. Paragraph 6 concludes.

2 Bail-in (resolution) and burden-sharing (State aid)

Bail-in as a means to limit public financial support to failing banks was not a novelty introduced by the BRRD. Prior to the adoption of the BRRD, the Commission had acted as the *de facto* Union resolution authority and applied a functionally equivalent practice – referred to as “burden-sharing” – in its State aid approval proceedings. According to its 2013 Banking Communication,¹⁰ the Commission requested, in principle, that losses be first absorbed by equity holders, hybrid capital holders and subordinated debt holders before it would approve the grant of any State aid.¹¹ However, it explicitly excluded from the burden-sharing requirement any mandatory contributions by *senior* debt holders.¹²

The treatment of senior creditors has remained the crucial discrepancy between burden-sharing under the State aid regime on the one hand and bail-in in resolution

⁸ Quaglia and Spendzharova (2017), p. 13.

⁹ OJ C 364, 18.12.2000, p. 1.

¹⁰ Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis (OJ C 216, 30.7.2013, p. 1).

¹¹ See 2013 Banking Communication, paras. 40-46.

¹² See 2013 Banking Communication, para. 42.

as introduced by the BRRD on the other. With the adoption of the BRRD, bail-in became a resolution tool, i.e. a technique applied by resolution authorities – either on a stand-alone basis or in combination with other resolution tools – to resolve a failing bank.¹³ As such, it is defined as “the mechanism for effecting the exercise by a resolution authority of the write-down and conversion powers in relation to liabilities of an institution under resolution (...).”¹⁴ Bail-in is, however, much more than that. It continues to serve as a precondition to any form of official financial support, effectively determining how the burden is to be distributed between the private and official sectors.¹⁵ The BRRD/SRMR go beyond the burden-sharing requirement imposed by the 2013 Banking Communication. They provide for a mandatory preliminary bail-in of at least 8% of total liabilities before resolution financing arrangements or any other source of official financing can be tapped to cover further losses.¹⁶ No such absolute bail-in rule exists under the State aid framework. Bail-in and burden-sharing are thus functional equivalents but differ in terms of their scope of application.¹⁷

The interrelation of the State aid and BRRD/SRMR frameworks is not entirely settled.¹⁸ As a rule, the use of State aid now triggers resolution and the (stricter) bail-in requirement will typically supersede the burden-sharing requirement associated with the grant of State aid.¹⁹ However, the burden-sharing requirement still takes exclusive effect if a bank is instead liquidated in normal (national) insolvency proceedings (liquidation aid)²⁰ or if the BRRD exception of a “precautionary recapitalisation” applies.²¹

¹³ Articles 43-55 BRRD, Article 27 SRMR.

¹⁴ Article 2(1)(57) BRRD, Article 3(1)(33) SRMR.

¹⁵ See Grünewald (2014), pp. 52-60, distinguishing three levels of burden-sharing: (i) among private creditors; (ii) between private creditors and official sources; and (iii) among Member States. Gardella (2015b) distinguishes a vertical and a horizontal dimension of burden-sharing.

¹⁶ Article 37(10)(a) and Article 44(5)(a) BRRD, Article 27(7)(a) SRMR.

¹⁷ Merler (2017) and (2016) suggests that the precautionary recapitalisation of Monte dei Paschi di Siena (MPS) and the “compulsory administrative liquidation” of Veneto Banca and Banca Popolare di Vicenza (BPVI) were at least partially motivated by authorities’ desire to avoid a bail-in of retail senior bondholders.

¹⁸ For an excellent overview see Gardella (2015a), paras. 11.04-11.21.

¹⁹ A bank is, in principle, deemed “failing or likely to fail” if it requires extraordinary public financial support (Article 32(4)(d) BRRD, Article 18(4)(d) SRMR). Moreover, the Commission must approve the grant of any State aid in the course of a resolution proceeding (see, in particular, Article 34(3) BRRD) and resolution authorities must ensure compatibility with the requirements of the State aid framework (see Article 52(1) and (3) BRRD regarding the business reorganisation plan).

²⁰ As was illustrated by the case of the two Venetian banks Veneto Banca and BPVI. According to the Commission’s press release (the public version of the decision was not yet available at the time of writing), shareholders and subordinated creditors fully contributed before liquidation aid in the amount of almost EUR 17 billion was authorised (see European Commission, “State aid: Commission approves aid for market exit of Banca Popolare di Vicenza and Veneto Banca under Italian insolvency law, involving sale of some parts to Intesa Sanpaolo”, 25 June 2017, IP/17/1791).

²¹ Article 32(4)(d)(iii) BRRD, Article 18(4)(d)(iii) SRMR. On 4 July 2017, the Commission authorised the precautionary recapitalisation of MPS. According to the Commission’s press release (the public version of the decision was not yet available at the time of writing), MPS’s shareholders and subordinated creditors contributed EUR 4.3 billion to the bank’s recapitalisation in consequence of the burden-sharing requirement (see European Commission, “State aid: Commission authorises precautionary recapitalisation of Italian bank Monte dei Paschi di Siena”, 4 July 2017, IP/17/1905).

3 How bail-in differs from insolvency and interferes with the right to property

In principle, bail-in is meant to mirror loss absorption in insolvency.²² Nevertheless, it differs from insolvency in several crucial ways.

3.1 “Failing or likely to fail”: bail-in as a pre-insolvency intervention

The BRRD supersedes the concept of insolvency by what it refers to as “failing or likely to fail” (FOLTF). It is the supervisor (and/or the resolution authority²³) that determines, in an administrative proceeding, whether a bank meets the FOLTF condition.²⁴ The BRRD remains rather unspecific regarding the determinants of FOLTF. Article 32(4) BRRD identifies four FOLTF scenarios, which may apply cumulatively or alternatively: (i) the bank infringes or is about to infringe requirements of authorisation to an extent that would justify its withdrawal, including due to a significant capital shortfall; (ii) the bank is or is about to become balance-sheet insolvent; (iii) the bank is or is about to become cash-flow insolvent; and (iv) the bank requires extraordinary public financial support, with a few exceptions. The open wording of Article 32(4) BRRD will make it difficult in practice to identify the point of (the assumed) non-viability. It reflects, however, the intention to enable the authorities to intervene early enough,²⁵ i.e. *before* actual insolvency. The more likely insolvency becomes, the more of a bank’s value may be destroyed irrecoverably, but the less intrusive is an ensuing bail-in regarding shareholders’ and creditors’ right to property. The question is thus: When is “likely to fail” *likely enough*?

Against this background, FOLTF is nothing less than the extrapolation of a bank’s *future* insolvency beyond reasonable doubt. This extrapolation remains largely an expert judgment, based on the outcomes of the supervisory review and evaluation process (SREP). The expert judgment is, however, guided by a number of “objective elements” set out in the EBA’s guidelines on the interpretation of FOLTF.²⁶ Because FOLTF determines the “likely” insolvency or the insolvency “in the near future”, many of these objective elements are naturally forward-looking and presumptive themselves.²⁷

As a consequence, it is no longer insolvency banks are afraid of under the BRRD/SRMR regime. The new reference point for failure is failing an ECB (or other relevant) stress test. If a bank is fine under the baseline scenario, but fails the

²² See Article 48 BRRD, Article 17 SRMR.

²³ Article 32(2) BRRD allows Member States to empower the resolution authority, under certain circumstances, to carry out the FOLTF assessment in addition to or instead of the supervisor.

²⁴ In accordance with Article 81(1) BRRD, the management body of a bank must notify the competent authority if it considers the FOLTF condition to be met.

²⁵ See also Freudenthaler and Lintner (2017), p. 106.

²⁶ European Banking Authority, Guidelines on the interpretation of different circumstances when an institution shall be considered as failing or likely to fail under Article 32(6) of Directive 2014/59/EU, 26 May 2015, EBA/GL/2015/07.

²⁷ The same is true for the SREP process more generally, which is designed to monitor and assess risks in a forward-looking manner.

adverse scenario, it qualifies for “precautionary recapitalisation”. If the bank fails the baseline scenario, this is a strong indicator for the supervisor to declare a bank as FOLTF. At this point, however, insolvency has not necessarily occurred. It is a point determined by authorities according to their best judgement, on which the design of the underlying stress test has a large influence.²⁸

3.2 Bail-in as a valuation-based intervention

A second difference between bail-in and insolvency consists in the fact that loss absorption in resolution is based on valuation rather than actual liquidation. The valuation of a bank’s assets and liabilities plays a key role in all different stages of the resolution process.²⁹ At the request of the supervisory or resolution authority, an independent valuer undertakes mandatory valuations *ex ante* resolution (valuation 1), at the point of resolution (valuation 2) and *ex post* resolution (valuation 3).³⁰

- Valuation 1 is aimed at supporting the supervisor’s determination as to whether a bank is FOLTF and should be put under resolution.³¹ This initial valuation essentially consists of an updated accounting valuation with regulatory adjustments, as used for ongoing supervision.
- More important regarding loss absorption are valuations 2 and 3: Valuation 2 informs the choice of resolution strategy, including the extent of bail-in. Valuation 3 then provides an estimate on the losses under hypothetical liquidation as the counterfactual benchmark under the NCWO test.³²

Unlike the realisation of assets in a liquidation, valuation is an estimate, not a fact. Eventually, there will be a factual outcome of every resolution proceeding, but authorities can apply bail-in only based on an estimate of that outcome at the point resolution is triggered. Other crucial parameters remain hypothetical to the very end, such as what the outcome of an insolvency proceeding would have been (valuation 3). In contrast to facts, valuations are necessarily subjective. It will be difficult to find two, let alone several, independent valuers coming to the exact same conclusions as to the estimated extent of losses under a (going-concern) resolution and a hypothetical (gone-concern) insolvency scenario. The subjective nature of the valuations is amplified by their dependency on macroeconomic assumptions and, over time, changing market conditions.³³

²⁸ See Philippon and Salord (2017), p. 43.

²⁹ The valuation is not subject to a separate right of appeal, but may be appealed together with the resolution decision itself (Article 36(13) BRRD, Article 20(15) SRMR).

³⁰ On valuation in resolution see Huber (2017), pp. 92-98.

³¹ For FOLTF see 3.1 above.

³² For the NCWO test and more details on the corresponding ex-post valuation (valuation 3) see 5.2.1 below.

³³ Hadjiemmanuil (2015), p. 245.

In *Kotnik and others*,³⁴ a preliminary ruling on the constitutionality of the Commission's 2013 Banking Communication, the Court of Justice of the European Union (CJEU) did not raise explicit concerns over the writing-down of shares and subordinated debt based on valuation rather than actual liquidation as a consequence of the Commission's burden-sharing requirement. It did, however, assume that the alternative to such valuation-based burden-sharing would be an insolvency proceeding.³⁵ This brings us right back to the difficulties associated with FOLTF, mentioned above. If the threat of insolvency is indeed beyond reasonable doubt, which FOLTF is meant to establish, there seems to be no *per se* concern about the fact that valuation drives bail-in action. Importantly, however, this does not preclude that *specific* valuation-based bail-in measures may infringe upon the right to property of individual investors/creditors.

3.3 Exemptions from bail-in in the public interest

A third important difference between bail-in and insolvency relates to their scope and the possibilities for exempting from their application certain (types of) creditors. The BRRD/SRMR provide for several statutory exemptions from the application of bail-in in resolution, which may violate the creditor ranking applicable in national insolvency proceedings. They include covered deposits, inter-bank loans, liabilities to payment and settlement systems as well as liabilities to employees, crucial commercial/trade creditors and tax/social security authorities.³⁶ More controversial is the empowerment of resolution authorities to exempt or partially exempt certain liabilities from bail-in on a discretionary basis.³⁷ While these case-by-case exemptions are confined to "exceptional circumstances" and must be "strictly necessary and proportionate" for the bank to continue critical functions and to avoid widespread contagion,³⁸ the resolution authority's discretion remains substantial. The required public interest largely coincides with the resolution objectives,³⁹ but is naturally subject to the appreciation of the resolution authority.⁴⁰

Exempting certain creditors from loss absorption logically increases the burden for the non-exempted creditors and/or the wider public. The BRRD/SRMR stipulate that if exemptions are applied, the level of bail-in of other liabilities may be increased to compensate for such exemptions, as long as the NCWO principle⁴¹ remains

³⁴ Case C-526/14, *Kotnik and others*, ECLI:EU:C:2016:570.

³⁵ Case C-526/14, *Kotnik and others*, para. 78 ("insolvency proceedings that followed such aid not being granted.").

³⁶ Article 44(2) BRRD, Article 27(3) SRMR.

³⁷ Article 44(3) BRRD, Article 27(5) SRMR.

³⁸ Article 44(3)(b) and (c) BRRD, Article 27(5)(b) and (c) SRMR.

³⁹ See Article 31(2)(a) and (b) BRRD, Article 14(2) SRMR (continuity of critical functions and maintaining financial stability).

⁴⁰ For the public interest test see 4 below. When exercising their discretion, authorities must also "give due consideration" to the ranking of claims in insolvency, the remaining loss-absorbing capacity of the bank and the need to secure adequate resources for resolution financing (Article 44(9) BRRD, Article 27(12) SRMR).

⁴¹ See Article 34(1)(g) BRRD and Article 15(1)(g) SRMR.

respected.⁴² According to that principle, the absolute limit of loss absorption is set at the amount that a creditor would have received had the bank undergone a normal insolvency proceeding.⁴³ That is, a non-exempted creditor may take a larger hit than if no creditors had been exempted from bail-in, but a smaller (or equal) hit than (as) under a hypothetical insolvency scenario.

Subject to certain conditions, the resolution framework thus allows for a differentiated treatment of creditors in violation of the *pari passu* principle and potentially creditor ranking applicable in insolvency. Previous cases show that it is often the differentiated application of bail-in (or loss absorption more generally) to creditors that gives rise to litigation.⁴⁴ Applicants may claim that the differentiated treatment was in fact based on illegitimate grounds and that a normal insolvency proceeding would have avoided such discrimination.

3.4 Bail-in as an interference with the right to property and its (potential) justification

The combination of the three characteristics mentioned above – bail-in as a pre-insolvency intervention, based on valuation and allowing for the preferential treatment of certain creditors to the detriment of others – render bail-in a practice that interferes with the fundamental right to property as protected by Article 17(1) CFR and Article 1 of the Protocol to the ECHR.⁴⁵

While left open by the CJEU and the European Court of Human Rights (ECtHR), any kind of bail-in measure – be it the writing-down or conversion of debt, be it the cancellation or severe dilution of shares – will qualify as a deprivation of possessions under the relevant provisions.⁴⁶ Bail-in measures must thus observe the highest standards regarding justification and compensation.

Three conditions must be met for a deprivation of possessions to be justified:⁴⁷

⁴² Article 44(3), last paragraph, BRRD, Article 27(5), last paragraph, SRMR.

⁴³ For the challenges in relation to the NCWO test see 5 below.

⁴⁴ Non-discrimination was, for example, invoked by Dutch and U.K. claimants in the Icelandic banking crisis. See Judgment of the EFTA Court, Case E-16/11, *EFTA Surveillance Authority and Commission v Iceland*, 28 January 2013. In its *HETA* ruling (VfGH 3.7.2015, G 239/2015 ua), the Austrian Constitutional Court found that the differentiated treatment of creditors within the class of subordinated creditors based on the cut-off date of their claims constituted a violation of the right to property (see Raschauer (2016) pp. 15-17). On the case of *Banco Espírito Santo/Novo Banco* (re-transfer of liabilities related to non-subordinated bonds intended for institutional investors in the amount of approximately EUR 2 billion) see *Goldman Sachs v Novo Banco* [2015] EWHC 2371 (Comm); *Guardians of New Zealand Superannuation Fund & Ors v Novo Banco SA* [2016] EWCA Civ 1092; Garcia (2016), pp. 56-57.

⁴⁵ In accordance with Article 52(3) CFR, the meaning and scope of Article 17(1) CFR correspond to those of the right to property guaranteed by Article 1 of the Protocol No 1 to the ECHR. Limitations to the guaranteed rights may not exceed those provided for in the ECHR. It is, however, possible for EU law to provide for further-reaching protection.

⁴⁶ See also Wojcik (2016), p. 119.

⁴⁷ See, e.g. Schabas (2015), pp. 974-979; Grabenwarter (2014), P-1 paras. 14-19; Wollenschläger (2014), paras. 17(1).38-42.

- The underlying legal basis must be sufficiently accessible, precise and foreseeable in its application.
- The interference must be in the public interest (in the terminology of the CFR: meet an objective of general interest). The ECtHR grants states a large margin of appreciation in determining what is in the public interest. Only a deprivation of possessions that is “manifestly without reasonable foundation” does not satisfy the public interest requirement.
- The principle of proportionality between the means employed and the aim pursued must be satisfied. The principle contains three elements: (i) suitability to achieve the aim pursued; (ii) necessity to achieve the aim pursued;⁴⁸ and (iii) proportionality in a narrow sense, i.e. a fair balance between the demands of the public interest and the individual’s fundamental rights. The CJEU applies different levels of scrutiny in its proportionality assessments.⁴⁹ Its more stringent version, the “least restrictive effective means test”, requires that “when there is a choice between several appropriate measures, the least onerous measure must be used (...).”⁵⁰

Compensation terms are material to the proportionality of interferences with the right to property.⁵¹ Deprivations of possessions “without payment of an amount reasonably related to its value”⁵² will normally be disproportionate.

The BRRD/SRMR take account of these elements of justification in the form of two key legal safeguards: the public interest test (paragraph 4 below) and the NCWO test (paragraph 5 below). Before these safeguards are discussed in more detail, the following section highlights the difficulties associated with the calibration of bail-in in light of the proportionality requirement.

3.5 Proportionality in applying bail-in – or: how to calibrate bail-in?

Bail-in is designed as a last-resort measure after a cascade of other measures have not brought the bank back to viability.⁵³ It is also designed to be a measure strictly necessary to avoid the disruption of critical banking functions, maintain financial stability or pursue other objectives in the public interest.⁵⁴ Moreover, the

⁴⁸ The CFR applies a different standard than the ECHR, as interpreted by the ECtHR, which does not include a necessity requirement. Contracting States determine the necessity for an intervention under the ECHR (see Grabenwarter (2014), P1-1, para. 10).

⁴⁹ For an excellent account of the CJEU’s jurisprudence on proportionality see Sauter (2013). See also Wollenschläger (2014), paras. 17(1).52-54 on standard of review.

⁵⁰ E.g. Case 265/87, *Schröder v Hauptzollamt Gronau*, judgment, ECLI:EU:C:1989:303, para. 21.

⁵¹ Compensation is not explicitly mentioned in the ECHR, but derived by the ECtHR from the principle of proportionality.

⁵² ECtHR, *Dennis Grainger and others v the U.K.*, Application No 34940/10, judgement of 10 July 2012, para. 37.

⁵³ Including supervisory measures, measures set out in the bank’s recovery plan, potentially early intervention measures. The principle of last resort is stipulated in Article 32(1)(b) BRRD and Article 18(1)(b) SRMR.

⁵⁴ Article 32(1)(c) BRRD and Article 18(1)(c) SRMR. For the public interest test see 4 below.

proportionality of a bail-in measure will critically depend on the amount by which authorities write down or convert liabilities. Article 46(2) BRRD and Article 27(13) SRMR require that the amount of bail-in must enable the bank to regain “sufficient market confidence” and “to continue to meet, at least for one year, the conditions for authorisation”. Additionally, if applied on a stand-alone basis, the amount should suffice to “restore [the bank] to financial soundness and long-term viability”.⁵⁵

The calibration of an appropriate (and thus proportionate) amount of bail-in represents a great operational challenge with significant legal consequences.⁵⁶ In *Kotnik and others*, the CJEU held that burden-sharing under State aid approval proceedings “must not exceed what is necessary to overcome the capital shortfall of the bank concerned.”⁵⁷ In light of the risks associated with (conjectural) valuation and uncertain market developments, authorities may have a tendency to “over-bail-in” to allow for a “safety margin” of resolution funding. After all, the need for an “after-bail-in” in case the initial bail-in turns out to be insufficient to restore the bank to full viability is arguably the less desirable scenario.⁵⁸

The issue was addressed elegantly in the context of the ESM financing granted to the Cypriot banking sector in 2013. The corresponding Memorandum of Understanding (MoU) between Cyprus and the Commission/ECB provided for the immediate conversion of 37.5% of Bank of Cyprus’ (BoC) uninsured deposits into shares and for the temporary freezing of a further 22.5% of those uninsured deposits with the possibility of an “after-bail-in”. Based on an independent valuation of BoC’s assets, an additional 10% of the frozen deposits were bailed-in, bringing the total bail-in to 47.5%. Crucially, the MoU further stated that uninsured depositors would be refunded through a buy-back of shares, should Bank of Cyprus turn out to be overcapitalised relative to the Core Tier 1 (CET1) target of 9% under stress.⁵⁹

In its ruling regarding the bail-in of BoC’s uninsured depositors, the CJEU appears to set the bar rather low for authorities to meet the proportionality requirement. It is regrettable that the court did not give a clearer and more comprehensive account of how it assessed the proportionality of the interference with the applicants’ right to property. Instead, the ruling confines itself to stating that the bail-in measures were *not* disproportionate:

“In view of the objective of ensuring the stability of the banking system in the euro area, and having regard to the imminent risk of financial losses to which depositors with the two banks concerned would have been exposed if the latter had failed, such measures do not constitute a disproportionate and intolerable interference impairing

⁵⁵ Article 43(3) BRRD and Article 27(2) SRMR.

⁵⁶ See also Wojcik (2016), pp. 123-124.

⁵⁷ Case C-526/14, *Kotnik and others*, para. 102.

⁵⁸ The resolution of Banco Espírito Santo (BES)/Novo Banco is a case in point. About a year after an initial transfer, Banco de Portugal re-transferred some non-subordinated bonds back from the bridge bank (Novo Banco) to BES to compensate for an over-valuation of the assets. For more details on the case see Garcia (2016).

⁵⁹ See European Commission (2013), p. 42.

the very substance of the appellants' right to property. Consequently, they cannot be regarded as unjustified restrictions on that right (...)."⁶⁰

Clearly, the judgement must be read in its specific context. It concerned the Union's and ECB's non-contractual liability,⁶¹ requiring not just any unlawful act but "a sufficiently serious breach of a rule of law intended to confer rights on individuals".⁶² The standard of the unlawfulness is thus elevated compared to actions for annulment. Only particularly serious illegality entails damages liability. Moreover, Cyprus was facing a collapse of its entire banking system, with the ESM programme arguably representing the only means to avoid sovereign default.

Two conclusions can nevertheless be drawn. First, the stability of the banking system constitutes an objective in the public interest that possesses much weight in the balancing with individual interests of bank creditors. And second, the court gives consideration to the hypothetical financial losses encountered in the counterfactual scenario of insolvency, provided there was an "imminent risk" of failure. Both conclusions are relevant for the analysis below.

4 The public interest test

The legality and legitimacy of bail-in relies heavily on the concept of public interest. A public interest test applies specifically at two stages of resolution proceedings:

- *Triggering resolution*: The BRRD/SRMR continue to declare winding-up in national insolvency proceedings the standard procedure for failing banks.⁶³ Taking resolution action, in deviation thereof, must be justified in the public interest.⁶⁴ Apart from identifying a bank as FOLTF⁶⁵ and determining that there is no reasonable prospect of any private-sector measure or supervisory action preventing the failure, the resolution authority must – as a third condition for resolution – establish that resolution action is necessary in the public interest.⁶⁶ It is a two-pronged test: The resolution authority must determine (i) that resolution action is necessary and proportionate to achieve at least one resolution objective and (ii) that the objective(s) could not be met to the same extent in a normal insolvency proceeding.⁶⁷ The second prong, the assessment of potential impacts of *not* taking resolution action, produces an obvious implementation challenge for the SRB: It must possess profound knowledge of the bank insolvency frameworks of all 28 Member States. Only with this knowledge, the SRB is able to judge the potential of resolution on the one hand

⁶⁰ Case C-8/15 P, *Ledra Advertising v Commission and ECB*, ECLI:EU:C2016:701, para. 74.

⁶¹ Based on Articles 268 and 340 TFEU.

⁶² Case C-8/15 P, *Ledra Advertising v Commission and ECB*, para. 65 (and judgements cited therein).

⁶³ Recital 45 BRRD, Recital 59 SRMR.

⁶⁴ Article 31(1)(c) and (5) BRRD, Article 18(1)(c) and (5) SRMR. No public interest test is required with regard to write-down or conversion of capital (WDCC) instruments (Articles 47, 59-62 BRRD).

⁶⁵ For FOLTF see 3.1 above.

⁶⁶ See the three conditions for resolution in Article 32(1) BRRD and Article 18(1) SRMR.

⁶⁷ Article 32(5) in conjunction with Article 31 BRRD, Article 18(5) in conjunction with Article 13 SRMR.

and of the default insolvency scenario on the other to achieve the public interest pursued.

- *Bail-in exemptions*: At the implementation stage, the exemption of certain (classes of) creditors from the application of bail-in according to Article 44(3) BRRD and Article 27(5) SRMR must be justified in the public interest, given that these exemptions lead to a less-favourable treatment of non-exempted creditors. The objectives that authorities may legitimately pursue with such exemptions – continuity of critical functions; maintaining financial stability; and avoiding the destruction of value – are broadly in line with the resolution objectives set out in Article 32(2) BRRD and Article 14(2) SRMR.⁶⁸

4.1 Public interest as a (too) discretionary concept

But what exactly *is* the public interest (in the multi-layered governance of the Union)? Albeit the concept of public interest is so crucial to justifying administrative intervention, it remains one of the most discretionary areas of the resolution framework. The BRRD/SRMR benchmark the public interest test against a number of resolution objectives: (i) ensuring the continuity of critical functions;⁶⁹ (ii) avoiding a significant adverse effect on the financial system; (iii) protecting public funds; (iv) protecting depositors and investors; and (v) protecting client funds/assets.⁷⁰ These objectives, however, are many and varied and remain themselves of a “generic qualitative nature”.⁷¹

Whether or not the failure of a bank may interfere with the public interest is a question that should inform resolution authorities’ decisions and actions already at the stage of resolution planning. Only if a bank’s failure and subsequent winding-up under normal insolvency proceedings would *likely* “have a significant negative effect on financial markets, on other institutions, on funding conditions or on the wider economy” is the drafting of a fully-fledged resolution plan warranted.⁷² The calibration of the minimum requirement for own funds and eligible liabilities (MREL) will also depend on the assessment.⁷³ The BRRD enumerates several quantitative and qualitative criteria against which banks must be assessed, including: size; interconnectedness; scope and complexity of activities; nature of business; shareholding structure; legal form; membership in an institutional protection scheme

⁶⁸ Article 44(3)(b)-(d) BRRD. According to Article 4(5) Commission Delegated Regulation (EU) 2016/860 of 4 February 2016 specifying further the circumstances where exclusion from the application of write-down or conversion powers is necessary under Article 44(3) of the BRRD (OJ L 144, 1.6.2016, p. 11), the decision to exclude a (class of) liabilities from bail-in must be based on at least one of the BRRD’s resolution objectives.

⁶⁹ “Critical functions” are defined as “activities, services or operations the discontinuance of which is likely in one or more Member States, to lead to the disruption of services that are essential to the real economy or to disrupt financial stability due to the size, market share, external and internal interconnectedness, complexity or cross-border activities of an institution or group, with particular regard to the substitutability of those activities, services or operations” (Article 2(1)(35) BRRD).

⁷⁰ Article 32(2) BRRD, Article 14(2) SRMR.

⁷¹ Freudenthaler and Lintner (2017), p. 107.

⁷² Article 4(1) BRRD, Article 11(3) SRMR.

⁷³ See Article 45(6) BRRD, Article 12(7) SRMR.

or other cooperative mutual solidarity system; and exercise of investment services or activities.⁷⁴

However, none of this replaces the establishment of a public interest *at the point of failure*. The BRRD acknowledges the possibility that the resolution authority dismisses or identifies a public interest in resolving a bank in deviation of previous resolution planning. The effects of a bank's failure are highly dependent on the specific macroeconomic conditions in which the bank operates. Resolution planning can only indicate a bank's systemic importance at a given time. It cannot predict market developments. It remains the task of the resolution authority to assess the risks associated with a bank's failure in light of this broader context once the bank is declared FOLTF. In this risk assessment, the resolution authority is guided solely by the overarching resolution objectives. The BRRD does not refer to any indicators of public interest at the point of failure, nor does it identify circumstances under which a departure from the resolution plan could be warranted.

The courts do not add much to the substantive contour of the public interest test. It is established case law of the ECtHR that “[b]ecause of their direct knowledge of their society and its needs, the national authorities are in principle better placed than the international judge to appreciate what is ‘in the public interest’.”⁷⁵ Especially regarding social and economic policies, States are granted a wide margin of appreciation, and the court will generally respect their policy choices unless they are “manifestly without reasonable foundation”⁷⁶. The ECtHR confirmed its willingness to apply a wide margin of appreciation in the case of a banking crisis in its ruling regarding the nationalisation of Northern Rock in 2008:

“The Court agrees that given the exceptional circumstances prevailing in the financial sector, both domestically and internationally, at the relevant time, a wide margin of appreciation is appropriate.”⁷⁷

The CJEU's standard of review regarding the legitimacy of the public interest pursued (and the consequential proportionality assessment) is similarly restricted. The margin of discretion granted to authorities is particularly wide in cases that involve “complex economic and social assessments”⁷⁸ or “choices of a technical nature”.⁷⁹ The CJEU does, however, review authorities' compliance with procedural guarantees, including their obligation to give a statement of reasons for measures they take, as required by Article 296(2) TFEU.⁸⁰ To enable persons concerned to determine the reasons for a measure and the CJEU to exercise its power of review,

⁷⁴ The criteria are further specified in the EBA Draft Regulatory Technical Standards on simplified obligations under Article 4(6) of Directive 2014/59/EU, 8 May 2017, EBA/CP/2017/05.

⁷⁵ ECtHR, *Dennis Grainger and others v the U.K.*, para. 36 (and rulings cited therein).

⁷⁶ E.g. ECtHR, *James and others v the U.K.*, Application No 8793/79, judgement of 21 February 1986, para. 46.

⁷⁷ *ibid.*, para. 39.

⁷⁸ Case C-526/14, *Kotnik and others*, para. 38 (and rulings cited therein).

⁷⁹ Case C-62/14, *Gauweiler and others*, judgement, ECLI:EU:C:2015:400, para. 68 (concerned a preliminary ruling).

⁸⁰ See *ibid.*, paras. 69-71.

authorities must state those reasons “clearly and unequivocally”, while they are not required “to go into every relevant point of fact and law.”⁸¹

This jurisprudence implies that, while authorities enjoy wide discretion in determining what is in the public interest, they must give clear account of the reasons for their decisions. It can be expected that such reasoning would include at least: (i) the assessment made in the resolution plan; (ii) any relevant developments since the last update of the plan; (iii) an assessment of the outcome of the chosen resolution scheme, if any, in light of the resolution objectives; (iv) an assessment of the outcome of an insolvency proceeding in light of the resolution objectives; (v) a comparison of the two scenarios; and (vi) an explanatory statement regarding less restrictive means. A public interest decision that deviates from the authority’s previous assessment in the resolution plan would have to meet a *higher* standard of reasoning and evidence. The decisions regarding Veneto Banca and Banca Popolare di Vicenza (BPVI), published by the SRB,⁸² are substantiated and appear to largely observe such procedural requirement.

4.2 Public interest in resolution and State aid: the case of Veneto Banca/Banca Popolare di Vicenza

Nevertheless, the handling of the failure of Veneto Banca and BPVI highlights just how open the concept of public interest is to differing interpretations. On 23 June 2017, the SRB decided *not* to take resolution action in respect to the two banks for lack of public interest. It justified its assessment as follows: First, the banks performed no critical functions, because they provided services to a limited number of third parties and these services were substitutable in an acceptable and timely manner. Second, the failure would not likely lead to financial instability, given that the banks had little financial and operational interconnections with other banks. And third, normal Italian insolvency proceedings would achieve the resolution objectives to the same extent.⁸³ In contrast, the SRB had established public interest in the resolution of Banco Popular Español due to the bank’s performance of critical functions – deposit-taking from households and non-financial corporations; lending to SMEs; payment and cash services – and systemic importance just a few weeks earlier.⁸⁴

While the SRB established *not enough* public interest for Veneto Banca and BPVI to enter resolution, the Commission established *enough* public interest for them to receive liquidation aid. On 25 June 2017, the Commission made public its decision to approve State aid to facilitate the liquidation of the two banks under Italian

⁸¹ *ibid.*, para. 70.

⁸² Decision of the Single Resolution Board in its Executive Session of 23 June 2017 concerning the assessment of the conditions for resolution in respect of Veneto Banca S.p.A., SRB/EES/2017/11 (non-confidential version), Article 4; Decision of the Single Resolution Board in its Executive Session of 23 June 2017 concerning the assessment of the conditions for resolution in respect of Banca Popolare di Vicenza S.p.A., SRB/EES/2017/12 (non-confidential version), Article 4.

⁸³ *ibid.*

⁸⁴ Decision of the Single Resolution Board in its Executive Session of 7 June 2017 concerning the adoption of a resolution scheme in respect of Banco Popular Español, S.A., SRB/EES/2017/08 (non-confidential version), Article 4.

insolvency law.⁸⁵ The “compulsory administrative liquidation”⁸⁶ of the two banks involves the transfer of some of their businesses to be integrated into Intesa Sanpaolo, while the remaining parts will be wound up in an orderly fashion. According to the burden-sharing requirement of the 2013 Banking Communication, shareholders were wiped out and subordinated creditors bailed-in prior to the grant of approximately EUR 17 billion in liquidation aid.

Where does that leave us regarding public interest? We can think of three scenarios: (i) The authorities applied the same public interest test in an inconsistent manner.⁸⁷ (ii) Different public interest tests apply regarding bail-in in resolution on the one hand and burden-sharing in State aid proceedings on the other. (iii) The authorities applied the same public interest test in a consistent manner, with the SRB accounting for the possibility that liquidation aid would be granted to facilitate the winding-up of the two banks.⁸⁸

The Commission appears to have acted on the assumption of the second scenario, i.e. that the approval of State aid is judged against a different benchmark, as it states:

“(…), Italy has determined that the winding up of these banks has a serious impact on the real economy in the regions where they are most active. *Outside the European banking resolution framework*, Union rules foresee a possibility for Italy to seek Commission approval for the use of national funds to facilitate the liquidation by mitigating such regional economic effects.”⁸⁹ [emphasis added by author]

While the public interest in resolution is determined by the resolution objectives, State aid may be approved “to remedy a serious disturbance in the economy of a Member State”⁹⁰ based on the conditions outlined in the 2013 Banking Communication. The Commission has consistently pursued financial stability as the “overarching objective” in its assessment of State aid to the financial sector.⁹¹ Liquidation aid, in particular, is meant to allow for the market exit of a failing bank “in an orderly manner so as to preserve financial stability”.⁹² Paragraph 66 of the 2013 Banking Communication further states:

“The Commission recognises that, due to the specificities of credit institutions and *in the absence of mechanisms allowing for the resolution of credit institutions without*

⁸⁵ European Commission, “State aid: Commission approves aid for market exit of Banca Popolare di Vicenza and Veneto Banca under Italian insolvency law, involving sale of some parts to Intesa Sanpaolo”, 25 June 2017, IP/17/1791.

⁸⁶ Liquidazione coatta amministrativa (see legislative decree no 385/1993, royal decree no 267/1942).

⁸⁷ The logical consequence of an identical public interest test would, however, be that liquidation aid would have ceased to exist with the entering into force of the BRRD.

⁸⁸ The SRB’s decisions on Veneto Banca and BPVI refer solely to the possibility of a DGS-assisted transfer of assets and liabilities.

⁸⁹ European Commission, “State aid: Commission approves aid for market exit of Banca Popolare di Vicenza and Veneto Banca under Italian insolvency law, involving sale of some parts to Intesa Sanpaolo”, 25 June 2017, IP/17/1791.

⁹⁰ Article 107(3)(b) TFEU. See also 2013 Banking Communication, para. 15.

⁹¹ 2013 Banking Communication, paras. 7-11.

⁹² *ibid.*, para. 65.

threatening financial stability, it might not be feasible to liquidate a credit institution under ordinary insolvency proceedings. For that reason, State measures to support the liquidation of failing credit institutions may be considered as compatible aid, subject to compliance with the requirement specified in point 44 [burden-sharing requirement].” [emphasis added by author]

With the entering into force of the BRRD/SRMR, there is no longer an absence of a mechanism allowing for the resolution of banks without threatening financial stability. In fact, under this framework, it is the task of the resolution authority – national or European – to determine whether liquidating a bank under ordinary insolvency proceedings threatens financial stability or not.

Can other factors play into the Commission’s assessment of a “serious disturbance in the economy”? The Commission has not formally distanced itself from the self-restraints set out in the 2013 Banking Communication regarding liquidation aid. Article 107(3)(b) TFEU *per se* would appear to be open to a legal interpretation that extends beyond the concept of financial stability. Italy perceived the aid necessary to avoid an economic disturbance in the Veneto region following the liquidation of BPVI and Veneto Banca. In the introduction of a decree submitted to the Italian Parliament regarding their “special insolvency proceeding” it says that liquidating the two banks would destroy value, cause serious losses for retail unsecured creditors and break up credit relationships with businesses and families.⁹³ Little is known yet about the reasons for the Commission’s endorsement of a public interest. However, if the Commission decided to apply a broadened public interest test in deviation of its previous practice and communication, it too would have to meet a *high* standard of reasoning and evidence.⁹⁴ This is particularly true given that such change of practice would introduce a public interest test that is inconsistent, in substance, with the test applied by resolution authorities based on the BRRD/SRMR.

From what is known at the time of writing, the public interest identified by the Italian authorities does not appear to deviate much, in substance, from the resolution objectives set out in the BRRD/SRMR. What clearly differs, however, is procedure. Resolution and State aid proceedings provide reverse roles for Member States in the banking union. Whether or not resolving a bank is in the public interest is determined by the Executive Session of the SRB in the interest of the Union as a whole.⁹⁵ In contrast, ownership of the procedure in State aid proceedings rests with the Member States. They are the initiators of such proceeding and provide the necessary information and data to back their determination of a public interest. Based on Member States’ (non-binding) input, the Commission endorses or rejects.

⁹³ Decreto-legge 25 giugno 2017, n. 99, Disposizioni urgenti per la liquidazione coatta amministrativa di Banca Popolare di Vicenza S.p.A. e di Veneto Banca S.p.A. (“in assenza di misure pubbliche di sostegno, la sottoposizione delle Banche a liquidazione coatta amministrativa potrebbe comportare una distruzione del valore delle aziende bancarie coinvolte, con conseguenti gravi perdite per gli operatori non professionali creditori chirografari, che non sono protetti né preferiti, e imporrebbe un’improvvisa cessazione dei rapporti di affidamento creditizio per imprese e famiglie, con conseguenti forti ripercussioni negative sul tessuto produttivo e sociale nonché occupazionali.”). See also European Parliament, Briefing – The orderly liquidation of Veneto Banca and Banca popolare di Vicenza, 25 July 2017, pp. 5-6.

⁹⁴ See 4.1 above.

⁹⁵ The SRB’s determination is subject to Commission/Council endorsement (Article 18(7) and (8) SRMR).

Accordingly, the State aid framework may be more flexible to include economic disturbances with an impact confined to the regional or even local level.

From all of this we can conclude that, currently, a European and a national public interest test co-exist. In the case of Veneto Banca and BPVI, their co-existence resulted in senior creditors and depositors being bailed-out instead of bailed-in. They likely ended up better off in liquidation than in resolution – a scenario that is at odds with the very objectives that led to the adoption of the BRRD/SRMR.⁹⁶ Bail-in in resolution and “burden-sharing” in State aid proceedings are functionally equivalent practices. There is no convincing reason why a different public interest test *should* apply. However, while aligning the European and national public interest tests is necessary, it remains challenging as long as bank insolvency (in contrast to resolution) stays within the remit of Member States.

5 The NCWO test

The second key legal safeguard of the BRRD concerns proportionality.⁹⁷ The NCWO test is designed to limit the extent to which bail-in may interfere with the right to property.⁹⁸ Bail-in should not inflict greater losses on shareholders and creditors than the losses they would have incurred had the bank instead been wound up in a normal insolvency proceeding. Article 34(1)(g) BRRD and Article 15(1)(g) SRMR establish the NCWO principle as a general principle governing resolution. If resolution action infringes the principle, shareholders and creditors are entitled to compensation.⁹⁹

As a rule, resolution that allows for preserving the franchise value of a bank will produce smaller *total* losses than liquidation based on gone concern. The experience with pre-BRRD bail-in cases confirms this: In the Austrian *HETA* case, valuation estimated a 34% recovery rate in a hypothetical insolvency scenario, compared to an estimated 46% recovery rate under resolution. And the hypothetical insolvency losses (valuation 3: DKK –142.7 million) were assumed to be about 50% higher than the losses under resolution (valuation 2: DKK –96.4 million) in the *Andelskassen* case in Denmark.¹⁰⁰ The NCWO test will be of particular relevance where the exemption of certain debt or classes of debt from the application of bail-in shifts a bank's losses to other (potentially higher-ranking) creditors. These creditors are prone to incur losses exceeding those resulting from a hypothetical insolvency proceeding.

⁹⁶ See EBA, The “banking reform package”: CRD 5/CRR 2/BRRD 2, Andrea Enria hearing at the Italian Senate, 5 July 2017 (English translation), p. 6.

⁹⁷ It also aims to counterbalance the restricted *ex-ante* judicial review of bail-in decisions (Article 85 BRRD). See also Wojcik (2015), p. 255; Athanassiou (2014), p. 16.

⁹⁸ Wojcik (2015), p. 256.

⁹⁹ Article 75 BRRD.

¹⁰⁰ Numbers taken from Merc (2017), p. 141. In the latter case, while some creditors received compensation under the NCWO principle, no litigation proceedings were initiated by shareholders or creditors whose claims were bailed-in (see Andersen, Lintner and Schroeder (2016), pp. 27-28).

5.1 Does NCWO protect from the protection of the right to property?

Even prior to the entering into force of the BRRD, the Commission had introduced a NCWO test in its State aid proceedings. The Banking Communication 2013 states:

“In the context of implementing points 43 and 44 [the burden-sharing requirement], the ‘no creditor worse off principle’ should be adhered to. Thus, subordinated creditors should not receive less in economic terms than what their instrument would have been worth if no State aid were to be granted.”¹⁰¹

In *Kotnik and others*,¹⁰² the CJEU concluded that based on this provision:

“(…) the burden-sharing measures on which the grant of State aid (…) is dependent cannot cause any detriment to the right to property of subordinated creditors that those creditors would not have suffered within insolvency proceedings that followed such aid not being granted.”¹⁰³

A narrow reading of this paragraph may suggest that the stipulated NCWO test precludes as a matter of legal principle that burden-sharing as a precondition for granting State aid may affect investors’ right to property. Arguably, however, the CJEU just repeats in its own words what the NCWO test *seeks to achieve*, i.e. to cause no detriment to the right to property of investors. According to such reading, the burden-sharing requirement set out in the 2013 Banking Communication can be applied in a way that is compatible with fundamental rights, with the NCWO test constituting a key legal safeguard. As Advocate General Wahl put it: the NCWO test “require[s] Member States to give due consideration to the property rights of the investors when restructuring a bank in distress.”¹⁰⁴

The conclusions we can draw from the ruling regarding the application of bail-in under the framework of the BRRD/SRMR are rather limited. *Kotnik and others* represents a preliminary ruling on the validity and interpretation of the Commission’s 2013 Banking Communication. It does not, however, evaluate a specific case where burden-sharing or, to that effect, bail-in was applied. Advocate General Wahl states the obvious when he argues that

“the fact that points 40 to 46 of the 2013 Banking Communication do not automatically lead to any breach of those rights does not imply that burden-sharing measures actually adopted by a Member State which comply with that communication are necessarily compatible with those rights.”¹⁰⁵

While the NCWO test contributes to the compatibility of the 2013 Banking Communication and, to that effect, the BRRD/SRMR with the right to property *in*

¹⁰¹ Banking Communication 2013, para. 46.

¹⁰² Case C-8/15 P, *Ledra Advertising v Commission and ECB* does not refer to the NCWO test.

¹⁰³ Case C-526/14, *Kotnik and others*, para. 78.

¹⁰⁴ Opinion of Advocate General Wahl in Case C-526/14, *Kotnik and others*, ECLI:EU:C:2016:102, para. 73.

¹⁰⁵ *ibid.*, para. 75.

principle, the judgement (unlike the opinion of the Advocate General¹⁰⁶) remains silent regarding such compatibility of *specific measures* applied by resolution authorities. After all, NCWO is a principle guiding the decisions and actions of authorities, not a condition or status. It does not suffice to preclude *a priori* that bail-in measures may, in reality, affect the right to property.¹⁰⁷

Moreover, the burden-sharing requirement under the State aid framework is confined to shareholders and subordinated creditors. Unlike in resolution, senior creditors are explicitly excluded from contributing to loss absorption.¹⁰⁸ The bail-in of senior creditors, including uninsured depositors, however, may raise additional concerns and require a somewhat different legal assessment.

5.2 NCWO as an assumption-based valuation exercise

The NCWO test is essentially a *valuation exercise* and thus conjectural in its nature. Article 74 BRRD stipulates that an independent valuer carry out a valuation after the application of a bail-in. This valuation establishes the difference in treatment of shareholders and creditors in resolution and in a hypothetical insolvency proceeding. If the difference turns out to be negative, affected shareholders and creditors are entitled to seek compensation directly from the national resolution financing arrangement or the Single Resolution Fund, respectively.¹⁰⁹ The valuation shall take place “as soon as possible” after resolution starts, with no explicit end-date.¹¹⁰ In practice, it will likely take several months, if not years.¹¹¹ The details of the valuation methodology are delegated to the Commission for further determination in a delegated regulation.¹¹²

The NCWO test is based on three main assumptions: (i) that the bank under resolution had instead entered normal insolvency proceedings at the time resolution was triggered; (ii) that the resolution had not taken place; and (iii) that the bank under resolution had received no extraordinary public financial support.¹¹³ Assumption 1 and 3 are particularly controversial.

¹⁰⁶ *ibid.*, paras. 85-91.

¹⁰⁷ See also Micossi, Bruzzone and Cassella (2016), p. 15.

¹⁰⁸ 2013 Banking Communication, para. 42.

¹⁰⁹ Article 43(3) third paragraph and Article 75 BRRD, Article 76(1)(e) SRMR.

¹¹⁰ Article 74(1) BRRD.

¹¹¹ Freudenthaler and Lintner (2017), p. 106.

¹¹² See Regulatory Technical Standards on valuation for the purposes of resolution and on valuation to determine difference in treatment following resolution under Directive 2014/59/EU on recovery and resolution of credit institutions and investment firms (final draft), 23 May 2017, EBA/RTS/2017/05 and 06 (not yet endorsed by the Commission at the time of writing). For an early account of the methodological difficulties see Athanassiou (2014). See also Hadjiemmanuil (2015), p. 244-245.

¹¹³ Article 74(3) BRRD.

5.2.1 Assumption 1: normal insolvency proceeding

Assumption 1 is that a failing bank – instead of resolution – undergoes a normal insolvency proceeding. But what is a “normal insolvency proceeding” in the Union?¹¹⁴ Lacking Union-wide harmonisation of bank insolvency, the comparator of a normal insolvency proceeding can only mean the specific national insolvency regime(s) applicable to the bank at hand.¹¹⁵ If the comparator of the NCWO test is based on different procedures and objectives set out in the applicable insolvency law and on the insolvency practice of each Member State,¹¹⁶ the test will necessarily produce different outcomes across borders. Creditors may be entitled to different amounts of compensation under the NCWO test depending on the Member State in which the resolution proceeding takes place.

While the assumption refers to national law and practice, it does not embrace *any* national practice as a “normal insolvency proceeding” under the NCWO test. Valuation 3 must be conducted on a gone-concern basis.¹¹⁷ This would exclude the (partial) restructuring of a failing bank on a going-concern or open-bank basis as a potential counterfactual scenario to resolution, such as the transfer of assets and liabilities to a purchaser in case of insolvency.

Yet, the insolvency proceeding of Veneto Banca and BPVI is exactly such a case. The Italian authorities essentially applied the sale-of-business tool outside of resolution, as it is provided for by the Italian compulsory administrative liquidation (CAL) regime. In its assessment of the public interest in the banks’ resolution, the SRB explicitly refers to the possibility of a sale-of-business transaction under Italian insolvency law:

“Since normal insolvency proceedings (i.e. CAL) allow for the transfer to a purchaser of the same portfolio which could have been transferred in case of resolution action, it can be concluded that CAL proceedings could meet these two resolution objectives [protecting depositors/investors and protecting client assets/funds] to the same extent.”¹¹⁸

¹¹⁴ According to Article 2(1)(47) BRRD, “normal insolvency proceeding” refers to a collective proceeding, “which entail[s] the partial or total divestment of a debtor and the appointment of a liquidator or an administrator normally applicable to institutions under national law and either specific to those institutions or generally applicable to any natural or legal person”.

¹¹⁵ According to Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions (OJ L 125, 5.5.2001, p. 15), this will be the law of the bank’s home Member State (Article 10). However, in addition, other legal regimes may be applicable to specific aspects of the insolvency proceeding (e.g. Articles 20-33).

¹¹⁶ According to the Regulatory Technical Standards on valuation for the purposes of resolution and on valuation to determine difference in treatment following resolution under Directive 2014/59/EU on recovery and resolution of credit institutions and investment firms (final draft), 23 May 2017, EBA/RTS/2017/05 and 06, the valuer shall take into account the “applicable insolvency law and usual insolvency practice in the relevant jurisdiction” as well as “the information on recent past insolvency cases of similar entities, where available and relevant” (Article 4(3)(a) and (c) Final draft RTS on valuation after resolution).

¹¹⁷ For more details see Final draft RTS on valuation after resolution, *ibid.*

¹¹⁸ Decision of the Single Resolution Board in its Executive Session of 23 June 2017 concerning the assessment of the conditions for resolution in respect of Veneto Banca S.p.A., para. 51; Decision of the Single Resolution Board in its Executive Session of 23 June 2017 concerning the assessment of the conditions for resolution in respect of Banca Popolare di Vicenza S.p.A., para. 51.

Do we apply different counterfactual scenarios under the public interest test on the one hand and the NCWO test on the other? Is open-bank restructuring a legitimate counterfactual scenario for determining whether resolution is warranted in the public interest, but an illegitimate counterfactual scenario for establishing creditors' right to compensation under the NCWO test? The fact is that the assumption of what constitutes a "normal insolvency proceeding" does not necessarily conform with actual practice.

5.2.2 Assumption 3: no extraordinary public financial support

Assumption 3 is that the failing bank receives no extraordinary public financial support. Relevant case law seems to support this assumption. In *Kotnik and others*, the CJEU ruled that there is no legitimate expectation for a bank to receive State aid.¹¹⁹ The ECtHR held in *Grainger and others* that the nationalisation of Northern Rock based on a valuation that ignored the Lender of Last Resort (LOLR) assistance provided to the bank by the Bank of England is legitimate.

"In the Court's view, the decision taken in the legislation that the former shareholders of Northern Rock should not be entitled to take the value which had been created by the Bank of England's loan was far from being 'manifestly without reasonable foundation'. Instead, it was clearly founded on the policy of avoiding 'moral hazard', which is at the heart of the principles which regulate the provision of LOLR."¹²⁰

Both judgements concerned shareholders (*Grainger*) and subordinated creditors (*Kotnik*), not depositors. The question remains as to what uninsured depositors can legitimately expect.

The NCWO test treats all stakeholders of a bank equally. Both investors and uninsured depositors are entitled to the *liquidation value* of their claims. However, there is a difference between investments and deposits that may warrant a differentiated legal standard. According to the case law of the CJEU, the loss of profit does not give rise to compensation claims under the right to property.¹²¹ The court makes this very clear in *Kotnik and others*, stating that "in accordance with the general rules applicable to the status of shareholders of public limited liability companies, they must fully bear the risk of their investments."¹²² Therefore, they "are liable for the debts of the bank up to the amount of its share capital (...)."¹²³ Regarding subordinated creditors, the CJEU holds that their claims are constituted by financial instruments of a hybrid nature, "which share certain characteristics with debt products and certain characteristics with shares in equity capital."¹²⁴ With their

¹¹⁹ Case C-526/14, *Kotnik and others*, paras. 61-69. The ruling was based on the NCWO test applied by the Commission in its State aid approval proceedings (see 2013 Banking Communication, para. 46).

¹²⁰ ECtHR, *Dennis Grainger and others v the U.K.*, para. 42.

¹²¹ E.g. Case C-283/11, *Sky Österreich*, ECLI:EU:C:2013:28, para. 34 ("opportunities, the uncertainties of which are part of the very essence of economic activity"); Case C-295/03, *Alesandrini and others v Commission*, ECLI:EU:C:2005:413, paras. 88 and 89. See also von Bonin and Olthoff (2016), p. 780.

¹²² Case C-526/14, *Kotnik and others*, para. 73.

¹²³ *ibid.*, para. 74.

¹²⁴ *ibid.*, paras. 27 and 76.

subordination to the holders of ordinary debt in the event of the bank's insolvency or winding-up, subordinated creditors assume a financial risk for which they are remunerated by a higher rate of return.¹²⁵ Hence, their qualification as investors.

The bail-in of depositors, in contrast, does *not* realise an investment risk. Depositors do not pay money to the bank now to get more later. They are interested in liquidity and/or having their savings stored safely. Deposits – both insured and uninsured – will generally not qualify as investments within the meaning of the CJEU's jurisprudence. Moreover, the moral hazard argument that both the CJEU¹²⁶ and the ECtHR¹²⁷ invoke regarding shareholders and subordinated creditors applies to a lesser extent to depositors. Retail depositors, in particular, will often not be in a position to monitor and curtail the risk-taking of "their" bank, independent of whether or not their funds are subject to loss absorption.¹²⁸

These considerations have led to measures being taken to protect (retail) depositors from having to absorb major losses in case a bank fails. The BRRD provides that uninsured depositors rank higher in bank insolvency and resolution than other unsecured creditors.¹²⁹ Moreover, the Commission proposes a new class of non-preferred senior debt instruments that would be bailed-in before uninsured retail depositors.¹³⁰ Against this background, it does not come as a big surprise that the possibility to provide liquidation aid to failing banks with a large retail depositor base has not been given up (yet). This raises the question, however, whether a normal insolvency proceeding with no extraordinary public financial support truly remains a credible counterfactual scenario with respect to (retail) depositors. Or does a legitimate expectation to liquidation aid in certain circumstances after all exist?

6 Conclusions

The Union has come far in its efforts to maintain financial stability, while shielding taxpayers from the cost of bank failures. Bail-in enables authorities to meet both objectives at the same time. It comes, however, with its own challenges. Designed as a pre-insolvency, valuation-based intervention by administrative authorities that allows for discretionary exemptions from loss absorption, bail-in differs from its prototype – insolvency – in several crucial ways. Bail-in measures interfere with shareholders' and creditors' fundamental right to property as guaranteed by the CFR and the ECHR and must be validly justified.

¹²⁵ *ibid.*, para. 27.

¹²⁶ Case C-526/14, *Kotnik and others*, para. 58.

¹²⁷ ECtHR, *Dennis Grainger and others v the U.K.*, para. 42.

¹²⁸ See also Avgouleas and Goodhart (2015), p. 17.

¹²⁹ Article 108(a) BRRD.

¹³⁰ See Proposal for a Directive of the European Parliament and of the Council on amending Directive 2014/59/EU of the European Parliament and of the Council as regards the ranking of unsecured debt instruments in insolvency hierarchy, 23.11.2016, COM(2016) 853 final. For the challenges of creditor ranking in resolution and insolvency, see the contribution of David Ramos Muñoz, entitled "Bank resolution and insolvency ranking and priorities", in this book.

This contribution took a closer look at two legal safeguards of the BRRD/SRMR aimed at ensuring that bail-in measures are compatible with the right to property: the public interest test and the NCWO test. While both safeguards are indispensable to the effectiveness of bail-in and resolution more generally, the devil is in the details. The aim of this contribution was to emphasise potential contradictions and future uncertainties in the application of these safeguards in light of recent developments.

With the public interest test, resolution authorities determine whether resolution and bail-in action is necessary or the default scenario of an insolvency proceeding according to national law sufficient to achieve a number of targeted objectives in the public interest. While the public interest is a discretionary concept, this contribution highlighted the importance of consistency in the application of the test. With its State aid decision in the case Veneto Banca/BPVI, the Commission (re-)introduced an intermediate regime between resolution and insolvency: insolvency with liquidation aid. This intermediate regime applies if there is not enough public interest in resolution (determined by the SRB, subject to Commission endorsement), but too much public interest for the bank to be liquidated without public financial support (endorsed by the Commission based on Member State application). The law may be open to an interpretation that justifies the continuing provision of liquidation aid to failing banks, even after the adoption of the BRRD/SRMR. From a legal policy perspective, however, the (remaining) *raison d'être* of such aid is much less evident.

The NCWO test is designed to give resolution authorities a benchmark regarding the proportionality of bail-in measures. While conclusive case law is still lacking, the test goes a long way towards limiting bail-in to a proportionate extent. Difficulties arise from its conjectural nature. The assumptions that the NCWO test is based upon may be prone to challenge, as they deviate from actual practice. Practice creates expectations and expectations may have legal implications. In light of the many uncertainties surrounding the interpretation and application of the new resolution regime and the continuing work on BRRD2, it is too early to expect a settled practice. What can be expected, though, is that authorities give clear account of the reasons underlying their decisions. This will help develop a consistent and coherent body of case law and sort out what really are legitimate expectations in banking.

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Restructuring, resolution and insolvency: shift of tasks from judicial to administrative authorities

By Pentti Hakkarainen¹

It was a pleasure to listen to the fascinating presentations of our three esteemed panellists². As discussant, I have read the papers and I will now seek to draw out some of the common themes that run through each of their contributions.

In doing this, I should explain that I approach these issues as a man of practice – having experienced a very severe banking crisis in Scandinavia in the early 90s and also having dealt closely with Icelandic banks in Finland. In those days we didn't have any rules for bank resolution, and so everything had to be invented ad hoc. Given this background, I won't be going into academic legal discussions, but will instead deal with the issues from a practical point of view.

1 The case for a special bank resolution regime

To begin, let me point out that the papers from Sabino Cassese and Seraina Grünewald both provided a useful reminder of the desirability of having a special insolvency regime for the banking sector – separate from the normal procedures. I heard three key elements of the rationale that they outlined.

First, there is a “need for speed” when dealing with bank failures. Speed in managing the clean-up of a bank in crisis is necessary, as a loss of confidence in a bank can lead to dangerous and precipitous liquidity runs. Swift remedies for bank failures are also required to limit the costs – as otherwise bank assets sour very quickly, thereby making the losses greater for creditors. Normal insolvency procedures do not provide this speed, so different procedures are required that allow a more proactive approach and thereby lead to swifter outcomes.

Second, there exists a widely acknowledged need to “preserve financial stability”. Unmanaged bank failures do not merely inconvenience those who are directly impacted – i.e. customers, employees, and investors. They can in fact threaten the

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² This paper refers to the following presentations made during Panel 5 of the ECB Legal Conference on the topic of “Restructuring, resolution and insolvency: shift of tasks from judicial to administrative authorities”:

- “A new framework of administrative arrangements for the protection of individual rights”, Sabino Cassese, Justice of the Italian Constitutional Court and Emeritus Professor at the Scuola Normale Superiore di Pisa;
- “Legal challenges of bail-in”, Seraina Grünewald, Assistant Professor for Financial Market Law at the Institute of Law of the University of Zurich;
- “Bank resolution and insolvency ranking and priorities”, David Ramos Muñoz, Senior Lecturer (Profesor Ayudante Doctor) of Commercial Law at the Universidad Carlos III de Madrid.

stability of the entire financial system. Lending can be disrupted, with knock-on effects on unemployment, GDP and tax receipts. Sometimes governments therefore feel obliged to provide bail-outs in order to protect society from these disruptions. The response to a bank insolvency must therefore reflect the need to protect society from the potentially massive negative spillover effects associated with bank failures.

Third – and this is related to the second point – the response to a bank insolvency must ensure the “continuation of the critical functions” of financial institutions. This is a logical consequence of the desire to avoid negative spillover effects on the real economy from bank failures. Citizens and businesses require continued access to certain financial services – such as deposit-taking, lending services, and payment systems. The authorities must be sensitive to this reality when they are managing bank failures.

A special system is therefore clearly desirable. If such special systems had been in place prior to the previous crisis, the cost to the taxpayer would undoubtedly have been lower, as would have been the disruption to the real economy.

2 Bank resolution frameworks need to be transnational

The next theme I detected across the presentations was a clear consensus on the desirability of a transnational framework for bank resolution. Sabino in particular provided an articulate explanation in saying that “if the problem crosses national borders, then the solution too cannot remain in the hands of national governments alone”. And David Ramos Muñoz also pointed to the challenges associated with legal recognition in foreign jurisdictions of a resolution action.

Given recent history, it is self-evident that the problems of failing international banks do indeed span national borders. Seraina and David listed some notable examples that demonstrate this clearly, including The Royal Bank of Scotland, Fortis and Iceland. I personally experienced the Iceland crisis at close quarters, so I am acutely aware of the difficulties in allocating the costs of bank failures across borders. This difficulty was even higher at that time, given the complete absence of any framework to structure the conversation on how to resolve a bank.

We are now further along the path of developing our resolution framework compared with where we were when these unfortunate cases played out. The Bank Recovery and Resolution Directive (BRRD)³ and the Regulation on the Single Resolution Mechanism (SRM Regulation)⁴ have provided a useful step forwards in enhancing

³ 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, p. 190).

⁴ 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).

authorities' ability to organise ourselves across borders, and to thereby avoid excessive costs arising from unmanaged and drawn-out resolution processes.

Nonetheless, as David has pointed out, we still have progress to make, as it remains possible for legal problems to arise in the resolution of cross-border banking failures. His explanation of the cross-border legal risks that can arise when attempts are made to apply bail-in to foreign liabilities revealed an important issue which is worthy of further contemplation.

3 The protection of fundamental rights in the new framework

One aspect of any design for an effective transnational resolution framework is a shift from judicial to administrative decision-making. Sabino provided a good explanation of why such a shift is needed. He explained that courts are not well suited to being the initial decider for bank resolution cases. They are too slow, given that they are reactive – and can only act upon the request of a particular party. They are ill-suited to consider the structural economic effects of bank failures for the rest of the economy. They also cannot coordinate their actions within a hierarchical supranational system, given their overarching need to retain full independence.

We have therefore moved to a system whereby losses can be imposed on creditors ahead of any judicial review. It is fair to ask whether this new process protects citizens' fundamental rights – in particular those of investors. Here, my overall impression is that the new process remains quite fair in protecting property rights – and the presentations given by Sabino and Seraina generally endorsed this view.

The right starting point for such a discussion is to recognise that prior to the instigation of proper cross-border resolution regimes, bank creditor and shareholder “property rights” were excessively prioritised ahead of the “property rights” of taxpayers. It was a deliberate and correct decision by policymakers to make the risks to bank investors more explicit in the new system – and this has been a legitimate and important step forwards.

Seraina points out that within the new framework property rights are protected by important principles established in legislation. The two key principles are that resolution actions must be justified via a public interest test, and that no creditor should face losses that leave them worse off than if the institution had been wound up under normal insolvency proceedings.

However, while these principles are strong, they cannot provide 100% certainty upfront. This is not possible, as it is necessary for the authorities to retain some discretion when they are deciding what actions are in the “public interest”. In addition, a degree of uncertainty arises because resolution actions are based on estimated valuations rather than actual liquidation.

These uncertainties for investors are balanced by the ex post right to legally challenge administrative decisions. This appeal right provides a substantial final safeguard for property rights.

4 Observations on some ways to improve the bank resolution framework

I will now look forwards by reflecting on the potential areas for useful future reform that have been identified so far.

Within his endorsement of the shift towards administrative decision-making, Sabino identified two ways in which fundamental rights might be more comprehensively protected in future.

The first was the idea of consolidating and boosting the independence of administrative actors by improving their means of resisting capture by interest groups. As an employee of an administrative body, I very much appreciate the importance of establishing independence within the legislative framework – and it is right to think about how further progress can be made in this regard.

The second was the idea of expanding the potential grounds for appealing administrative decisions on bank resolution. On this topic, I think we can all agree that the right of appeal must exist, but I open this topic up to comments from the audience – with a particular emphasis on the question of whether expanding appeal grounds would potentially make legal challenges too easy.

David referred to ongoing work at European level to improve the loss absorbency framework via minimum requirement for own funds and eligible liabilities (MREL) instruments. The work is aimed at implementing the total loss-absorbing capacity (TLAC) standards into the European legal sphere. Of course, it will take time and effort for banks to build up their loss-absorbing capacity in this respect. I am confident though that this effort will be worth it, as it will make future resolution cases easier. Moreover, I believe it will simplify things – by at least partially addressing the layers of complexity that David identified. From my own perspective, I think it is important to note the importance of making progress towards building a single European deposit guarantee scheme (DGS). For me, this is the natural next step in deepening financial integration across the banking union. Amongst other benefits it would greatly simplify the task of cross-border bank resolutions.

Clearly, this is a difficult and politically sensitive topic, and we therefore need to find innovative ways to move forwards. Difficult problems include the legacies of problem assets, and the associated question of how to alleviate concerns that the mutualisation of risk could proceed too quickly.

In recent talks with a senior central banker, I was told of an idea to begin by creating a single DGS merely for the banks supervised directly by the European Central Bank (ECB). This would make resolution of these banks far more feasible, especially as many of them operate across multiple borders.

Further, given that banking supervision and bank resolution – i.e. the Single Supervisory Mechanism (SSM) and SRM – are already aligned at the euro area level, it also makes sense for the DGS to adopt this alignment. The European DGS would apply for the biggest and most internationally active banks, with national schemes continuing to take care of smaller banks. Such a solution may alleviate the concerns of those who are worried that a European DGS should wait for further progress on risk reduction.

5 Conclusion

Overall, I see that we have made progress in developing the resolution framework in Europe. At a minimum, we have now at least established clarity that substantial private sector burden-sharing is a non-negotiable prerequisite prior to public funds being touched. This represents important progress.

However, we must recognise that taxpayers are still not fully insulated from the risks of bank failure. One question for the audience's comments is whether, as resolution regimes mature, we should continue to aim for the goal of full taxpayer protection?

Another question that I will leave you with regards the degree of protection that is afforded to depositors within DGSs. My view is that it is important to cultivate the interests of bank clients in the risk profile of the banks that they do business with. In regulating and supervising financial institutions, we should still make space for market forces and market discipline to act.

Panel 6

Overcoming silo thinking – a
cross-sectoral approach to financial
market policies and rules



Overcoming silo thinking: a cross-sectoral approach to financial market policies and rules

By Christian Kroppenstedt¹

The sixth panel had as its topic “Overcoming silo thinking: a cross-sectoral approach to financial market policies and rules”. The panel explored this topic from four different perspectives. Sir Paul Tucker looked at it from the perspective and experience of the Bank of England and addressed the issue in a presentation entitled “Restructuring, resolution and insolvency – shift of tasks from judicial to administrative authorities”. Professor Otmar Issing shared his experience as member of the Executive Board of the European Central Bank (ECB) with the two-pillar structure of the ECB’s monetary policy strategy in his paper “Importance of price stability considerations in the fulfilment of the mandate of the ECB – separation of functions”. Professor Kern Alexander delivered a presentation entitled “Relationship between supervision/resolution and monetary policy/supervision – issues of separation, conflicting competences and complementarity” in which he identified in today’s set-up a significant gap for macroprudential considerations/competences at the EU level. Finally, Joanne Kellermann addressed from the perspective of the Single Resolution Board the need for cooperation between the different competence levels by looking at the issue of how “financial stability in the Eurozone is enhanced by cooperation among authorities”.

For the purposes of framing the discussion and for a better understanding of the relevant issues, the following provides a short and general introduction to the topic of the panel.

1 Some reflections on financial stability considerations

The financial and sovereign debt crises demonstrated the need to improve the rules and policies governing the financial markets, as well as the need to reorganise the institutional set-up within the framework and boundaries established by existing EU primary law. One of the key objectives of the improved policies and rules is the concept of financial stability. Therefore, a high-level look at how this concept is defined by EU law seems warranted.

If we look at EU primary law there are only very few references to this concept.

Article 127(5) of the Treaty on the Functioning of the European Union (TFEU), or Article 3 of the Protocol on the Statute of the European System of Central Banks and

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of the European Central Bank (Statute of the ESCB) provides that “the ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to [...] the stability of the financial system”. The use of the word “contribute” seems to indicate that the ESCB competences in this respect are to be qualified as supporting competences within the meaning of Article 2(5) of the TFEU, also implying that the responsibility for the stability of the financial system lies with the competent authorities of the Member States, and that the Eurosystem may intervene to support, coordinate or complement the actions of those Member States whose currency is the euro. Article 141(2) of the TFEU provides that “if and as long as there are Member States with a derogation, the European Central Bank shall, as regards those Member States [...] hold consultations concerning issues falling within the competence of the national central banks and affecting the stability of financial institutions and markets”. Article 25 of the Statute of the ESCB provides that “the ECB may offer advice to and be consulted by the Council, the Commission and the competent authorities of the Member States on the scope and implementation of Union legislation relating to [...] the stability of the financial system”. Both of these competences also seem to fall within the category of competences as defined by Article 2(5) of the TFEU.

It follows from Article 136(3) of the TFEU that financial stability in relation to financial markets has to be distinguished from, and should not be confused with, the concept of stability of the euro as further specified in Article 3 of the European Stability Mechanism (ESM) Treaty to mean “financial stability of the euro area as a whole and of its Member States” for the purposes of which the ESM can provide financial assistance. The clear allocation of this competence implies that there is no scope for any actor at EU level to argue any competence, including any based on EU secondary law, for the purposes of protecting the financial stability of the euro area.

Secondary EU law provides some detail to the concept of financial stability in relation to specific actors and their relevant activities at EU level. Article 1 of the Single Supervisory Mechanism (SSM) Regulation² establishes the concept of stability of the financial system within the Union and each Member State by conferring on the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions, with a view to contributing to the safety and soundness of credit institutions and the stability of the financial system within the Union and each Member State. Article 1(5) of the European Securities and Markets Authority (ESMA) Regulation³ establishes the concept of contribution to the short, medium and long-term stability and effectiveness of the financial system by conferring on ESMA the objective “to protect the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system, for the Union economy, its citizens and businesses”. The same objective applies to the European Banking

² 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).

³ Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).

Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA). Article 2 of the ESMA Regulation establishes the concept of preserving financial stability and ensuring confidence in the financial system as a whole by conferring on the European System of Financial Supervision (ESFS) the objective “to ensure that the rules applicable to the financial sector are adequately implemented to preserve financial stability and to ensure confidence in the financial system as a whole”. Finally, Article 3 of the European Systemic Risk Board (ESRB) Regulation⁴ establishes the concept of preventing or mitigating systemic risks to financial stability in the Union by conferring on the ESRB the responsibility for the macro-prudential oversight of the financial system within the Union “in order to contribute to the prevention or mitigation of systemic risks to financial stability in the Union that arise from developments within the financial system and taking into account macroeconomic developments”.

With the exception of the SSM Regulation and the ESRB Regulation, which are based on Article 127(6) of the TFEU, EU secondary law, referred to in the previous paragraph, is based on Article 114 of the TFEU meaning that the concept of financial stability was developed for the purposes of the approximation of provisions in law, regulations or administrative actions in Member States which have as their objective the establishment and functioning of the internal market. For the qualification of the competences which have been allocated to the EU level this implies the following. The objective of stability of the financial system within the Union and each Member State will be pursued by the ECB in the exercise of an exclusive EU competence within the meaning of Article 2(1) of the TFEU. The financial stability objectives as allocated to the EBA, ESMA, EIOPA, the ESFS and the ESRB on this basis will be pursued by these EU bodies in the exercise of shared competences within the meaning of Article 2(2) of the TFEU or support competences within the meaning of Article 2(5) of the TFEU.

To the extent that competences with regard to the objective of financial stability in relation to financial markets have not been allocated to the EU level – in line with the principle of conferral that governs the division of powers between the EU and the Member States – they remain within the competence of the Member States to be exercised by national competent authorities. In this respect, reference is made to the *Dowling* judgment⁵ in which the Court of Justice held that a national measure overriding secondary EU law may be justified in specific circumstances in order to prevent a systemic risk and ensure the stability of the Union.

This complex competence mix and the far from clear delimitation of “who is responsible for what” in relation to powers exercised for the objective of the stability of the financial markets imply that the different actors at EU and national level need to be very careful in justifying their actions based on financial stability considerations and, at the same time, be mindful that any of their actions may also impact on the

⁴ Regulation (EU) No 1092/2010 of the European Parliament and the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (OJ L 331, 15.12.2010, p. 1).

⁵ Case C-41/15, *Gerard Dowling and Others v Minister for Finance*, ECLI:EU:C:2016:836.

actions of other actors which have financial stability considerations as part of their objectives.

2 Cooperation between the different actors

As pointed out above, EU primary law not only implies that the allocation of competences within the broad, not clearly defined concept of financial stability will be an ongoing mix of national, exclusive EU, shared and EU-supporting competences, but also that EU competences will remain allocated to different EU executive bodies and institutions. Therefore, in order for the new policies to work, cooperation on activities across the different competence levels seems to be required. In this context, Article 13(2) of the Treaty on European Union is often mentioned as a general legal basis, obliging EU institutions to practise sincere cooperation. This applies equally to cooperation between the national and the EU level, or vice-versa. However, from an institutional law perspective, it is doubtful whether the principle of sincere cooperation would qualify as a legal basis, as principles generally limit the exercise of powers, but do not grant them. As a consequence, the conditions and limits of such cooperation have to be assessed on the basis of the institutional framework applying to each of the actors involved in such cooperation.

Finally, cooperation should not lead to a blurring of the responsibility, accountability and liability of each of the different actors. The example of the ECB demonstrates that different accountability requirements apply to the ECB in the exercise of its monetary policy function and its supervisory function, the latter as laid down in the SSM Regulation⁶. In addition, the SSM Regulation explicitly recognises the need to separate the supervisory function from the monetary policy function not only for the purposes of carrying out the tasks and the related decision-making but also in terms of pursuing the objectives.

3 The specific aspect of information sharing by the ECB

Sharing of information may be one of the means of cooperation. In general, i.e. even in the absence of a specific legal basis, the ECB is implicitly authorised to transmit information to other EU institutions and bodies on a discretionary basis within the framework what is legally permissible. Limitations for transmission of information may result from statutory obligations and contractual obligations vis-à-vis commercial data vendors pursuant to which the ECB may transmit data to other EU institutions and bodies only under certain conditions. These conditions can be that the ECB may only transmit data to other EU institutions and bodies (i) with the prior consent or authorisation of the data subject or person who has collected the data or otherwise

⁶ Mersch, Y. (2017), "Central bank independence revisited", *Symposium on building the financial system of the 21st century: an agenda for Europe and the United States*, Frankfurt am Main, 30 March.

owns it⁷ (ii) subject to compliance with applicable confidentiality requirements⁸ or (iii) a combination of both⁹. Confidentiality requirements may be overcome or fulfilled, i.e. they will not limit the transmission of information to other EU institutions or bodies if other EU institutions and bodies abide by the same or at least comparable rules¹⁰ (see, e.g. Article 88(6) of the Single Resolution Mechanism (SRM) Regulation)¹¹ or if compliance with applicable confidentiality requirements is specifically assessed before authorisation to transmit information is given (see, e.g. Article 8(4a) of Council Regulation (EC) No 2533/98).

The purpose of a specific legal basis is, thus, to frame or limit the discretion of the ECB to transmit information to other EU institutions and bodies by, e.g. (i) specifying the EU institutions and bodies to which certain categories of information may be transmitted on a discretionary basis, thus excluding those that are not specified (Article 8(4a) of Council Regulation (EC) No 2533/98) or (ii) laying down a legal obligation to transmit information with regard to a specific EU institution or body (Article 30(2) of the SRM Regulation).

Irrespective of whether the ECB acts under a specific or the general legal basis, it may only transmit information where there is a “need to know”. In other words, any information transmitted to the recipient must be “necessary” for the exercise of the recipient’s tasks. In this respect two qualifications are relevant. First, as the term “necessary” refers to the principle of proportionality, the requested information not only has to be necessary for the exercise of the recipient’s tasks within the strict meaning of the term, but must also be adequate, relevant and not excessive in relation to the legitimate exercise of these tasks. Second, the ECB must not rely on the recipient’s assessment of its “need to know”, but must make its own assessment as to whether the request for information complies with the principle of proportionality. This does not preclude that the ECB limits ex ante the scope of its own assessment by pre-identifying certain data or types of data that are generally considered “necessary” for the exercise of the recipient’s tasks.

Where the ECB is not legally obliged to transmit information (for instance where the information is outside the scope of Article 30(2) of the SRM Regulation), it needs to take into account specific considerations when exercising its discretion as to whether to transmit information to a recipient. Two considerations that generally weigh in favour of transmitting information are (i) the general principle of sincere cooperation (which obliges EU institutions and bodies to assist each other in carrying out their

⁷ Article 8(1)(a) of 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).

⁸ Article 37 of the Statute of the ESCB; Article 27(1) of the SSM Regulation.

⁹ Article 8(4a) of Council Regulation (EC) No 2533/98.

¹⁰ This is the reason why information exchange is often mentioned in the context of professional secrecy (see e.g. Article 37 of the SSM Regulation, Article 88 of the SRM Regulation and Articles 53 et seq. of the CRD IV). Information exchange may be possible in spite of the limitations resulting from statutory obligations relating to professional secrecy, provided that applicable confidentiality requirements are generally or specifically met.

¹¹ 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).

tasks) and (ii) the avoidance of any duplication in the collection of information (which aims to ensure that collection is efficient and that the reporting burden on agents from whom information is collected is not therefore excessive). However, these considerations cannot override any others. As far as the principle of sincere cooperation is concerned, the weight that should be given to it is relatively low in cases where there is a specific legal basis for transmitting information. This is because it can be safely assumed in such cases that the EU legislature has already specified the conditions under which the ECB fulfils its obligation to assist other actors in carrying out its tasks by transmitting information to them. As far as the avoidance of any duplication in the collection of information is concerned, this does not necessarily override limitations applicable to the transmission of information, which should be carefully analysed. This is especially warranted when information is collected in the exercise of the supervisory function, but relates in substance to the monetary policy function of the ECB. In this regard, specific requests may be treated more benevolently, as they are limited in scope.

Central banks as trustees for monetary system stability: combining banking supervision with monetary policy

By Paul Tucker¹

The debate about whether or not central banks should be – or, even, can decently be – prudential supervisors and regulators is distinctly odd, mixing economics with law, and combining fanciful descriptions of reality with arguments of principle that are sometimes general but sometimes specific to particular jurisdictions. I am going to try to disentangle some of this, along the way drawing on the recent reforms of the UK system that I helped author after the 2008/09 phase of the Great Financial Crisis.²

1 Attitudes to responsibility for prudential supervision are shaped by local traditions

First a story. Years ago, while sitting next to him at dinner, I asked former Bundesbank President Helmut Schlesinger why he publically maintained that central banks should not be the bank supervisor when, as a matter of fact, many Bundesbank (Buba) staff were engaged on bank supervision. The response was that the central bank was not formally responsible or accountable, so banking problems would not infect the Bundesbank's reputation and standing as a monetary authority.³

1.1 Cultural differences: accountability

There might be cultural specificities here. In my own country, and I would guess the United States, the central bank could not escape censure over a banking crisis by saying that it was only one of a number of *de facto* supervisors, not the *de jure* regulator. Indeed, the Bank of England did not escape responsibility for the Northern Rock crisis in 2007 even when it had no role in supervising banks and markets.

¹ Chair, Systemic Risk Council, and fellow, Harvard Kennedy School.

² This chapter draws on material from *Unelected Power: The Quest for Legitimacy in Central Banking and the Regulatory State*, scheduled for publication by Princeton University Press during Spring 2018. Printed by permission of Paul Tucker and Princeton University Press.

³ On BaFin's routine reliance on Buba supervision: section 7(2) of the Banking Act. Anticipating the influence of the Buba myth, its extensive role in supervision was underlined in Quinn (1993).

1.2 Constitutional differences: delegation-with-insulation

That is one big difference. Another is the constitutional set-up. Unusually for an advanced-economy democracy, Germany's Basic Law makes explicit provision for the administrative state, including delegation by the parliament to the elected executive branch, and on-delegation by ministers to agencies. The Basic Law also makes clear, however, that, with the sole exception of the Bundesbank, agencies must be under the control of the relevant ministry.⁴

Accordingly, drafts of regulatory rules are often submitted to ministries for vetting, before being finalized and issued in the name of the agency itself.

The Bundestag and its committees do not have to approve proposed rules. Nor, in marked contrast to Britain, do they actively oversee the work of agencies, apparently on the grounds that it (simply) comprises implementing a clear policy set down in law, under the control of the designated ministers.

Against that backdrop, it is hardly surprising that there is reluctance in Germany, and especially in the Bundesbank itself, to give the central bank *de jure* responsibility for banking supervision. To do so would mean that the central bank was not fully insulated from politics in *all* of its functions, which might lead to political leverage over monetary policy.

That is a good, perhaps even decisive, argument for not giving the Bundesbank formal powers over banking. It is, however, quite different from arguing that supervision should not be combined with monetary policy in any jurisdiction, whatever the constitutional circumstances. To argue more generally that central banks must never be responsible for prudential supervision, as German officials are wont to do, is to maintain that the German constitutional arrangements are optimal for all. Given its membership of the EU, Germany itself can hardly believe that.

This basic driver of the German position on the scope of central bank responsibilities could usefully be brought into the open, since it affects ongoing debates about whether the ECB should continue to be the prudential supervisor of euro area banking stability.

We had better, then, look at the substantive issues:

- Should central banks be involved in prudential supervision?
- If so, should they be independent in that function?
- How should such a regime be structured?

⁴ Views differ on the Bundesbank's constitutional status prior to European monetary union: a monetary institution was specifically contemplated by the Basic Law but its independence was made explicit only in the ordinary legislation that created Buba. Germany's first post-WWII Chancellor, Adenauer, was sceptical about monetary independence: Marsh, D (1992). More specifically, in common with the core civil service, each agency is formally subject to one or two types of ministerial oversight and override: *Rechtsaufsicht* and *Fachaufsicht*, which are broadly equivalent to the English-American *vires* and substantive merits. The financial regulator (BaFin) is subject to both; the famous cartel office (*Bundeskartellamt*) only to *Rechtsaufsicht*.

2 The argument for central banks being involved in prudential supervision

The essential argument, hinted at already, is that central banks cannot avoid being involved in stability issues, whether they like it or not.

2.1 An inalienable interest: the LOLR at the scene of financial disasters

Runs on the banking system – people demanding that their deposits be redeemed immediately in cash – amount to increases in demand for a central bank’s money. If banks do not hold sufficient central bank money (or assets that can be converted into central bank money via the market) to meet their customers’ demand for cash, they will fail if they cannot go to the central bank and exchange illiquid assets for cash. Assuming the central bank agrees, it is doing two things at the same time. It is stabilizing banking by acting as a lender of last resort (LOLR), and it is ensuring that the liquidity crunch does not interfere with the course of monetary policy. The mission of preserving banking stability and price stability are intimately intertwined not only for society but for the central banks in their most elemental function: creating money.

This has dramatic effects on where and when the central bank crops up in a country’s economic life. As the LOLR, they are almost certain to find themselves at the scene of a financial disaster.

In many societies, that generates demands for the central bank to give an account of how things could have come to such a pretty pass. After the collapse of Northern Rock in 2007, the front cover of the British edition of *The Economist* was a photograph of the then Governor of the Bank of England under the headline “The Bank that failed.”⁵ Not a triptych of central banker, regulator and finance minister – the members of the UK’s then Tripartite Committee for stability – but the first only. My point is that a statutory regime where supervision and regulation were formally and practically at arm’s length from the central bank could not, when it mattered most, insulate the reputation of the monetary authority from prudential problems, as some in the UK and elsewhere had mistakenly expected.

All that being so, central banks, as lenders of last resort, have an interest in being able to influence the system’s regulation and supervision. At the most basic level, when they lend, they want to get their money back! They need to be able to judge which banks (and possibly near-banks) should get access to liquidity, and on what terms: the source of their historical pragmatic authority over banking. Even opponents of ‘broad central banking’ generally accept that, as the lender of last resort, the central bank cannot avoid inspecting banks that want to borrow. Events in the UK in 2007 demonstrated that doing so from a standing-start is hazardous for society. A central bank must be in a position to track the health of individual banks during peacetime if it is to be equipped to act as the liquidity cavalry.

⁵ *The Economist*, 20 September 2007.

What I am describing is, I believe, uncontroversial. It is one reason the Buba employs bank supervisors and is active in international fora on regulatory policy such as the Basel Committee and the Financial Stability Board.

2.2 Cooperation and information exchange

Couldn't that be accomplished without putting the central bank in the lead? The answer must be, yes. If, however, the central bank and the lead stability authority are separate, they need to cooperate – indeed, coordinate – to an unusually high degree. Information flows would need to be frictionless. That is more easily stipulated and promised than secured. For individual bureaucrats, clashes that can be painted as 'turf wars' can be highly damaging, leaving underlap as an institutional equilibrium that suits the private of interests of those concerned. For society, however, underlap can be a lot more damaging than overlap. The world discovered exactly that when it bore the costs of the distance between central bankers and regulators in the two main international financial centres over the decade or so leading up to 2007/08.

If the central bank is involved, it needs a statutory right to obtain information from banks and from any separate supervisory authority.

2.3 De facto power should be formalised in modern constitutional democracies

As I have described it, central banks cannot sensibly be excluded (or exclude themselves) from regulation and supervision of the financial system, but nor can they make a unique claim that only they should regulate or supervise in the cause of system stability.

The extra step I want to make is that *if* central banks are to be involved materially in supervision, whether alongside other agencies or not, our democratic values demand that their role should be formalized, so that it is clear what they are accountable for.

3 From influence to insulation: trustees for monetary-system stability

Arguing that central banks warrant some kind of formal role in stability policy is not sufficient to make the case for their being insulated from day-to-day politics in pursuing those responsibilities. That is to say, should their independence extend to any role in prudential supervision and stability policy? I think it should.

3.1 Credible commitment

It is probably uncontroversial to say that booms in the supply of credit, in house prices and in financial-asset prices more generally can be deeply alluring once underway. In this, stability policy shares some of the characteristics of monetary policy. A political decision-maker (and so an agency under political control) would be tempted to substitute their own interests (re-election, popularity) for the country's interests during a period of exuberance, allowing a potentially destabilising credit boom to persist in order to harness the 'feel-good factor'. In other words, there is a classic problem of credible commitment here: society would ideally like to tie itself to the mast of 'stability' but finds it difficult to do so.

Independence in this field has some of the same grounds, therefore, as the case for monetary policy independence.

3.2 The curse of taxpayer bailouts: fiscal risks must be bracketed away

What, though, of the historical prevalence of taxpayer solvency bailouts, an unambiguously fiscal measure, when preventative measures have failed and the only remaining choice lies between the abyss and capitulation? Traditionally, this gave the elected executive (and their civil service protectors) an ongoing interest in the conduct of prudential supervision, wanting to know when any firm might be ailing. But it seems to me that the reforms to resolution regimes over recent years have changed that. Today, there is no good reason why resolution plans for banks should not be sufficiently credible for independent central banks to be independent in their role as banking supervisors.⁶

Where doubt remains, the executive branch could be granted a power to override the supervisor's actions when ministers believe that there is a tangible *direct* threat to the public finances, subject to any use of that override power being contemporaneously transparent to the relevant legislative committee and to the full assembly after a suitable delay (if immediate public disclosure would be destabilizing). That would replicate the monetary policy override power that exists in some countries without undermining monetary independence.

3.3 Central banks as trustees of monetary-system stability

A central bank with both functions would have the mission of maintaining the stability of the *monetary system*.

The public policy objective of preserving a stable financial system, able to provide the core services of payments, credit and risk insurance in all weathers, is not completely separable from monetary stability, because it is largely the stability of the

⁶ Tucker (2014).

private part of an economy's monetary system, the banks, that is at stake. We should think of what I am calling 'monetary-system stability' as having two components:

- stability in the value of central bank money in terms of goods and services; and
- stability of private-banking system deposit money in terms of central bank money.

To be clear, the second leg absolutely does not entail that no banking institution can be allowed to fail; only that the monetary liabilities of distressed firms must be transferable into claims on other, healthy deposit-taking firms or otherwise mutualized so that payments services are not interrupted.

That view of the importance of the banking system used to be orthodoxy at the summit of central banking. It is now being restored after the brutal lessons of the Great Financial Crisis.

Summing up so far, I am arguing that since society is clearly averse to financial crises and that since there is a problem of credibly committing to a policy designed to keep crisis at bay, stability policy might formally be delegated to an independent agency charged with preserving monetary-system stability. As put, that would be welfare enhancing. But can it be squared with the values of democratic governance? So far, we have left open what the objective would be; what activities would be entailed; how such a multiple-mission central bank should be organised; and how the central bank would be organised. Each takes us beyond economics into public law. We begin with the objective.

4 A highly focused mandate: system resilience

The mandate should be as limited as possible, and the objective should be framed so that success or failure is capable of being monitored by legislators and the public. On the monetary policy side, an inflation target passes those tests. More debate is needed on how to achieve this on the stability side.

Part of the problem is that the pathologies and frictions in the financial system give rise to two distinguishable types of social cost:

1. *Boom*: a misallocation of resources and, in particular, over accumulation of debt during 'booms', which matter whether or not boom ends in 'bust'.⁷
2. *Bust*: a collapse in asset values and a withdrawal or severe tightening in the supply of essential financial services following a crisis at some intermediaries, bringing about a macroeconomic downturn and social distress.

⁷ Borio, Kharroubi, Upper and Zampolli (2015).

Much debate and, more important, some jurisdictions' regimes leave it unclear whether a central bank (or other regulator) is being charged with both, only one, or something unclear. This matters.

The drivers of the first include myopia and incentives to herd. They are grasped in only broad or qualitative terms, typically involve some violation of 'rationality', and so, today, are hard to predict or model. That being so, a system designed to *fine-tune* credit and asset-price dynamics would be too ambitious for delegation-with-insulation as we would not know how to frame a monitorable objective that would, if achieved, deliver an agreed purpose. For example, while the ratio of outstanding credit to aggregate national income (or a ratio of their growth rates) could be set as an objective and would be monitorable, it is not clear how well it connects to things we care about. Nor is it clear whether available policy instruments could steer it reliably or predictably. Political policymakers might take on that kind of mission but not insulated unelected technocrats.

The second type of social cost – chaos followed by severe economic downturn – is both more salient with the public and better understood by technocrats. It is driven by fire-sales of assets, contagion, and the dislocations entailed by intermediaries entering bankruptcy, when the shutters come down and liquidators look after the private interests of creditors not the wider economy and society. The remedy is a resilient financial system that can continue functioning in the event of bankruptcies and distress. In this case, the instruments are relatively straightforward: when banking institutions are required to increase their equity, most likely there is a proportionate increase in the scale of losses it would take to push a bank over the edge in most states of the world. That can, I shall argue, be cashed out in terms of a monitorable objective.

This approach has important implications for central banks. Notably, it precludes their intervening in market malfunctions, including some asset-price booms, that jeopardize the efficient allocation of resources in the economy but *not* the financial system's resilience. It is not a regime directed towards actively managing credit conditions for different sectors or regions, since that would entail making the kind of big distributional choices that do not belong with unelected policymakers. More basically, it is not about consumer protection.

But how resilient should the system be, and who should decide?

4.1 Politics and a standard for system resilience

If the public-policy purpose of a central banking stability mandate should be continuity of services from the system as a whole, thus avoiding the worst costs of a 'bust', the core of the regime must, I say, be a monitorable *standard of resilience*.

Abstractly, policymakers need to determine the severity of shock that the system should be able to withstand. In principle, that would be driven by three things:

- (a) a view of the underlying (stochastic) process generating the first-round losses from end-borrowers that hit the system;
- (b) a picture (or model) of the structure of the financial system through which those losses and other shocks are transmitted around the system;
- (c) a tolerance for systemic crisis.

The first and second are properly objects of scientific inquiry by technocrats and researchers. The third is different. Whereas the central belief of monetary economics relevant to the design of policy institutions is that there is no *long-run* trade-off to speak of between economic activity and inflation, we do not yet know whether prosperity could be damaged by totally eliminating the risk-taking behaviour that can threaten periodic bouts of instability.⁸ How much residual systemic risk to permit is, in democratic societies, properly a matter for democratic debate and choice.

The 'tolerance for crisis' that, in principle, elected politicians would bless needs unpacking. Crisis/non-crisis is not binary, but more akin to Dante's Circles of Hell: there are degrees of wretchedness. In 2008/09, policymakers avoided a repeat of the 1930s' Great Depression. The next generation must (and can) improve on that.

In consequence, we should think in terms of society's tolerance for different bad states of the world. The spectrum ranges from, at one end of the spectrum, all core services ceasing to be provided to, at the other end, severe impairment of only one broad type of service. We might plausibly impose a probability of very close to 0% on a seizure of the payments system causing us to have to resort to barter, as happened in parts of the United States during the 1930s. But maybe society wants to tolerate a slightly higher probability of a temporary interruption to bank lending or insurance.

Thus, real-world regulatory standards for different activities should be tailored to the nature and degree of the threat posed by each to system-wide resilience.

In fact, something like a tolerance for crisis is implicit in existing regulatory standards, such as the Basel III Accord for banks. When it was blessed by G20 leaders and, in Europe, formally passed into European Union law by the Council and Parliament, politicians surely understood that they could have chosen a much tougher or much lighter standard. (It is less clear that high-level consistency has been maintained across sectors and activities.)

⁸ Ranciere, Tornell and Westerman (2008), pp. 359-406.

4.2 Monitoring the system's resilience: stress testing

What about monitoring delivery of the objective?

We have learnt that mechanical compliance – for banks, publishing a suitably high capital ratio – is grotesquely insufficient given regulatory arbitrage and shifts in the economic environment.

The advent of stress testing, introduced by the Federal Reserve in 2009 and since adopted by the ECB and Bank of England, is much more promising. Regular stress tests help supervisors to assess system resilience and to make judgments about the safety and soundness of individual firms taking into account correlated exposures across intermediaries. Transparency means commentators, elected politicians and the public can monitor the results.

This will help legislators think about the degree of resilience they want to require in the financial system, about how well the regime is working, where it needs reform, where responsibilities should be rejigged.

The centrality of stress testing to the post-crisis regimes underlines the vital importance of supervisors being independent from politics and the industry, turning their backs on forbearance, a form of opaque gambling with the people's welfare. Rising to that might be easier if each major jurisdiction's supervisors allowed in observers or participants from foreign authorities that have a stake in the system's resilience; and by independent reports on the integrity of each centre's process.⁹

5 Functions: micro- and macro-prudential

Two important things flow from that discussion.

First, micro-prudential supervision and macro-prudential policy overlap in all sorts of ways. They share an objective; and macro-prudential instruments are simply micro-regulatory requirements calibrated to the needs of the system as a whole. If the central bank is involved in one, it is inevitably involved in the other. This chapter's prescription that a modern central bank's functions be formalised accordingly applies to both.

Second, neither function is mechanical. Both involve judgment. A macro-prudential policymaker needs to make judgments on whether changes in the environment or structure of the financial system warrant dynamic adjusting core regulatory requirements, such as minimum capital requirements, in order to sustain the desired degree of system resilience.

Micro-supervision is not simply a matter of enforcing a detailed rule book. Rules provide a shaky foundation for stability given endemic avoidance and evasion. Supervisors are bound to lose the game of catch-up if they approach their role as

⁹ Cecchetti and Tucker (2015).

mechanically checking compliance with the letter of rules. Identifying and punishing rule breaches after the financial system has imploded, creating economic havoc, does not rise to the seriousness of the stability mission.

Instead, the micro-supervisor has to be ready and able to make judgments of the kind: “Firm X is managed so imprudently that there is no reasonable prospect of its meeting the required *standard of resilience* in the states of the world it is likely to confront”. Where that judgment is reached, the micro-supervisor needs to be ready (and so legally empowered) to revoke the firm’s licence, or place (monitorable and enforceable) constraints on its risk-taking.

This is what US lawyers would call an adjudicatory function. The basic criteria (standards) underpinning the supervisor’s findings – e.g. prudence, competent management, a separation of powers within the intermediary – have to be established in statute, and interpreted in the light of the regime’s purpose.

5.1 The potential functions of a multiple-mission central bank

The potential functions of the post-crisis central banks are now clearer. While the core standard of resilience should carry some kind of political sanction, a central bank trustee of broad monetary-system stability could in principle play a role in:

1. calibrating how that standard is applied to the banking system (broadly defined) and, conceivably, to other parts of the financial system;
2. micro-prudential supervision of banking intermediaries at or towards the core of the payments system;
3. micro-prudential supervision, to detect and deter hidden actions, of other individual firms, funds, structures, etc. which might need liquidity reinsurance to maintain the provision of core services to the economy;
4. surveillance of the system as a whole to identify vulnerabilities;
5. dynamic ‘macro-prudential’ adjustment of regulatory requirements to maintain the desired degree of resilience in exuberant conditions;
6. deploying crisis-management tools and policies, notably as lender of last resort.

This is not theoretical. Amongst the advanced-democracy central banks, the Bank of England unambiguously has all six roles (not exclusively in every one of them), with the Fed and ECB differing only in having, respectively, slightly more limited or informal macro-prudential responsibilities and powers.

5.2 The organisation of multiple-mission central banks

A risk with multiple-mission agencies, and so with multiple-mission central banks, is that they are liable to prioritize one mission ahead of the others, notably if its effects are more easily observed and more highly valued by the public and politicians.

The pre-crisis Federal Reserve could be regarded as emphatically exhibiting the pitfalls of combining in one agency functions as apparently disparate as monetary policy and bank supervision. With the top brass selected according to their expertise in monetary economics and/or forecasting the path of the economy, and with the level of interest rates massively salient, supervision of banks became a backwater for a couple of decades.

By contrast, the lamentable fate of the UK's post-1997 regulatory architecture points to the dangers of strict separation. Following the 2007/09 phase of the crisis, the UK drew the conclusion that monetary policy and banking system stability are so inextricably linked that they should be housed under one roof, but that there should be separate committees for each function to ensure that all are taken seriously. Each – the Monetary Policy Committee (MPC), Financial Policy Committee and Prudential Regulation Authority – was to have a majority of members who were on only that committee.¹⁰

Separate statutory committees for micro- and macro-prudential policy were adopted essentially so that a majority on the latter are not infected by any lapses in micro-oversight and to draw on different types of technocratic skill, the macro-prudential policymakers needing to understand macroeconomics as well as the financial system.

Like the monetary policy committee, the stability committee must meet regularly given a potential bias to inaction. Faced with uncertain long-term benefits but a risk of unpopularity, policymakers might incline towards delaying action until the resilience-eroding threats of exuberance or imbalances are widely perceived. To help avoid that, the stability committee has to formally reset various core regulatory instruments at fixed intervals, with published minutes giving reasons for its decisions, including 'no change'.

This is not a million miles away from the Fed's longstanding structure, with monetary and regulatory responsibilities split between the Federal Reserve Board and the Federal Open Market Committee (FOMC). But, in contrast to the Fed, it separates micro- from macro-stability, and does not confine outsiders to the monetary committee.

Broadly, it is also approximated in the euro area, with the ECB having separate monetary and micro supervisory committees, albeit with the former having a right of

¹⁰ Reflecting proposals that former Deputy Governor and Basel-Committee chair George Blunden and I had each aired in the late 1970s, mid-1980s, early 1990s and mid-2000s, the micro-supervision body was initially established, on the French model, as a formal subsidiary in order, amongst other things, to give the external members a statutory role in internal organization given that some supervisory outputs are effected at desk level.

override over the latter (and both being too big to be properly deliberative bodies). But the euro area's macro prudential structure is much more complicated, involving the Commission and others.¹¹

6 Transparency and accountability

My penultimate heading is transparency and accountability, which are vital pre-conditions for the legitimacy of any central banking stability regime. Nothing short of a revolution is needed but stress-testing might be just that.

6.1 The long-standing problem of monitoring prudential supervision

While *regulatory* outputs – rules and regulations – are obviously observable, historically the activities of prudential *supervisors* have been largely invisible, except to the individual regulated firms themselves.

Within the community of prudential supervisors, sensitivity to the social costs of firm failure long ago gave rise to a culture, doctrine even, that their work must be confidential: that the world would not be safe if they revealed what they knew about banks' weaknesses or what remedial actions they were requiring or urging. Although those worries are understandable, they are at odds with the notion that prudential supervisors should be insulated from day-to-day politics.

Fortunately, as already discussed, regular and transparent stress testing gives supervisors something concrete and important to say in public.¹² This could over time transform public accountability for and public debate around prudential supervision, taking it towards what has become standard in the monetary policy world. Year by year, everyone can see the severity of the chosen stress scenarios as well as the firm-by-firm results. Legislators are able to examine regulators on both, drawing on commentary from different parts of the financial system and independent analysts. In time that will be informed by academic research on the effects on market discipline, the relative toughness of different jurisdictions' tests, how well stress testing pinned down vulnerabilities ahead of large losses, and so on.

More broadly, a regime of regular, highly publicized stress tests can help to increase public awareness of prudential supervision, making it more salient during 'peacetime'. For those who have reservations about central banks acting as supervisors, that would mitigate one set of concerns but open up another: scrutiny.

¹¹ As I write, the system is under review.

¹² Transparency is not complete: notably, the regulator's own models are not published given the risk of gaming by the banks. Tarullo (2017).

6.2 Parliamentary hearings, including in camera

All this comes together in hearings before committees of the legislature. In Britain they are regarded as essential. At the Bank of England, we thought of them as the most important occasion for communicating with the public, allowing their representatives to decide whether to maintain a regime of delegation-with-insulation.

Things are a bit different for the ECB, as a Treaty institution over whom elected politicians have few if any levers other than whipping up public protest. But as unelected officials serving a confederation of democratic Member States, ECB policymakers have a duty to make the so-called dialogue as rich, illuminating and as difficult for themselves as they can.

Unquestionably, there are special challenges in giving an account of supervision and LOLR operations. The provision for private hearings with the European Parliament's ECON Committee is therefore an innovation that could act as a model for the rest of the world.

7 Multiple-mission central banks: choice of instruments, and judicial review

Armed with both regulatory and balance-sheet powers, a central bank would in theory have numerous options when faced with some kinds of threat to monetary-system stability. When a credit and asset-price boom jeopardized both the resilience of the banking system and price stability, it might in principle raise regulatory capital and/or liquidity requirements, apply stricter supervisory controls to those individual banking intermediaries that were especially vulnerable, increase the haircuts (excess collateral requirements) applied to its operations in the particularly exuberant markets, increase interest rates, and so on.

The prospect of judicial review should not influence the central bank's choice. In particular, contrary to the likely effect of some prescriptions in this area, the central bank should not be incentivised to turn immediately to monetary policy measures simply because more intense judicial scrutiny would apply to regulatory interventions. Instead, each should face the same broad standard of not being unreasonable or irrational.¹³

More profoundly, the articulation of a central bank's place in the regulatory state cannot proceed independently of its place in the fiscal state. Concretely, which arm should move first to head off threats to stability, the financial stability committee or the monetary policy committee? Put another way, should a multiple-mission central bank lead with regulatory policy or with balance-sheet policy if it believes that the price of risk is so dangerously cheap that it is undermining the system's resilience? That lies beyond the scope of this paper, but illustrates the range of outstanding challenges.

¹³ This seems broadly consistent with Goldmann (2014), pp. 266-280.

8 Conclusions: central banks can pursue system stability without deflecting monetary policy from price stability

The argument of this chapter is that it is time to stop denying the inevitable involvement of monetary authorities in stability policy. It is unavoidable because most of the money circulating in our economies is issued by private sector intermediaries, banks. The economy's credit system and monetary system are intertwined.

That being so, our democratic values argue for central banks' roles as supervisors and regulatory policy makers being formalised. That is the position with the ECB since the SSM was created. To take supervision away would be to endorse a system of power without responsibility.

This is not a threat to monetary independence. As good a case can be made for supervisors of system resilience being insulated from day-to-day politics.

It does, however, mean that there is a premium on the supervisors' objective being clear and monitorable. The supervisor must be as transparent as possible, and must embrace political oversight so that the people's representatives can keep the efficacy of the regime under review.

It is possible to resolve these issues without getting into whether, as monetary policy makers, central banks should actively lean against the wind. Instead, the focus should be on what is entailed by their role as lenders of last resort.

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Financial stability and the ECB's monetary policy strategy

By Otmar Issing¹

1 Lessons from the financial crisis

In the early 1990s, when the statute of the future European Central Bank (ECB) was discussed, there was a broad consensus about the optimal framework for a central bank:

1. Price stability should be the objective.
2. Political independence would allow the central bank to conduct the right monetary policy to reach this goal.

The ensuing Great Moderation, a period of low and stable inflation, satisfactory results for growth and employment, seemed to support this view. Financial stability concerns were largely ignored. It was assumed that maintaining price stability would, more or less, implicitly also guarantee financial stability. Early discussions mainly organised by the Bank for International Settlements (BIS) were devoted to the role of asset prices in the conduct of monetary policy and to potential conflicts between price and financial stability.²

However, “maintaining price stability is not enough,” was a major lesson from the 2008/09 financial crisis. Longer periods of low and stable inflation might even foster unwarranted risk taking that may lead to a “Minsky moment” and finally end in a collapse of financial markets.

In the aftermath of the crisis, one conference after the other was organised and a plethora of papers was published, all discussing which lessons to draw from the crisis.³

It is premature to claim that a new consensus has already emerged. Yet, one conclusion should be uncontroversial: the prior position of focusing exclusively on the maintenance of price stability and of relying on the power of a “mop-up strategy” once a financial crisis has emerged has been invalidated by the huge economic and social costs incurred after 2008.

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² Issing (2003).

³ For an excellent survey, see Smets (2013).

This strategy was characterized in the following way:

“The ‘mop-up-after strategy’ received a severe real-world stress test in 2000, when the biggest bubble in history imploded, vaporising some \$8 trillion in wealth in the process. It is noteworthy, but insufficiently noted, that the ensuing recession was tiny and not a single sizable bank failed. In fact, and even more amazingly, not a single sizable brokerage or investment bank failed either. Thus, the fears that the ‘mop-up-after strategy’ might be overwhelmed by the speed and magnitude of the bursting of a giant bubble proved to be unfounded. Regarding Greenspan’s legacy, then, we pose a simple rhetorical question: If the mopping-up strategy worked this well after the mega-bubble burst in 2000, shouldn’t we assume that it will also work well after other, presumably smaller, bubbles burst in the future? Our suggested answer is apparent.”⁴

2 Preventing a major crisis – but how?

In retrospect, it is surprising that such a position at that time represented “mainstream thinking” and was hardly disputed. It is interesting to note that Rajan’s warning at the same Jackson Hole Conference was more or less ignored although even in his words there was only a “still small probability of a catastrophic meltdown.”⁵ But, exactly such a meltdown happened in 2007/08. As a consequence, all measures available had to be taken to prevent the world from falling into a depression of a magnitude comparable to the 1930s. Once the financial system collapsed there was no alternative after all. However, the aftermath of the crisis entailed immense and lasting economic and social costs.

Just relying on “mopping-up” is not anymore an advisable strategy. “The Greenspan doctrine, which was strongly supported by Federal Reserve officials, held great sway in the central banking world before the crisis. However, the lesson from the crisis that the cost of cleaning up after financial crises is very high undermines one of the key linchpins of the argument for the Greenspan doctrine, that the cost of cleaning up after an asset price bubble would be low.”⁶ It is not only coming with extremely high costs, one can also not be sure that next time a calamity of the same order could be managed in a way not to end in a global depression.

The simple logic is to prevent the emergence of a situation comparable to the developments which led to the financial crisis of 2008.

But, how to deliver on this promise?

Greenspan⁷ also advocated a “risk management approach” to policymaking which should take into account low-probability events in case their potential costs were likely to be large. One might ask whether such a concept should be applied at all in

⁴ Blinder and Reis (2005), p. 67.

⁵ Rajan (2005), p. 346.

⁶ Mishkin (2017), p. 260.

⁷ Greenspan (2004).

monetary policy.⁸ Greenspan's position was insofar asymmetric as his focus was on the risks of the bursting of a bubble – this was called the “Greenspan put”. However, risk management should by construction be neutral toward upside and downside risks.⁹ This would imply that the cost-benefit analysis should also estimate the risks implied in the emergence of a bubble and the costs and benefits of trying to prevent them.¹⁰ The outcome of a symmetric application of risk management would have led to a quite different monetary policy as advised by Greenspan.

“Leaning against the wind” is a monetary policy strategy which takes financial stability risks into account.¹¹ In short, this approach would lengthen the time horizon needed to reach the price stability goal by setting interest rates temporarily higher to contain unwarranted increases in asset prices. Critics had two major objections. For a long time the uniform answer was that central banks cannot identify the emergence of a bubble in real time. This was mostly linked to the prevalence of the efficient-market hypothesis, according to which market prices incorporate all relevant information. How could central banks know better? This argument is, however debatable. A central bank as a neutral observer might effectively warn against financial market developments which are excessive in relation to historical experience. This is especially the case if these are accompanied by strong growth of money and credit.

Critics also claimed that to mitigate upward developments of asset prices, strong increases in central bank interest rates would be needed, which would imply major and essentially too high macroeconomic costs in the form of losses in output and employment.¹²

The fundamental problem of this approach was seen in the violation of the Tinbergen rule according to which one instrument, the central bank interest rate, could not be applied to the pursuit of two different goals, in this case price stability and financial stability. The newly developed “macroprudential policy” tool was soon praised as the solution to this dilemma. Monetary policy should target price stability, whereas the manifold tools of macroprudential policy should concentrate on containing risks to financial stability. To avoid problems of coordination, one institution, obviously the central bank due to its special expertise, should decide on the application of these instruments.

However, the theoretical and practical honeymoon of this approach was rather short-lived for different reasons:

1. The macroprudential policy lacks experience. The appropriate timing of this tool is extremely difficult and the impact of its various instruments is hard to assess. Smets summarizes the result of empirical studies as follows: “To what extent

⁸ Buiter (2008).

⁹ Issing (2012).

¹⁰ White (2009).

¹¹ Borio and Lowe (2002).

¹² Kohn (2007).

such measures are effective enough to significantly reduce systemic risk is, however, as yet, unclear”.¹³

2. Trying to influence specific categories of asset prices like housing might expose the central bank to pressure not only from lobby groups, but also from politics.¹⁴ Most if not all instruments of macroprudential policies have distributional effects, which not only increases the risk of pressure from politics and lobby groups but also raises the argument that a central bank has no mandate for interventions with a direct impact on redistribution. This would undermine the statute of independence of the central bank. It is true that monetary policy also has distributive effects.¹⁵ However, it makes a fundamental difference if these are basically unintended consequences or if the central bank applies macroprudential instruments which develop their impact via direct distributional effects.

Some measures of macroprudential policy might also have a quasi-fiscal character.¹⁶ Overall, involvement in financial stability risks may also create time inconsistency problems for monetary policy.¹⁷ This would also make the decision on exiting from an expansionary path even more difficult than it already is.

If for all these reasons the competence for macroprudential policy was not given to the central bank, tremendous coordination problems between the central bank being “only” responsible for price stability on the one hand, and the other agency with macroprudential responsibility on the other hand, would arise.

3. To assign two instruments to the two goals seems straightforward. However, the notion that just by creating a new instrument, namely macroprudential policy, the Tinbergen problem would be solved is too simple. (There exists a vast literature on the general discussion of the Tinbergen approach.)

Macroprudential measures have an impact on financial institutions and markets which influence the working of the transmission process of monetary policy – and the same holds vice versa for monetary policy. “Price stability and financial stability are inherently interlinked. They tend to be mutually reinforcing, and, in the long run, each is a necessary, albeit insufficient, condition for the other”.¹⁸

In the meantime, a number of new models have been developed which try to provide a basis for distinguishing if not separating price stability and financial stability

¹³ Smets (2013), p 143.

¹⁴ Mishkin (2017).

¹⁵ Brunnermeier and Sannikov (2012).

¹⁶ Pill (2010).

¹⁷ Smets (2013), p. 141.

¹⁸ Draghi (2017), p. 1.

aspects.¹⁹ It is, however, hard to claim that a reliable foundation for the separate application of monetary and macroprudential measures has already been laid.²⁰

Do we have to live with this unsatisfactory result or is there not a more promising approach that succeeds in reconciling the goals of price and financial stability?

3 The fundamental flaw of inflation targeting

Since the 1990s inflation targeting was seen as state of the art for monetary policy. Inflation targeting (IT), IT with judgement, and flexible IT²¹ reflect how this approach has been adjusted over time. Neglect of money and credit was nevertheless the main reason why IT was unable to counter the risk of the emergence of financial instability which led to the crisis of 2008. There is ample evidence that all major unsustainable booms in asset prices were accompanied if not preceded by strong increases in credit and money.²²

From this perspective it is surprising that IT is still, or even more seen as the optimal strategy after the financial crisis.²³ As stated by Svensson²⁴: “In the end, my main conclusion so far from the crisis, applied the right way and using all the information about financial factors that is relevant for the forecast of inflation and resource utilization at any horizon, remains the best-practice monetary policy before, during, and after the financial crisis.” It is difficult to understand how a reliable inflation forecast “at any horizon” can be produced using all the information. And stating that a strategy just should fulfil these demanding conditions immunizes IT against any criticism.²⁵

IT notwithstanding all refinements is based on inflation forecasting. With its basic flaw of the neglect of the role of money and credit it is inherently unable to deal with the challenge of financial stability. As a consequence it has to rely on the separation principle and on the contribution of macroprudential policy for maintaining financial stability and, therefore is exposed to the above criticism.

4 The ECB’s monetary policy strategy

The ECB’s monetary policy strategy was designed to integrate economic and monetary (in a wide sense including credit etc.) developments in an encompassing approach. The policy of “leaning” against the wind of asset price booms must be based on a reliable assessment of emerging misalignments. The ECB’s monetary

¹⁹ Smets (2013).

²⁰ Fahr and Fell (2017).

²¹ Svensson (2009).

²² Borio and Lowe (2002); Detken and Smets (2004).

²³ Mishkin (2010).

²⁴ Svensson (2009), p. 7.

²⁵ Issing (2012).

pillar draws attention to rising imbalances in the monetary sector that are well correlated with financial imbalances. “A market bubble which progresses in symbiosis with a credit bubble, and which then spills over into excess money creation, is certainly a policy-relevant event. Being vigilant to the monetary imbalance means for a central bank being better able to discriminate between benign and less-benign phenomena in financial markets.”²⁶ However, information from money and credit goes far beyond just monitoring quantitative developments of money and credit.²⁷

The argument that “leaning” implies too high economic costs meets strong criticism.²⁸ Taylor²⁹ presents a counterfactual exercise to show how the Fed could have moderated housing prices by a timely increase in interest rates.³⁰ New research and empirical evidence have delivered further arguments in the same direction:

1. Even small changes in the spread between long- and short-term interest rates might have a substantial effect on the profitability of financial actors with high leverage and maturity mismatch.³¹ By influencing the yield curve the central bank could contribute to curtailing maturity mismatch and leverage.³² For such actions to be effective, it is important that they be taken before herd behaviour takes hold.
2. Communication about evolving imbalances combined with relatively small changes in the key central bank interest rate could serve as a signalling device and support the credibility of the assessment of the central bank.

Financial stability aspects are an endogenous element of the ECB’s monetary policy strategy, assessing both upward as well as downward risks symmetrically. To make timely decisions on interest rate policy remains a huge challenge in the context of a potential extension of the allowed period to achieve price stability, given the aim to take the financial dimension into consideration. However, this approach leaves the central bank’s main goal of price stability in the “pole position.” This is all the more important as money and credit are the main drivers of asset price imbalances, both to the up- and to the downside.

A combination of a high level of liquidity and low interest rates lay behind the developments which culminated in the 2008 crisis.

“...The high level of liquidity did not remain without consequences. It led to rising asset prices around the world. The combination of high liquidity and low interest rates produced a strong incentive to choose ever riskier investments. As a result, the

²⁶ Fahr, Motto, Rostagno, Smets and Tristani (2011), p. 48.

²⁷ Papademos and Stark (2010).

²⁸ Issing (2012).

²⁹ Taylor (2007).

³⁰ Orphanides and Wieland (2008).

³¹ Papademos (2009).

³² Adrian and Shin (2009).

premium over secure investments became ever smaller. This trend was enhanced by numerous financial innovations.”³³

Macroprudential policy should still play a role, however, complementary to monetary policy. The medium-term orientation applies to both instruments. “Macroprudential supervision and monetary policy are not tools for fine-tuning the economy ... The mandate for these policies is long-term stability, but too often the immediacy of the short term has taken precedence – and the cost has been great.”³⁴

5 Conclusion

There is a consensus that financial stability is an important goal and missing it could entail substantial economic and social costs. Yet, the discussion of how this objective could be reached is still at a rather early stage. Central banks will be made responsible for any emergence of financial instability regardless of whether they have a corresponding legal mandate or not. This might be a strong argument in favour of including financial stability explicitly in the mandate of the central bank. There are still diverging views on this question and whether the competence for macroprudential policy should be transferred to the central bank or another actor.³⁵

If the central bank has a direct legal responsibility for financial stability, it should have all the necessary instruments at its disposal.

According to one approach, macroprudential policy should be the main tool for preserving financial stability, and financial stability should become an “explicit objective of monetary policy to be used when macroprudential policies fail as an instrument of last resort.”³⁶

However, this approach could blur the ranking of the objectives of the central bank. And relying on macroprudential policies in the first place, notwithstanding all the critical arguments against too high expectations, might bring monetary policy in an untenable position. If and when macroprudential policies fail in a boom phase, it might be too late for an appropriate reaction by monetary policy. The challenge might be close to “pricking the bubble” which would cause turmoil in the financial markets, cause major economic costs, and have a negative impact on the reputation of the central bank.³⁷

The ECB’s monetary policy strategy presents a much more convincing approach as explained above. Concerns about financial stability are an endogenous element of monetary policy aimed at maintaining price stability. The application of macroprudential measures should support the achievement of financial stability. According to Article 127(5) of the Treaty on the Functioning of the European Union,

³³ Issing Committee (2008).

³⁴ Hoenig (2017).

³⁵ Bundesbank (2015).

³⁶ Smets (2013), pp. 151-152.

³⁷ Issing (2017).

the “ESCB shall contribute to ... the stability of the financial system.” A change in the Treaty will be difficult to achieve anyway, but the present formulation of the mandate gives the ECB responsibility for financial stability without raising concerns about the priority of the objective of maintaining price stability.

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The European Central Bank's supervisory powers: the need for enhanced macro-prudential supervision

By Kern Alexander¹

This chapter discusses recent international regulatory reforms and developments in macro-prudential supervision in Europe and analyses whether the supervisory competences and the institutional design of the European Central Bank and the Single Supervisory Mechanism are adequate for the ECB to carry out its prudential supervisory powers and whether these powers are adequate for the ECB to be an effective macro-prudential bank supervisor. In doing so, it discusses recent international regulatory reforms and institutional reforms in macro-prudential supervision in Europe, the United Kingdom and the United States.

Although the SSM Regulation² has been praised as part of necessary regulatory reforms to restore euro area banking stability, it raises important legal and institutional issues regarding the extent and scope of the ECB's competence to supervise banks and financial groups under the EU Treaties and, alternatively, whether or not its powers and capabilities are adequate to achieve prudential regulatory objectives. This chapter analyses the European Central Bank's legal competences to regulate credit institutions under the SSM Regulation and whether its institutional design is adequate to carry out its supervisory tasks and to protect the European financial system against systemic risks. For instance, the SSM only provides the ECB with supervisory competence for individual banking institutions and banking groups defined as such by the Capital Requirements Directive IV.³ It does not authorise the ECB to engage in broader supervision of the financial system, including, among other things, the shadow banking industry, the wholesale structured securities markets and the OTC derivatives markets and derivatives clearing houses. In other words, the EU Treaties provide the ECB with a limited competence to act as a micro-prudential supervisor, and not as a macro-prudential supervisor with responsibility for oversight of other financial institutions and the broader financial system.

The second area of concern is that the SSM Regulation's strict separation between the ECB's monetary policy function and the SSM's supervisory function may inhibit and limit the ECB in achieving its price stability mandate because it is precluded from

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² 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).

³ 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).

having access to adequate supervisory information about individual banks that would allow it to understand more fully how its monetary policy measures are affecting bank lending and overall credit intermediation and associated risks. Conversely, the ECB Supervisory Board does not have access to adequate data and related information held by the ECB regarding its monetary policy operations. In other words, the ECB's narrow competence under the SSM Regulation to be a supervisor of individual credit institutions and banking groups, while only possessing limited macro-prudential tools, prevents it from fully carrying out macro-prudential supervision and from coordinating its supervisory activities with its monetary policy operations. The chapter argues that based on the above the ECB suffers from legal and institutional limitations that inhibit its ability to be an effective bank supervisor under the SSM framework.

1 International regulatory context of the Single Supervisory Mechanism

Before considering the effectiveness of the ECB as a bank supervisor, it is necessary to place the analysis in the context of the international regulatory reforms that have occurred since 2009 that are designed to restructure financial regulation to address both micro-prudential risks at the level of the institution and macro-prudential risks across the financial system. A major weakness in financial regulation prior to the 2007-2009 crisis was that banking supervision and regulation was disproportionately focused on bank balance sheets and less concerned with systemic risks across the broader financial system. There was a conventional view that the shifting of risks through off balance sheet entities through the use of credit default swaps and securitisation structures reduced banking sector instability because other market participants (i.e. long-term institutional investors) were willing to invest in bank credit and absorb the related risks. The spreading of risk throughout the wholesale debt markets was viewed to be beneficial for financial stability and thought to lead to a more resilient financial system.⁴

The micro-prudential focus on institutions, however, failed to take account of the systemic risks in the structured finance and derivatives markets. The lack of a macro-prudential focus in banking supervision and regulation resulted in massive amounts of leverage building up across the financial system and an over-reliance by banks on short-term wholesale funding.⁵ Moreover, central bankers failed to understand the linkages between monetary policy and prudential financial regulation and in particular how accommodative interest rate policies can cause asset price bubbles and excessive debt in the financial system. The prevailing approach to prudential regulation was essentially micro-prudential, that is, it was concerned mainly with the stability of individual financial institutions and the response of individual banks to exogenous risks, while ignoring the correlation of risks across

⁴ See Alexander, Eatwell, Persaud and Reoch (2007), pp. 5-7, and Brunnermeier, Crockett, Goodhart, Persaud and Shin (2009), p. 18.

⁵ Brunnermeier, Crockett, Goodhart, Persaud and Shin (2009), pp. 26-27.

asset classes and counterparty credit and liquidity risks in wholesale securities and derivatives markets.⁶ Indeed, the crisis has led to regulatory reforms that aim not only to identify and control risks at the level of individual institutions, but also across the financial system. This means that the concept of prudential regulation has expanded beyond the regulation and supervision of individual credit institutions to include a broader supervisory mandate to monitor and control system-wide risks in the securitisation and structured finance markets, maturity transformation risks in the shadow banking markets, and the risks associated with centralised trading and clearing of OTC derivatives and oversight of securities settlement systems.

The Financial Stability Board⁷ and the Basel Committee on Banking Supervision have taken the lead in adopting international regulatory standards to address macro-prudential risks. Since the financial crisis both international bodies have cooperated in developing proposals for macro-prudential reforms by encouraging countries to assess the risks outside the banking sector that can threaten banking and financial stability. In particular, the FSB has analysed the shadow banking market involving non-bank financial firms engaged in maturity transformation – borrowing short and lending long – and the systemic risks that this may pose to the financial system. The FSB has also adopted principles that states are encouraged to follow for the orderly resolution of large systemically important financial institutions. The FSB's principles and objectives are designed to broaden the scope of prudential supervision to include systemic risks that can arise from excessive lending in the shadow banking industry as well as the risks in the trading, clearing and settlement of securities and derivatives.

Moreover, the macro-prudential standards adopted by the Financial Stability Board and International Organization of Securities Commissions provide that regulators and supervisors should be monitoring risk exposures across the financial system with particular focus on the transfer of credit risk to off-balance sheet entities and the trading book risks related to the over-the-counter derivatives market. For example, the G20/FSB objective of requiring systemically significant financial instruments (i.e., OTC derivatives) to be traded on exchanges and centrally cleared with central counterparties (CCPs) or clearing houses is an important regulatory innovation to control systemic risk in wholesale securities and derivatives markets, but raises important questions about whether or not central clearing of derivatives might lead to a concentration of risks in CCPs and clearing houses that creates financial stability risks, especially if one of these institutions were to fail. The overriding theme of international initiatives (e.g., the G20/Financial Stability Board and IOSCO) has been how to devise effective regulatory frameworks that durably link micro-prudential supervision with broader macro-prudential systemic concerns of controlling systemic risks.

⁶ *ibid.*

⁷ The Financial Stability Forum was reconstituted as the Financial Stability Board in 2009 at the G20 London Summit with a clearer mandate and broader membership. The FSB is a similar intergovernmental body set up by the G20 – a group of finance ministers and central bank governors from twenty major national economies – to promote financial stability through better coordination on the international level as well as more effective regulatory policies.

2 Institutional design of macro-prudential supervision

The move towards macro-prudential regulation will require empowering regulatory institutions to have greater powers to monitor and collect data from across the financial system and to intervene where deemed necessary by applying supervisory measures and tools. Micro-prudential regulation has depended to a great extent on the collection and assessment of data from individual institutions and applying supervisory measures to the risk-taking of individual institutions. In contrast, macro-prudential regulation and supervision will necessarily involve the collection and analysis of data from across the financial system and applying measures based on assessments of risk across the system. Central banks are generally the main repositories of macro-economic and financial data. This means that central banks will play some type of role in the macro-prudential supervision process – whether indirectly by providing data and analysis to the competent supervisory authorities or by acting directly as the competent authority themselves. In either case, central banks will play a significant role in macro-prudential policy and in monitoring system-wide risks and by working closely with micro-prudential supervisors to ensure that risk-taking at the entity level does not cumulatively undermine financial stability across the system.

In Europe, the institutional restructuring of financial regulation and supervision has played a major role in macro-prudential regulatory reforms. The European Union has embarked on a major institutional restructuring of financial regulation by creating a European System of Financial Supervision (ESFS)⁸ consisting of three micro-prudential supervisory authorities – the European Banking Authority, the European Securities and Markets Authority and the European Insurance and Occupational and Pension Authority – and a European Systemic Risk Board (ESRB) to conduct macro-prudential oversight of the European financial system.⁹ The ultimate authority however over macro-prudential powers and policies rests with Member State authorities but their macro-prudential monitoring and decision-making will be coordinated through their membership in the ESRB and other ESFS bodies.

The European System of Financial Supervision attempts to establish a more coherent institutional framework that links the ESRB's macro-prudential supervision and oversight function with the three European Supervisory Authorities' (ESAs) function for coordinating the harmonised implementation of EU financial law and the

⁸ The ESFS was adopted based on proposals by the De Larosière Committee in February 2009 in the wake of the financial crisis that was aimed at further institutional consolidation of the previous EU framework established by the European Council in June 2001 under the Portuguese Presidency and which became known as the Lamfalussy framework, named after the Chairman of the Committee of Wise Men established by the Commission to promote enhanced supervisory coordination and harmonised implementation of EU financial legislation.

⁹ Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (OJ L 333, 15.12.2010, p. 1). The ESRB's became operational on 16 December 2010. The impetus for the creation of the ESRB was the proposal for a European Systemic Risk Committee by the De Larosière Committee in 2009. See generally The de Larosière Group (2009), also calling for enhanced capital buffers offered by Basel III, new leverage requirements, greater financial transparency, and structural reforms in the banking sector. See Green and Jennings-Mares (2014), p. 3.

supervisory practices of Member States.¹⁰ Indeed, this linkage is essential for building an efficient EU supervisory regime that allows Member States to exercise more effective oversight of individual firms and investors, whilst monitoring, measuring and issuing recommendations and warnings about systemic risk in the broader European financial system and across global financial markets. Moreover, the ESFS and the three ESAs will ensure that Member State regulatory and supervisory authorities can work more effectively together at the micro-prudential level to control and manage systemic risk and develop a harmonised regulatory code and implementation across all EU states.¹¹

Regarding macro-prudential oversight, the ESRB's scientific committee conducts research and collects data from Member State central banks. Decision-making is vested in the ESRB Board whose members include the central bank governors of EU Member States. Bearing in mind the different jurisdictional domains of the EU Member States (consisting of Member State authorities and the monitoring function of the ESRB) and the euro area (for which the ECB has supervisory jurisdiction), responsibility for macro-prudential supervision is thus overlapping and not well coordinated between the ECB, national regulatory authorities and central banks¹² and the ESRB – whose powers are limited to issuing recommendations and warnings.¹³

The ESRB has set out five intermediate objectives that macro-prudential policy should aim to achieve. These intermediate objectives are (1) mitigating and preventing excessive credit growth and leverage; (2) mitigating and preventing excessive maturity mismatch and market illiquidity; (3) limiting direct and indirect exposure concentrations; (4) limiting the systemic impact of misaligned incentives with a view to reducing moral hazard; and (5) strengthening the resilience of financial infrastructures.¹⁴ These five objectives provide the basis for the development of the ESRB's future macro-prudential monitoring function.

2.1 Redesigning UK regulation

Following the crisis of 2007-2009, the UK undertook a review of the institutional structure of financial regulation and concluded that the former Tripartite model based on coordination among the Bank of England, the Financial Services Authority and the

¹⁰ See Alexander, K. (2010).

¹¹ See Alexander (2011); Alexander (2012a), Appendix 2, 103.

¹² For instance, the EU Capital Requirements Directive IV includes a number of macro-prudential instruments, such as counter-cyclical capital buffers, systemic risk, buffers, buffers for global systemically important institutions (G-SII) and other systemically important institutions (O-SII). For the euro area countries, there is a fair degree of complexity and legal uncertainty about whether the European Central Bank or national supervisory authorities will have the final say in deciding whether to apply macroprudential instruments.

¹³ See Lastra and Goodhart (2015).

¹⁴ Recommendation of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (ESRB/2013/1) (OJ L 170, 15.06.2013, p. 1). The ESRB considers that: 'identifying intermediate objectives makes macro-prudential policy more operational, transparent and accountable and provides an economic basis for the selection of instruments'. *Ibid.*, para. 4.

Treasury had failed to fulfil their responsibilities of protecting the financial system against systemic risks and fulfilling other regulatory objectives.¹⁵ The newly-elected Government in 2010 proposed draft legislation that ultimately became the Financial Services Act 2012, which created the Financial Policy Committee (“FPC”) at the Bank of England as the primary macro-prudential regulatory coordinator.¹⁶ The Financial Services Act 2012 also created a ‘Twin Peaks’ institutional structure for micro-prudential regulation consisting of a Prudential Regulation Authority, responsible for supervising individual banks, insurance firms, and large investment banks, and a Financial Conduct Authority, responsible for investor protection, exchanges and market conduct.¹⁷

As macro-prudential supervisor, the FPC is tasked with coordinating and directing macro-prudential policy by making recommendations and issuing directives regarding the use of macro-prudential measures and instruments and assessing macro-prudential conditions in the financial sector.¹⁸ The FPC is expected to conduct research on macro-prudential risks and to challenge conventional wisdom in micro-prudential regulatory practices to ensure that generally accepted principles are continually tested. For instance, by challenging conventional wisdom, the FPC is also expected to challenge the judgments of other supervisors and international organisations, such as the International Monetary Fund, which had failed to detect and assess the risks that toppled the financial system in 2007 and 2008.¹⁹

2.2 The USA Dodd-Frank Act of 2010

After the financial crisis, the United States recognised that its financial regulation had focused too heavily on micro-prudential regulation without an adequate appreciation of macro-prudential systemic risks.²⁰ Congress responded by enacting the Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act), the preface of which states it is “[a]n Act to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ‘too big to fail,’ to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.”²¹ Title I of the Dodd-Frank Act attempts to set the groundwork for a more comprehensive future macro-prudential framework by creating the Financial Stability Oversight Council (FSOC), which brings together top regulators from across the government in order to identify and address systemic risk.²² A new Office of Financial

¹⁵ See Financial Services Act, 2012 (UK), section 85.

¹⁶ *ibid.*, para. 4.

¹⁷ *ibid.*

¹⁸ Both the PRA and FCA are subject to directions and recommendations on a comply-or-explain basis by the FPC in regards to macro-prudential measures to the entities or activities they oversee. See Financial Services Act, paras. 4 and 6.

¹⁹ For instance, the International Monetary Fund (IMF) issued a report a year before the crisis began in 2006 claiming that “the dispersion of credit risk by banks to a broader... group of investors... helped make the... financial system more resilient.” See IMF (2006).

²⁰ See Block (2012), p. 317.

²¹ See Dodd-Frank Act.

²² *ibid.*, Section 111, 112.

Research (OFR) supports FSOC's mission by collecting data across regulators in order to identify potential macro-prudential risks.²³ In addition to its general oversight and advisory role, FSOC can make recommendations on a “comply or explain” basis to other government agencies.²⁴ These institutional reforms are deemed to be crucial elements in building a more effective macro-prudential supervisory system.

Despite many efforts across Europe and globally to reform the institutional design of financial regulation, it should be emphasised that policymakers and regulators often conflate the need for a conceptual macro-prudential framework with the need for a unified macro-prudential supervisory institutional scheme – or, at least, they assume that the latter obviates the need for the former.²⁵ It is true that the nature of administrative supervision can influence the degree of regulatory consistency and completeness.²⁶ Nonetheless, even a unified supervisor will fail if it administers an ad hoc set of laws that are not based on a coherent regulatory philosophy and set of values that have a consistent focus.²⁷ Similarly, even if a single regulatory authority is tasked with overseeing financial stability, macro-prudential regulation can fail if that authority lacks a coherent regulatory philosophy and the power to adequately implement that regulation.

Aside from the issue of who should actually exercise macro-prudential regulatory and supervisory authority, the macro-prudential supervisory approach involves, among other things, the following activities: devising regulatory standards to measure and limit leverage levels in the financial system as a whole, requiring financial institutions to have enhanced liquidity reserves against short-term wholesale funding exposures, and, more generally, counter-cyclical capital regulation whereby capital requirements are linked to points in the macro-economic and business cycle. Moreover, macro-prudential regulation may also involve linking monetary policy (interest rates & money supply), fiscal policy (i.e., government taxation & spending), and exchange rate policy (i.e., influencing the value of the currency) to the regulation of institutions by monitoring how these policies affect prudential supervisory risks across the financial system; this could involve taking supervisory measures that support the stability of the financial system as a whole and account for the interconnectivity of financial institutions and their effects on the global economy in times of crisis.

²³ *ibid*, Section 153.

²⁴ *ibid*, Section 120.

²⁵ FSB, IMF and BIS (2011), (observing that although countries recognise the need for a system-wide perspective, the “main disagreement is on the importance of carving out a specific macroprudential [supervisory] framework”).

²⁶ See FSB, IMF and BIS (2011), p. 4, observing that although countries recognise the need for a system-wide perspective, the ‘main disagreement is on the importance of carving out a specific macroprudential [supervisory] framework’. Even otherwise ideal macroprudential regulation can be misapplied by fragmented supervisory authorities, especially if some of the regulators lack a mandate to promote financial stability.

²⁷ For example, the Financial Services Oversight Council (FSOC) – the coordinating overseer of financial stability in the United States – lacks the power to directly regulate entities or practices. See Financial Stability Oversight Council Authority, 12 U.S.C. § 5322 (2010) (laying out the structure and powers of the Financial Stability Oversight Council). In contrast, the Financial Policy Committee – the United Kingdom’s macroprudential regulator – has the power to direct the other financial regulators how to act on macroprudential issues. See Walker (2012), 793. See also Financial Services Act. The UK system lays out how the regulators will interact with one another, but does not elucidate how the primary macroprudential regulator will approach or use macroprudential policies.

3 The ECB's bank supervisory mandate

The SSM provides the main pillar of the banking union and consists of the ECB and the national competent authorities of participating Member States. Its overriding objectives are to ensure safety and soundness of the European banking system and to ensure the unity and integrity of the EU internal market.²⁸ All euro area Member States are automatically members, while non-euro area members can decide to participate in the SSM through a procedure involving the national competent authority entering into a 'close cooperation' with the ECB.²⁹ For the other non-participating Member States, the ECB is authorised to adopt a memorandum of understanding with the relevant national competent authority that explains how the ECB will cooperate with the competent authority in performing their respective supervisory tasks.³⁰ The ECB will also conclude memoranda of understanding with each EU home state competent authority of a systemically important financial institution.³¹

The ECB is responsible for direct supervision of 'significant' credit institutions, which represent almost 85% of banking assets in the euro area.³² The ECB will also be indirectly responsible for the supervision by national competent authorities of smaller, less systemically important institutions.³³ The EU General Court has held that the determination of the legitimacy of the ECB's classification of an institution as a 'significant entity' must be assessed in the context of the ECB's plenary competence under the SSM Regulation to supervise credit institutions, and that any challenge by a bank on proportionality grounds against such a classification should be assessed, among other things, in light of the plenary competence transferred to the ECB against the subordinate role attributed to the national competent authorities under the Regulation.³⁴ Moreover, it should be emphasised that the ECB only has competence to apply its powers to enforce EU prudential banking law and regulatory

²⁸ 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), Article 1.

²⁹ SSM Regulation, Article 7(1) & (2)(a)-(c), providing the legal requirements for ECB cooperation with national competent authorities that enter 'close cooperation' with the SSM, including rules that apply directly to banks established in participating countries.

³⁰ SSM Regulation, Article 8.

³¹ SSM Regulation Article 6(7)(b).

³² The criteria used to define a bank as significant are: total value of assets, whether it is one of the top three largest banks in its home Member State; its importance to the economy of its home state or the EU as a whole; and whether it has requested or received direct public financial assistance from the European Stability Mechanism (ESM) or the European Financial Stability Facility (ESFS). SSM Regulation, Article 6(4)(i)-(iii).

³³ SSM Regulation, Article 4(1).

³⁴ See Judgment of General Court in Case T-122/15, *Landeskreditbank Baden-Württemberg v ECB*, T:2017:337, paras. 50-64.

requirements against 'credit institutions' defined as such under EU law.³⁵ For instance, financial institutions that do not accept 'deposits or other repayable funds from the public' are not defined as 'credit institutions' under EU law and therefore are not subject to SSM jurisdiction. Similarly, a 'credit institution' subject to SSM jurisdiction for carrying on activities governed by EU prudential banking law is not subject to SSM jurisdiction for activities not subject to EU prudential banking law, such as brokering and dealing securities or the marketing and sale of retail financial products. For such non-prudential activities, the bank would be subject to other EU banking and financial law requirements, such as conduct of business rules, which are the sole supervisory responsibility of national competent authorities to monitor and enforce.³⁶

The ECB will act through an executive board – the Supervisory Board³⁷ – that is responsible for supervising the euro area's largest cross-border banks and the top three banks by size in each participating Member State.³⁸ The Supervisory Board is also responsible for overseeing the supervisory actions of participating national competent authorities who directly supervise small and medium sized credit institutions in the SSM regime.³⁹ The ECB's Supervisory Board has ultimate discretion to decide whether to intervene and take direct oversight of small and medium-sized institutions that are ordinarily subject to direct supervisory control by national competent authorities.⁴⁰

³⁵ See Capital Requirements Regulation, Regulation 575/2013 of the European Parliament and Council of 26 June 2013 on prudential requirements for credit institutions and investment firms [2-13] OJ L 176/1 (CRR). CRR, article 4 (1), no 1, defines 'credit institution' as 'an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credit for its own account'. See generally Capital Requirements Directive IV (CRD IV Package): 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) (including the Capital Requirements Directive and Capital Requirements Regulation), entered into force 1 January 2014. The CRD IV transposes into European law the prudential capital requirements for credit institutions and investment firms which are based on the internationally-agreed Basel Capital Accord (Basel III agreement).

³⁶ The SSM does not apply to most conduct of business rules that govern a credit institution's capital market activity – such as prospectus requirements, insider dealing and market abuse rules, or misselling of retail financial products. These are subject to other areas of EU and national law and are supervised by Member State competent authorities (not the ECB).

³⁷ SSM Regulation, Article 26 ('planning and execution of the tasks conferred on the ECB shall be fully undertaken by an internal body composed of its Chair and Vice Chair').

³⁸ The ECB's bank supervisory powers are exercised through a Single Supervisory Mechanism (SSM) that has an executive board – a Single Supervisory Board (SSB) – that is responsible for supervising large cross-border euro area banks and overseeing the supervisory actions of national competent authorities responsible for supervising small and medium sized credit institutions in participating Member States. The ECB has ultimate discretionary authority to decide whether to intervene and to take supervisory decisions that could supersede the decisions of national competent authorities with respect to smaller credit institutions which the ECB does not directly supervise.

³⁹ SSM Regulation, Article 6(7)(a)-(c). See also Article 25(8) (SSB shall adopt 'draft decisions' 'to be transmitted... to the national competent authorities of the Member States concerned'.)

⁴⁰ SSM Regulation, Article 6(5)(b), 'when necessary to ensure consistent application of high supervisory standards, the ECB may at any time, or on its own initiative after consulting with national competent authorities or upon request by a national competent authority, decide to exercise directly itself all the relevant powers for one or more credit institutions'.

3.1 ECB's limited competence as a bank supervisor

The overarching rationale of the SSM was to sever the tie between banking and sovereign debt crises by providing the ECB with supervisory powers over individual banking institutions. However, it does not provide the ECB with oversight responsibility for non-bank financial firms, shadow banks and off-balance sheet entities operating in the financial system. Member State competent authorities retain supervisory responsibility for financial institutions and firms not defined as 'credit institutions' (that take deposits and make credit available to borrowers) under the Capital Requirements Directive IV and for oversight of the broader financial system. Generally, the ECB does not have legal competence or institutional responsibility to monitor systemic and macro-prudential risks across the financial system, as this is the responsibility of the European Systemic Risk Board – as discussed above, a soft law body comprising all EU Member State central bank governors and a secretariat including technical experts.

At the height of the euro area sovereign debt and banking crisis of 2012, EU policymakers debated whether the ECB should act as a bank supervisor and play a role in bank resolution. On the one hand, there was an urgent need to sever the link between fragile banking institutions and sovereign debtors by enhancing banking supervision to repair the banking sector. A redesigned banking supervision regime built on the shoulders of the European Central Bank was considered necessary to stem the market panic that was sweeping euro area sovereign debt markets in early 2012.⁴¹ After EU institutions agreed to provide emergency funding support for Spain from the European Stability Mechanism in May 2012, the European Council issued its decision in June proposing a European Banking Union for euro area and other participating Member States that would centralise banking supervision with the ECB and concentrate resolution powers and deposit guarantee rules at the EU level.⁴² In respect of banking supervision, this expedited plan of action required activation of the enabling clause of Article 127(6) TFEU that provides:

“The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.”

On the other hand, policymakers questioned whether existing Treaty provisions provided an adequate legal basis for the creation of a banking union. In particular, there was concern that the ECB's potential treaty powers were limited strictly to micro-prudential supervision of banking and financial institutions based on a unanimous vote of EU states, and therefore the ECB could not play a role in broader supervision of financial markets, nor could it play a direct role in a reformed bank

⁴¹ As Spain began to lose access to sovereign debt markets in May 2012, urgent action was considered necessary by EU policymakers to restore confidence in financial markets so that fragile euro area countries could regain access to debt markets on sustainable terms. See House of Lords (2014), p. 8-9.

⁴² See supra note 12.

resolution regime.⁴³ According to this view, the EU Treaties required amendment before the ECB and other EU bodies could be entrusted with broad new financial supervisory and resolution powers to stabilise the euro area banking sector. Revising the Treaties, however, would require unanimous approval by Member States and would take much more time than what was available to stabilise the euro area sovereign debt markets in 2012 as the sovereign debt crisis spread to Spain and Italian banks were having difficulties funding themselves. As a result, EU policymakers decided to utilise Article 127(6) of the Treaty to establish the Single Supervisory Mechanism (the first pillar of the banking union) while providing a fiscal backstop through the European Stability Mechanism for ailing euro area sovereigns and banks.⁴⁴

Regarding the ECB's competence to act as a bank supervisor, Article 13(2) TFEU provides that EU institutions operate under the doctrine of conferred powers, which states that public institutions are constrained by law, in this case by treaty, because they are creatures of law.⁴⁵ EU institutions only have powers granted to them by the EU Treaties.⁴⁶ The rationale behind this is that the exercise of state power in a liberal society or market economy should be exceptional and require justification and constraint.⁴⁷ In other words, European institutions have legal competence to exercise powers that are specifically conferred.

Under the Treaty, the ECB expressly does not have conferred powers to exercise supervision over credit and other financial institutions unless it is authorised to do so based on unanimous consent of all Member States. Therefore the SSM Regulation was adopted unanimously by activating the enabling clause of Article 127(6) TFEU as a basis for conferring supervisory powers on the ECB for credit and other financial institutions. According to the language of Article 127(6), however, the ECB can only have supervisory powers conferred on it 'concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.' This means it can only have supervisory powers conferred on it for individual credit and financial institutions, not wider powers involving bank resolution, nor oversight of financial conglomerates or investment firms not defined under EU law as 'credit or other financial institutions.' Article 127(6) essentially applies to micro-prudential supervision of 'credit institutions and other financial institutions' and not to supervision of other financial firms or areas of the

⁴³ Indeed, it seemed unlikely until just before euro area sovereign debt crisis re-erupted in May 2012 that the Council (Ecofin) would activate the enabling clause of Article 127(6) TFEU. EU Ministers of Finance had rejected formal activation of the clause on a number of previous occasions. See Davies (2006), p. 42.

⁴⁴ See Treaty Establishing the European Stability Mechanism (ESM Treaty; T/ESM 2012-LT), Article 15. See also [European Stability Mechanism \(ESM\), Establishment of the instrument for the direct recapitalisation of institutions](#) (Board of Governors Resolution, 8 December 2014).

⁴⁵ Case C-133/06, *Parliament v Council* (Safe Countries of Origin) [2008] ECR I-3189, holding, inter alia, 'each institution is to act within the powers conferred upon it by the Treaty,' para. 44, and 'it has already been held that the rules regarding the manner in which the Community institutions arrive at their decisions are laid down in the Treaty and are not at the disposal of the Member States or of the Institutions themselves' para. 54.

⁴⁶ Case C-133/06, [2008] ECR I-3189, para 55. Article 13(2) TFEU provides '[e]ach institution shall act within the limits of the powers conferred on it in the Treaties, and in conformity with the procedures, conditions, and objectives set out in them'.

⁴⁷ See discussion in Chalmers, Davies and Monti (2011), p. 60.

financial markets that are off the balance sheets of credit and financial institutions, such as the shadow banking market.⁴⁸ The restrictive language of Article 127(6) is presumably why the SSM Regulation was designed specifically to apply only to individual 'credit institutions' as defined under EU law and possibly to the larger banking groups of which they are a part.

The limited competence of the ECB to act as a bank supervisor under Article 127(6) therefore would preclude it from engaging in any supervisory activities directed at the broader financial system, including, for instance, the wholesale debt securities markets, securities clearing and settlement systems, or bank resolution and restructuring.⁴⁹ This means that the ECB would not have the competence to oversee the shadow banking market, which was a source of systemic risk that caused the global banking crisis of 2007-09. Moreover, the ECB would not have the competence to put a credit institution (which it had the competence to supervise) into resolution, nor could it exercise resolution powers, such as transferring the assets of a distressed bank to a private purchaser or to a bridge bank, as it would only have the competence to make a determination about whether a bank is failing or likely to fail, but this determination would not have any binding effect on the decision of the resolution authority (the SRM Single Resolution Board) to take a credit institution into resolution. The narrow supervisory competence allocated to the ECB under Article 127(6) suggests that the ECB would be acting *ultra vires* if it took broader macro-prudential supervisory measures that go beyond prudential policies that concern the supervision of individual credit institutions or mixed financial conglomerates largely consisting of credit institutions. The narrowly conferred powers on the ECB under Article 127(6) TFEU significantly limit its ability to perform effective banking supervision and supports the view that the ECB should not be granted banking supervisory powers unless the Treaty is amended to provide it – at a minimum – with enlarged powers to monitor the broader financial system (i.e., macro-prudential supervisory powers) and to take interventionist measures (i.e., prompt corrective action) as part of a bank resolution or restructuring.

3.2 The ECB and macro-prudential supervision

As discussed above, international financial regulatory norms now require that bank supervisors and regulatory authorities have the competence to exercise macro-prudential supervisory powers and adopt macro-prudential regulatory rules to address systemic risks across the financial system. Notwithstanding, the SSM appears to provide inadequate macro-prudential supervisory powers to the ECB. This can largely be attributed to the limited legal basis in Article 127(6) TFEU for the ECB to have responsibility for the supervisory policies of individual 'credit institutions

⁴⁸ The Financial Stability Board has defined shadow banking as 'a system of credit intermediation that involves entities and activities outside the regular banking system'. See Financial Stability Board, (2011), p. 2. See also European Systemic Risk Board (2017), p. 2, defining the 'broad measure' of shadow banking as 'comprising total assets of investment funds, including money market mutual funds, and other financial institutions, amounting to €40 trillion at the end of 2016'.

⁴⁹ See also Allemand (2015), arguing that: 'that Article [Article 127(6)] is a too narrow basis for the creation of an independent body'.

and other financial institutions.’ To analyse whether the ECB can engage in macro-prudential supervision, it is necessary to try to define what is exactly meant by macro-prudential supervision.

Although the definition of macro-prudential regulation and supervision is intensely debated, it consists mainly of four main areas: 1) adjusting the application of regulatory rules to institutions according to developments in the broader economy (i.e., countercyclical capital requirements);⁵⁰ 2) imposing regulatory controls on contractual relationships between market participants (i.e., OTC derivatives counter-parties, loan-to-value or loan-to-income ratios); 3) monetary policy controls, such as interest rates, exchange rate controls, regulating money supply, and capital controls; and 4) prudential requirements for financial infrastructure or firms providing infrastructure services (i.e., capital requirements for derivative clearing houses).⁵¹ A growing literature has analysed these different areas of macro-prudential regulation.⁵²

At the institutional level, some macro-prudential supervisory authorities have identified specific macro-prudential supervisory levers or tools (i.e. counter-cyclical capital requirements and limits on distributions).⁵³ For example, the use of counter-cyclical capital requirements can be varied depending on the riskiness of assets at points in the economic cycle. Denmark and Switzerland have used counter-cyclical capital buffers to dampen credit booms in their respective housing markets by imposing higher capital requirements on home mortgage loans as opposed to other types of loans. Other macro-prudential measures include liquidity tools, that is, where financial institutions can be required to hold liquid assets, i.e. assets that can be easily turned into cash.⁵⁴

Macro-prudential regulatory measures are wider in scope of coverage and application and necessarily involve a broader array of prudential supervisory tools that include both ex ante supervisory powers, such as licensing, authorisation and compliance with regulatory standards, and ex post crisis management measures, such as recovery and resolution plans, deposit insurance and lender of last resort.⁵⁵ Indeed, the objectives of macro-prudential regulation – to monitor and control systemic risks and related risks across the financial system – will require greater regulatory and supervisory intensity that will necessitate increased intervention in the

⁵⁰ Experts have observed that countercyclical buffers could be difficult to implement. See Brunnermeier, Crockett, Goodhart, Persaud, and Shin (2009), chapter 4, (discussing design of countercyclical regulation).

⁵¹ See FSB, IMF and BIS (2011).

⁵² Generally, for a review of the literature, see Alexander (2012b), p. 332.

⁵³ See Bank of England, Financial Policy Committee (2012).

⁵⁴ *ibid.* Also, leverage ratios could be used to limit the amount of leverage relative to the value of the bank's assets. Forward-looking loss provisions: Financial institutions can be required to set aside provisions against potential future losses on their lending. Collateral requirements: Lending could be limited by imposing higher collateral restrictions, for example if growth in lending appears to be unsustainable. An example is a loan to value requirement, which would limit the size of a loan relative to the value of the asset. Similarly, “haircuts” on repurchase agreements would limit the amount of cash that can be lent as a proportion of the market value of a set of securities. Information disclosure: Greater transparency could help markets work better. For example, in times of crisis, more information about different institutions' risk exposure could increase the flow of credit as uncertainty is reduced.

⁵⁵ See The de Larosière Group (2009). See also UK Financial Services Authority (2009).

operations of cross-border banking and financial groups and a wider assessment of the risks they pose. Under the SSM, does the ECB have the necessary scope of authority to be an effective macro-prudential supervisor?

As discussed above, the SSM Regulation allocates broad competences and powers to the ECB/SSB in the field of prudential supervision for individual credit institutions and certain investment firms: for instance, monitoring capital adequacy, liquidity buffers and leverage limits⁵⁶ and approving bank recovery plans and asset transfers between affiliates within banking groups or mixed financial conglomerates.⁵⁷ The SSM provides however for limited macro-prudential tasks that are set forth in Article 5, entitled “Macroprudential tasks and tools”, which include the discretion to impose stricter prudential requirements, including higher capital buffers, on individual banks based on macro-prudential factors in the country where the bank is based.⁵⁸ Although the exercise of these macro-prudential tools rests primarily with the NCAs;⁵⁹ the ECB may intervene and utilise these tools “if deemed necessary”,⁶⁰ and in adopting a particular measure is then required to take the specific circumstances of the Member State’s financial and economic situation into account⁶¹ as well as “duly consider” any objection of a national competent authority that seeks to address a macro-prudential risk on its own.⁶² Moreover, the Capital Requirements Regulation⁶³ permits the ECB/SSM to take macro-prudential measures, other than increased capital buffers, only in limited circumstances for banks based in a participating Member State where the ECB has identified macro-prudential or systemic risks.⁶⁴

Another macro-prudential concern with the SSM is that it applies only to banking institutions that are legally defined as ‘credit institutions’ under EU law – that is, banks that perform traditional intermediary functions of taking deposits and providing credit through commercial and retail lending.⁶⁵ The SSM’s regulation of credit institutions, however, does not cover the growing number of non-bank financial intermediaries and structured entities that are not defined as ‘credit institutions’ under EU law. These non-bank financial intermediaries or ‘shadow banks’ are playing an

⁵⁶ Article 4(1)-(4) SSM Regulation.

⁵⁷ Article 4(1)(k) SSM Regulation.

⁵⁸ Article 5 Regulation (EU) No 1024/2013.

⁵⁹ Article 5(1) Regulation (EU) No 1024/2013.

⁶⁰ Article 5(2) Regulation (EU) No 1024/2013.

⁶¹ Article 5(5) Regulation (EU) No 1024/2013.

⁶² Article 5(4) Regulation (EU) No 1024/2013.

⁶³ 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).

⁶⁴ Capital Requirements Regulation (CRR): 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), Article 458. Article 458 is entitled ‘Macro-prudential or systemic risk identified at the level of a Member State’ and states in relevant part: ‘2. Where the authority determined in accordance with paragraph 1 identifies changes in the intensity of macro-prudential or systemic risk in the financial system with the potential to have serious negative consequences to the financial system and the real economy in a specific Member State and which that authority considers would better be addressed by means of stricter national measures, it shall notify the European Parliament, the Council, the Commission, the ESRB and EBA of that fact and submit relevant quantitative or qualitative evidence’.

⁶⁵ See Article 4.1(1) of the Capital Requirements Regulation.

increasingly important role in the maturity transformation process – borrowing short and lending long – outside the formal banking sector in the European economy, but which are not subject to prudential regulatory controls. It is this type of non-bank credit intermediation and related trading of credit instruments that, although important for the development of the European economy and its capital markets, must nevertheless be regulated carefully to address macro-prudential financial risks. Presently, the ECB does not have the competence to address these risks.

Moreover, under the proposal for a Special Resolution Mechanism, the ECB will have only limited powers, merely allowing it to cooperate with the SRM's Single Resolution Board (SRB) in conducting an assessment of the extent to which banks and groups under its direct supervision are resolvable without the assumption of extraordinary public financial support,⁶⁶ and to notify the SRB of a supervised entity requiring resolution.⁶⁷ In addition, under the Commission's proposed Regulation to implement the Liikanen Committee's proposals on structural regulation, the ECB will have the authority to review the trading activities of banking groups under its supervision,⁶⁸ and to have discretion to initiate the separation of deposit-taking banks from the group's trading entities.⁶⁹ And the ECB may exempt entities under its supervision from the scope of the proposed EU Structural Regulation altogether if it deems that they have a sufficiently robust resolution strategy in place.⁷⁰

From a macro-prudential perspective, the SSM should help to mitigate systemic risk at the level of the individual credit institution. However, the ECB/SSM will only have competence to supervise individual banks or 'credit institutions' as defined under EU law.⁷¹ As a result, the ECB/SSM will have only limited authority to impose regulation aimed at reducing systemic risk, involving, for example, imposing higher capital and liquidity requirements on individual banks. It will not have competence to regulate non-bank financial intermediaries – such as shadow banks – nor will it have the competence to regulate the off-balance sheet entities involved in the securitisation and structured finance markets that are increasingly playing a greater role in channelling large volume of credit and leverage to European businesses and consumers.⁷² In other words, the ECB will have very limited authority to address macro-prudential systemic risks that can arise in the broader financial system where

⁶⁶ Article 8(1) Commission Proposal of 10 July 2013 for a Regulation of the European Parliament and of the Council 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 Bank Resolution Fund and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council (COM(2013) 520 final).

⁶⁷ Article 16(1) Commission Proposal of 10 July 2013 for a Regulation of the European Parliament and of the Council 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 Bank Resolution Fund and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council (COM(2013) 520 final).

⁶⁸ Proposal for a Regulation of the European Parliament and of the Council on structural measures improving the resilience of EU credit institutions COM/2014/043 final – 2014/0020 (COD) Article 9(1).

⁶⁹ Article 10(2). Once the separation initiated, the ECB will review the separation plan submitted by the entity and can require its amendment (Article 18).

⁷⁰ Article 4(2).

⁷¹ See Article 4.1(1) Capital Requirements Regulation.

⁷² Article 5 Regulation (EU) No 1024/2013.

non-bank financial intermediation is growing along with increased trading and clearing of risky financial instruments such as credit default swaps.

Although the ECB has exceptional powers to impose stricter prudential requirements and additional capital buffers have been carved out in Article 5,⁷³ the use of these tools now rests primarily with the national designated authorities (NDAs); the ECB may take over the task “if deemed necessary”,⁷⁴ and is then required to take the specific circumstances of the Member State’s financial and economic situation into account⁷⁵ as well as “duly consider” any objection of an NCA proposing to address the local situation on its own.⁷⁶

4 Separating ECB monetary policy from banking supervision

The ECB’s role as a bank supervisor might bring it into conflict with its main treaty objective of price stability.⁷⁷ According to this view, the ECB might be tempted to lower interest rates or to loosen conditions for bank access to liquidity in order to stabilise the banking sector, but this might lead to easier terms of credit thereby conflicting with its price stability objective.⁷⁸ This is why supervisory mandates for central banks tend to be controversial. In general, the price stability mandate of central banks is obstructed by short-term goals, e.g. avoiding high interest rates and unemployment due to electoral and political pressures – hence the need for central banks to be independent so that they are immune from these pressures. Accordingly, a central bank receiving explicit or implicit employment or economic growth mandates will face the same conflict. A supervisory mandate thus potentially results in lenient monetary policies to prevent bank illiquidity and insolvency; central banks also enjoy easier ‘bureaucratic entrenchment’ than a supervision-only agency would, making them less accountable for the moral hazard they create. The optimal governance architecture needed for such a double mandate is unclear: lawmakers struggle to combine an efficient relationship between the monetary and supervisory sides whilst yet ensuring adequate accountability. Other governance issues are both external (especially towards national resolution authorities) and internal, such as the transparency of central bank policies: while excessive transparency may potentially damage the credibility of central banks, e.g. when responding to temporary market disturbance, empirical evidence shows that higher transparency in forecasts is

⁷³ Article 5(1) Regulation (EU) No 1024/2013.

⁷⁴ Article 5(2) Regulation (EU) No 1024/2013.

⁷⁵ Article 5(3) Regulation (EU) No 1024/2013.

⁷⁶ Article 5(4) Regulation (EU) No 1024/2013.

⁷⁷ Article 127(6) TFEU provides that ‘price stability’ is the primary objective of the European System of Central Banks. In relation to the ECB’s primary objective of ‘price stability’, a ‘financial stability’ objective is mentioned incidentally in Article 127(5) TFEU as follows: ‘The ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system’.

⁷⁸ This is why Principle 2 of the Basel Core Principles for Effective Banking Supervision recommends that the functions of the bank supervisor and monetary policymaker be independent from one another. See Principle 2 of Basel Committee on Banking Supervision (2012).

associated with lower average inflation, and to some extent both less inflation persistence as well as reduced inflation volatility.⁷⁹

The SSM Regulation attempts to address the potential conflict in dual central bank mandates by requiring that bank supervision decisions and monetary policy be strictly separated by creating a Supervisory Board which would have separate staff to work solely on banking supervision matters and not to have links with staff involved with monetary policy.⁸⁰ To reinforce the independence of the Board, ECB President Mario Draghi set forth conditions that were added as an amendment to the SSM which he argued were necessary to make the plan work and protect the ECB's reputation for maintaining and achieving its monetary policy objective of price stability. It is an important policy objective for the ECB, therefore, that supervision and monetary policy are 'rigorously separated', and the SB governance structure allows national supervisors to play a significant role in any supervisory plan for participating states.

Under Article 25 of the SSM Regulation, the Board's organisational structure and operational functions will be separate from the ECB's monetary policy operations and related functions.⁸¹ For instance, the SSM tasks are further prohibited from interfering with or being determined by the ECB's other mandates, whether in relation to the European Systemic Risk Board or to the solvency monitoring of monetary policy counterparties.⁸² As mentioned above, the separation between monetary policy and supervisory tasks within the ECB is reinforced by a requirement to ensure the organisational separation of both the staff involved and their reporting lines.⁸³ Beyond the separation of the staff involved on both sides of these firewalls, the Regulation now requires the ECB to ensure an operational separation for the Governing Council itself as regards monetary and supervisory functions, e.g. through separated meetings and agendas.⁸⁴ Moreover, the procedure for appointing the Chair and Vice Chair of the Supervisory Board also reflects this separation: rather than having the ECB Governing Council elect a member of the Supervisory Board as

⁷⁹ *ibid.*

⁸⁰ Germany insisted on separation of the ECB's supervisory functions from its monetary policy functions in order to protect ECB monetary policy from being influenced by the pursuit of banking supervision mandates. See Mulbert (2014).

⁸¹ SSM Regulation, Article 25 ('Separation from monetary policy function'). Article 25 (2) states '[t]he ECB shall carry out the tasks conferred on it by this Regulation without prejudice to and separately from its tasks relating to monetary policy and any other tasks.'

⁸² Article 18(2) first subparagraph of the March compromise.

⁸³ SSM Regulation, Article 25(2).

⁸⁴ Article 18(3a) March compromise.

was proposed in the draft Regulation, the Chair and Vice Chair are now appointed by the Ecofin and cannot be a member of the ECB Governing Council.⁸⁵

Despite the SSM's focus on independence and separation between the monetary policy function and banking supervisory mandate, it is submitted that the broader focus of macro-prudential supervision and regulation require some degree of coordination between monetary policy and banking supervision. Indeed, much of the literature justifying the separation of monetary policy from banking supervision arose in a period when monetary policy was seen to be independent from banking supervision and that the use of monetary policy instruments to increase bank lending in certain sectors of the economy (i.e., small and medium-sized businesses) were considered not to be within the central bank's mandate. However, since the global financial crisis of 2007-09, central banks have adopted extraordinary measures of monetary policy (i.e., the ECB's Long-Term Refinancing Operation and the Bank of England's quantitative easing and funding for lending schemes) that necessarily involve central banks in assessing the healthiness and viability of bank balance sheets in order to have a better understanding of whether the central bank is achieving its monetary policy objectives (i.e., price stability). This has particularly been the case in the euro area where the European Central Bank has adopted an array of monetary policy measures, including its role as the main purchaser of asset-backed securities issued by banks and bonds issued by non-bank corporates, in order to increase bank lending with an overall view of achieving the ECB's price stability objective of two percent inflation. It is arguable whether the use of such broad measures of monetary policy requires the central bank to have more information and a view as to the healthiness and ability of individual banks or groups of banks to lend in the broader economy. In a financial system where the central bank's use of monetary policy measures has grown to play such an important role in affecting bank lending and banking regulation, it calls into question the utility of the strict separation between monetary policy and the supervision of individual banking institutions. Therefore, the strict separation between the ECB's monetary policy function and its banking supervision mandate in the SSM should be reconsidered.

5 Conclusion

This chapter discusses how macro-prudential regulation and supervision have become the major organizing theme for international regulatory reforms following the global financial crisis of 2007-2009. The major lesson to be drawn from macro-prudential regulatory reforms is that the focus of regulation will no longer be

⁸⁵ Article 26(3). But the SB's oversight of the SSM is ultimately accountable to the ECB's Governing Council, whose strong form of independence is guaranteed by the Treaty and whose overriding mandate is to maintain price stability, which under the Treaty arguably takes precedence over the ECB's banking supervision mandate. However, the Governing Council's dual oversight of monetary policy and banking supervision will be subject to separate agendas that rely on separate groups of staff and reporting channels respectively to maintain a semblance of independence for the Council whilst making decisions on monetary policy and banking supervision. However the Council's oversight of these dual areas is subject to the "separation" requirement in Article 18(3a), which mandates that Council decision-making is based on separate agendas that rely on separate staff and reporting channels.

on individual banks and financial firms and the protections of their depositors and investors but on the structure of the financial system and how off-balance sheet activity or 'shadow banking' can shift risk around the system while still posing a threat to financial stability. Indeed, macro-prudential regulation has necessitated a major rethinking of prudential regulation including the urgent need for a major re-balancing in capital regulation and risk management. An important aspect of this rethink is the consensus that is developing over the need for macro-prudential regulation and supervision, yet different approaches remain across jurisdictions.

This chapter argues that effective financial regulation in Europe requires that the responsibility for banking supervision be coordinated with monetary policy and that supervision is based on a macro-prudential approach that aims to monitor and control systemic risks across the financial system. The SSM Regulation, however, primarily envisions the ECB engaging in micro-prudential supervision of individual 'credit institutions' and banking groups with limited macro-prudential supervisory powers. Further, monetary policy and banking supervision are hindered because of the strict separation in the SSM Regulation between banking regulation and monetary policy. Finally, enhancing the ECB's role in macro-prudential supervision and regulation should involve formal institutional linkages with the European Systemic Risk Board along with legal competence for the ESRB to monitor systemic risk in financial markets to coordinate its efforts formally with the ECB in carrying out its micro-prudential functions.

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Financial stability in the Eurozone is enhanced by co-operating authorities

By Joanne Kellermann¹

1 Introduction

Although the financial crisis has inspired a host of new regulation for the financial markets, we can safely say that the creation of the banking union is the key regulatory development since the financial crisis. It was undertaken by the European Union in the first place to create a level playing field for the supervision of banks within the euro area by setting up the Single Supervisory Mechanism (SSM) as the central supervisor for the largest banks. A second objective was to sever the doom loop between sovereigns and banks by ensuring that taxpayer money would no longer be used to bail out banks, with the overarching objective of strengthening financial stability within the euro area and the Union as a whole. In setting up this new system, the Union in record time established new authorities, including the SSM and the Single Resolution Mechanism (SRM). Having said that, some of the challenges the Single Resolution Board (SRB) now faces may result from the speed with which these changes were brought about, as the urgency of the problems facing the banks did not allow for a transitional period. I will come back to this aspect below.

While the need for co-operation across authorities overseeing the financial sector is not new, the introduction of these new European authorities, in particular in a novel discipline such as resolution, adds a new dimension to this challenge. I will start by reflecting on the more general challenges for authorities in co-operating effectively before considering some of the specific challenges faced by resolution authorities in their work.

2 Financial stability and price stability

Since the financial crisis, central banks have generally strengthened their functions supporting financial stability, while still retaining responsibilities for price stability. These different functions might well be mutually reinforcing, for example financial instability could weaken the transmission mechanism of monetary policy. And conversely, enhanced price stability can serve to support financial stability. For example, anchoring inflation expectations could reduce the risk of misperceptions about potential asset valuations and avoid price bubbles from forming.

¹ Board Member, Single Resolution Board. The author is grateful to Jordan Thursby for his valuable contribution.

But of course, the existence of two objectives will naturally also lead to situations where these objectives conflict. While maintaining a low interest rate could align to the price stability objective, it could also be viewed as inflating asset price bubbles, with the ensuing prudential dangers for banks. Policymakers will have to consider potential means of mitigating these risks; an important question will be whether these should be best addressed by monetary policy, by a macro-prudential tool, by micro-prudential supervision or otherwise². This may well depend on the circumstances at the time. The determination of whether to address risks through action at the level of the financial system as a whole, or through micro-prudential measures for specific banks, will depend on the specific risk identified, and on the ability of the relevant authorities, if they are not under one roof, to cooperate and decide upon coordinated action. In Europe, this was one of the drivers for the inception of the European Systemic Risk Board in December 2010, which, on a worldwide level, was preceded by the inception of the Financial Stability Board in 2009.

3 Co-operation and separation of authorities

Beyond the conflicts of different objectives for one authority, there is also the challenge of how different authorities co-operate to meet their different objectives. In meeting these objectives, the authorities should co-operate to the greatest extent possible, while respecting the structural separation laid out in the regulations. In some cases the mode for co-operation will be clearly set out in the regulations. In our case, the SRB co-operates with the National Resolution Authorities (NRAs) in drafting resolution plans and in setting resolution strategies for the banks within its remit. In addition, for the banks outside the direct remit of the SRB³, the NRAs have direct responsibility while the SRB has an oversight role. This co-operation is clearly defined within the Single Resolution Mechanism Regulation (SRMR)⁴, and so it can be easily understood how this co-operation will function in practice. In his introduction, Professor Alexander has pointed out that there are, on the other hand, also still many legislative gaps. It would be interesting to see if these gaps can be overcome by informal co-operation.

In other cases, the different roles and responsibilities may be less clearly defined, and the objectives of the different authorities may well conflict. For example, a twin peaks model, with clear separation of responsibility for particular objectives between different authorities, naturally creates the possibility of conflict between those authorities. But ensuring that there is a single authority responsible for meeting a particular objective may enhance transparency around how the authorities pursue their objectives. Sometimes the 'horses for courses' model does yield better results. The question of co-operation remains, but it will be necessary for the different

² During the panel session this topic was discussed by Prof. Otmar Issing.

³ Generally speaking these banks will be Less Significant Institutions within the meaning of the SSM Regulation, with the exception of cross-border banks.

⁴ 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).

authorities to consider how this co-operation best supports their specific responsibilities.

4 Resolution and financial stability

In this context, the SRB's responsibilities for resolution could be viewed as separating responsibility for financial stability and resolution matters between the European Central Bank (ECB) and the SRB. But it would be a mistake to separate resolution from financial stability. The origin of resolution is in the view that it supports financial stability. Indeed, this is set out in the Bank Recovery and Resolution Directive (BRRD)⁵ and SRMR, and it certainly makes sense: effective resolution regimes directly strengthen the resilience of the financial system.

At the same time, actions taken to reduce risks to the financial system, such as limiting the channels of contagion between banks, will support resolution. Reducing the extent to which any one bank's failure can have broader systemic consequences would make it easier to resolve that bank. In this sense resolution and financial stability may be viewed as mutually reinforcing. The recent Banco Popular case evidences that the failure of a bank, with the write-down of its capital instruments pursuant to the resolution framework, does not necessarily need to lead to systemic disruption. Similarly, implementation of the European Deposit Insurance Scheme, one of the pillars on the banking union that is still under construction, would further reduce the bank-sovereign link, thereby enhancing European financial stability.

More broadly, some say that the redistributive effects of resolution could even support the further integration of the banking union in other ways than just by facilitating cross-border banking and promoting financial stability. Recently Martin Sandbu suggested in a *Financial Times* article⁶ that the bail-in of creditors, unlike bail-out, potentially transfers ownership of the bank away from the Member State in which the bank operates. For financial stability, this could well mean that bank ownership becomes more diffused across Member States. This would have the benefit of reducing the links between banks and the Member States in which they operate and therefore, by reducing the bank-sovereign nexus, materially improve financial stability across the euro area.

⁵ 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).

⁶ Sandbu, M., "Banking union will transform Europe's politics", *Financial Times*, 25 July 2017.

5 Co-operation between supervisors and resolution authorities

Still, undoubtedly some tensions may remain between going and gone concern supervisors as they are inherent to their different roles. The clearest example of a divergence in view is in the approach to the Minimum Requirement for Own Funds and Eligible Liabilities (MREL). For the resolution authority, setting MREL is vital to ensure that banks are resolvable. For the prudential supervisor this may well be viewed as capital depletive (if it increases interest costs), or as an inferior alternative to higher Common Equity requirements. Prudential authorities may also be concerned that banks will be unable to meet their MREL requirements in the timeframes set by resolution authorities.

So it is understandable that going and gone concern authorities will bring different perspectives to this process; but it is also clear that the authorities will need to work together effectively to ensure that all banks become resolvable. The introduction of the resolution framework, as stated before, was a matter of utmost urgency to help stabilize the euro area after the crisis. This means that banks as well as supervisors and resolution authorities need to do their utmost to ensure that banks are resolvable. Apart from structural measures to ensure this and where necessary removing impediments to resolution, making sure that all banks create a layer of MREL is vital for the successful application of the new resolution instruments. And of course, moving to a more resilient financial system in which banks can fail without undermining financial stability will support the objectives of *all* bank supervisors. Similarly, if the bank-sovereign link is severed by the banking union, then this will make the going concern supervisor's job easier by reducing the extent to which vested national interests may interfere with its work.

At the SRB, we are committed to ensuring that there is effective co-operation between the SRM and the SSM, and we know the same holds true for the SSM. We are also committed to setting effective transitional arrangements to ensure that banks can adjust their business models and liability structures to meet the demands of the new regulatory environment, without extending the transition indefinitely. And for that we count on our hosts, both the SSM and the ECB, so that together we will contribute to a stable and resilient financial sector that will support stable growth in the euro area.



Concluding remarks

By Chiara Zilioli¹

Ladies and Gentlemen,

I would like to thank you all very much for your participation in the Conference. There have been some very interesting and thought-provoking discussions.

We touched upon many topics and I will do my best to summarise the conclusions. The conference began yesterday with the topic of the **transparency and accountability of central banks and banking supervisors**.

Yves Mersch said that accountability and sovereignty need to be aligned to address risks of a perceived “accountability deficit”, emphasising that we cannot be complacent when it comes to Euroscepticism. There is an ongoing need to ensure there is full clarity regarding the allocation of responsibilities and accountability arrangements at European and at national level. He also called for the completion, not only of the banking union, but of Economic and Monetary Union, as did the President this morning.

Sabine Lautenschläger’s panel examined the overarching theme of how the concepts of transparency and accountability underpin the legitimacy of central bank action. On this topic, we also discussed the very premise that a central bank should be subject to high standards of accountability and transparency with respect to its core central banking tasks, or whether the legislator, by granting independence to it, had precisely decided to restrict such accountability. The general conclusion reached was that it is not necessary to create a new legal order to ensure that high standards of accountability apply; indeed, there is still scope to flesh out the existing one.

The second panel considered judicial review in a central bank context. We raised questions about whether decisions of central banks should be justiciable; the appropriate level of intensity of the review; and the role of fundamental rights in central bank policies and crisis management decisions. Here, I sensed there was a consensus as to the need for very clear and predictable criteria for judicial review, for example, to ensure central banks are not incentivised to select policy measures based on different levels of risk of the review. It appears that we are some way away from achieving such legal certainty, also owing to the “newness” of some of the powers.

We then moved to a topic that no one can avoid, which was described as ‘the task of a lifetime or of generations’, namely **Brexit**.

¹ Director General of Legal Services of the European Central Bank, Professor at the Law Faculty of the Goethe University in Frankfurt am Main.

Two key aspects were considered. The first was the problem of **disentangling the United Kingdom from the Union legal order**. The second was a discussion of the legal challenges of trying to **develop a future relationship** with the United Kingdom. In both panels, as well as in Professor Weiler's keynote speech, we heard criticisms of the handling of these issues by both the United Kingdom and the European Union. Indeed, as Peter Praet remarked, the questions to which Brexit gives rise are very complex and difficult; some speakers even made comparisons to a state of madness (Professor Douglas-Scott and Professor Weiler, for example). But, as Benoît Cœuré noted, constructive legal solutions are required as we want to build a secure bridge and to know where it is leading to.

The second day's panels turned our attention to the banking union and, in particular, the restructuring, resolution and insolvency procedures.

We looked at the emergence of new administrative frameworks for the protection of individual rights. It was concluded that the introduction of quasi-judicial proceedings in these administrative frameworks ensures this protection, provided that the independence of the administrative decision-maker is ensured.

We looked at the priorities of bank resolution and insolvency and the possibility of aligning resolution and insolvency law, improving the minimum requirement for the own funds and eligible liabilities (MREL) framework and the total loss-absorbing capacity (TLAC) standards.

This was complemented by a discussion of the legal challenges of bail-in, in particular, the possibility for different interpretations of the public interest test and the challenges of valuation and the "no creditor worse off" principle.

As Pentti pointed out, and as members of the audience emphasised, there is still much room for progress in terms of the institutional framework and the tools available for resolution authorities.

Finally, we looked at the need to overcome silo thinking and to take a cross-sectoral approach to financial market policies and rules. For us lawyers, it has been very interesting to hear the views of very experienced central bankers and economists on these issues.

We considered whether there is scope for a central bank to take account of financial stability considerations in fulfilling its mandate; whether or not a central bank should be responsible for prudential supervision; the relationship between supervision and resolution and monetary policy and supervision; and financial stability and price stability considerations in fulfilling the ECB's mandate. It is clear that price stability cannot suffice in crisis times, however the debate is whether there is a need to change the objectives, or the hierarchy of the objectives, set up in the Treaty. On some of these issues, the views expressed diverged.

I would now like to thank all of the Chairs of the panels, the panellists and the discussants for their contributions to this Conference. The interventions were insightful, the discussions were lively and, while the conclusions may not always have been able to solve the myriad of legal issues faced by Europe, they have given

us inspiration and tools to face the challenges ahead. I also would like to thank the participants for their questions and contributions. As I said at the beginning of the Conference, through these contributions, we play our small part in keeping the bicycle of Europe moving forward. The President has encouraged us to continue our work in this direction.

Before concluding, I would like to say a very special thanks to the colleagues behind the scenes who made all of this come together. In particular Sarah Jane Hlásková Murphy, who is an exceptional lawyer here at the ECB's Directorate General Legal Services and has put an enormous amount of work into the conception, fine-tuning and coordination of the inputs by the speakers. I would like to thank my colleagues in the Legal Groups Team, Luminita Descalu and Yasemin Kantekin, for their commitment and the impeccable technical organisation of the conference. They are exceptionally dedicated professionals. In addition, I thank all the others who supported us in the organisational matters relating to the Conference, from administration to security, and from linguistic services to communication.

With regard to the publication of the ECB Legal Conference Book, I would like to thank the Official Publications team, English Translation and Editing, Multimedia Services and a number of highly dedicated lawyers in the Directorate General Legal Services for their support and assistance.

Ladies and Gentlemen, I hope you enjoyed the Conference, and I look forward to welcoming you back to the ECB in the future.



Programme

Monday, 4 September 2017

- 09:00 Registration
- 09:30 **Welcome address**
Chiara Zilioli, European Central Bank
- 09:40 **Keynote speech – Aligning accountability with sovereignty in the European Union: the ECB's experience**
Yves Mersch, European Central Bank
- 10:00 **Panel 1**
Transparency and accountability of central banks and banking supervisors
Chair: Sabine Lautenschläger, European Central Bank
- Democratic principles demand that, as agents of government, central banks and banking supervisors must be transparent in their policies and accountable in the pursuit of their mandates. Although these principles underpin the legitimacy of central bank independence, the financial crisis has raised questions about potential conflicts between the goals of democratic legitimacy and the effectiveness of central bank policy. A related theme concerns the broad construction that the Court of Justice of the European Union has given to the types of central bank policies announced to the public that may be subject to judicial scrutiny or give rise to liability (see, for example, case C-62/14 Gauweiler and case C-T496/11 United Kingdom v ECB). The panel will discuss the implications of these themes for central banks and banking supervisors and the strategies they might pursue to balance conflicting goals.
- Strengthening transparency and accountability of economic governance – the IMF experience**
Presenter: Sean Hagan, International Monetary Fund
- Liability and accountability for policies announced to the public and for press releases**
Presenter: Alexander Türk, King's College London
- Accountability and audit requirements in relation to the SSM**
Presenter: Frédéric Allemand, Centre Virtuel de la Connaissance sur l'Europe
- Discussant:**
Deirdre Curtin, European University Institute
- Discussion (questions from the audience)**
- 11:30 Coffee break
- 12:00 **Panel 2**
Judicial review in a central bank context – focus on fundamental rights
Chair: Chiara Zilioli, European Central Bank
- This panel explores how EU courts have responded to legal and policy-related measures that have been adopted in response to the eurozone-crisis. There is a trend of increasing judicial involvement in review of such measures which raises questions regarding the institutional balance between the courts and EU institutions and the extent to which economic decision-making is justiciable. The panel also explores the reasons why there can be differing levels of judicial protection afforded to differing kinds of central bank policies and decisions, contrasting the treatment of cases arising in a monetary policy context to those in a supervisory context. A key development of interest is the extent to which recent rulings (e.g. cases C 8/15 P to C 10/15 Ledra Advertising and case C-105/15P Mallis) on the non-contractual liability of EU institutions for economic decision-making place new emphasis on fundamental rights considerations.
- Judicial review and institutional balance in European law**
Presenter: Juliane Kokott, Court of Justice of the European Union
- Varying levels of scrutiny in judicial review of central bank measures**
Presenter: Matthias Lehmann, University of Bonn
- Relevance of fundamental rights for central bank policy and decision-making**
Presenter: Pauliine Koskelo, European Court of Human Rights
- Discussant:**
Marco Ventoruzzo, Bocconi University
- Discussion (questions from the audience)**
- 13.30 Lunch
- 14.30 **Panel 3**
Brexit – Looking inwards
Chair: Benoît Cœuré, European Central Bank
- The key legal issue this panel will explore is the interpretation of the procedural requirements involved in invoking Article 50 TEU. The panel will examine what it means for the UK to withdraw "in accordance with its own constitutional

requirements" by exercising its rights under Article 50, a constitutional rule of the EU. The procedural challenges of negotiating and implementing the withdrawal agreement and the scope for specifying transitional arrangements will also be explored, including the implications that arise by reason of WTO law and practice.

Interplay between Union law and UK constitutional law in the negotiation and conclusion of the withdrawal agreement under Article 50 TEU

Presenter: Sionaidh Douglas-Scott, Queen Mary University of London

Problems of negotiating and implementing the withdrawal agreement under Article 50 TEU in practice: the scope of transitional arrangements

Presenter: Hubert Legal, European Council

Implications of WTO law: what legal difficulties may arise in the negotiation and implementation of the withdrawal agreement or in the context of a new EU-UK bilateral free trade agreement?

Presenter: Christoph Herrmann, University of Passau

Discussant:

Federico Fabbrini, Dublin City University

Discussion (questions from the audience)

16:00 Coffee break

16:30 **Panel 4**

Brexit – Looking outwards

Chair: Peter Praet, European Central Bank

This panel considers some of the legal challenges involved in developing a future relationship with a withdrawing Member State, with a focus on implications for the financial sector. One issue concerns the extent to which existing treaties and trade agreements could provide a point of reference for the future bilateral arrangements between the EU and UK, in particular, with respect to trade in financial services. Some EU financial law regimes recognise non-EU third country regulatory regimes which are deemed 'equivalent' to those of the EU. However, there may be legal or practical limitations on equivalence which limit the extent to which it could mitigate the potential loss of passporting rights. There are various dispute resolution mechanisms included in free trade agreements and in WTO law, which raise questions about how any future EU-UK bilateral arrangements might be policed

To what extent can existing treaties and trade agreements serve as role models for future EU-UK bilateral arrangements?

Presenter: Luis Romero Requena, European Commission

Recognition of third country equivalence in EU financial law – an obstacle or a way forward for future EU-UK bilateral arrangements?

Presenter: Eilis Ferran, University of Cambridge

What would be the scope and elements of an appropriate dispute resolution mechanism under a new EU-UK bilateral free trade agreement?

Presenter: Paul Nihoul, General Court

Discussant:

Maria Chiara Malaguti, Università Cattolica Sacro Cuore

Discussion (questions from the audience)

18.00 End of day 1

19.00 Dinner and reception - InterContinental Hotel (Room "Silhouette"), Wilhelm-Leuschner Straße 43, Frankfurt am Main

Key Note Speech – Brexit: Those whom the Gods wish to destroy they first make mad

Joseph H.H. Weiler, New York University

Tuesday, 5 September 2017

08:30	Registration
09:00	Welcome address Mario Draghi, European Central Bank
09:15	Panel 5 Restructuring, resolution and insolvency: shift of tasks from judicial to administrative authorities Chair: Roberto Ugena Torrejón, European Central Bank <p>This panel will examine the institutional framework that has been established for the management of banking crises at EU level, alongside developments in Member States which have set up administrative procedures to address the consequences of the crises, e.g. arbitration of investor compensation claims or frameworks to facilitate the restructuring of non-performing loans. The implications of these changes for the development of administrative law in the EU will be discussed, taking into account the margin of discretion allocated to these administrative authorities, the scope of judicial review of their actions and the implications of these developments on fundamental rights. These themes provide the background for considering the challenges involved in harmonising the hierarchy of creditor claims in bank and corporate insolvency, and of the application of the bail-in tool in cases of cross-border bank resolution.</p> The rise of a new framework of administrative arrangements for the protection of individual rights Presenter: Sabino Cassese, Scuola Normale Superiore di Pisa Liability and accountability for policies announced to the public and for press releases Presenter: Alexander Türk, King's College London Bank resolution and insolvency priorities Presenter: David Ramos Muñoz, Universidad Carlos III de Madrid Legal challenges of bail-in Presenter: Seraina Grünewald, University of Zurich Discussant: Pentti Hakkarainen, European Central Bank Discussion (questions from the audience)
10:45	Coffee break
11:15	Panel 6 Overcoming silo thinking: a cross-sectoral approach to financial market policies and rules Chair: Christian Kroppenstedt, European Central Bank <p>Following the financial crisis, the legislative projects for regulating the financial system have resulted in a large number of actors on both the national and EU levels. This panel explores the advantages and disadvantages of the present system and considers whether overcoming silo thinking could result in better regulation. It considers the importance of price stability considerations in the fulfilment of the mandate of the ECB and how this might be contrasted with the fulfilment of financial stability considerations in the mandate of the Bank of England. This debate illustrates the broader issues of separation and the conflicting and complementary competences of EU institutions in the monetary and fiscal domain that are of interest from a legal perspective.</p> Scope for financial stability considerations in the fulfilment of the mandate of the Bank of England – complementarity of functions Presenter: Sir Paul Tucker, Harvard Kennedy School Importance of price stability considerations in the fulfilment of the mandate of the European Central Bank – separation of functions Presenter: Otmar Issing, Goethe University Frankfurt Relationship between supervision/resolution and monetary policy/supervision – issues of separation, conflicting competences and complementarity Presenter: Kern Alexander, University of Zurich Discussant: Joanne Kellerman, Single Resolution Board Discussion (questions from the audience)
12:45	Concluding remarks
13:00	Lunch
14:00	End of conference



Biographies

Mario Draghi

Mario Draghi has been President of the European Central Bank (ECB) and Chair of the European Systemic Risk Board since November 2011.

Since June 2013 he has also chaired the Group of Governors and Heads of Supervision at the Bank for International Settlements.

From 2006 to October 2011 he served as Governor of the Banca d'Italia. Prior to that he was Vice Chairman and Managing Director at Goldman Sachs International, and a member of the firm-wide Management Committee (2002-05). He was Director General of the Italian Treasury between 1991 and 2001, during which time he chaired the committee that revised Italy's corporate and financial legislation and drafted the law that governs Italian financial markets.

Mr Draghi graduated from the Sapienza University of Rome in 1970 and received his PhD in economics from the Massachusetts Institute of Technology in 1977. He is the author of a number of articles on international and European monetary and financial issues.



Chiara Zilioli

Chiara Zilioli has dedicated her entire career to the European integration project, with a particular focus on European monetary union. After starting her career in the Legal Service of the Council of the European Union in 1989, she moved to the European Monetary Institute in 1995 and then to the ECB in 1998, where she was initially appointed as Head of Division and then subsequently as Director General of Legal Services (General Counsel) of the ECB. She holds an LL.M. from Harvard Law School and a PhD from the European University Institute. She has been appointed a professor at the Law Faculty of the Goethe University in Frankfurt am Main.

Ms Zilioli has published three books and several articles, mainly on the position of the ECB within the EU institutional framework and the functions of the ECB. For the past few years she has been a lecturer at the Institute for Law and Finance of the Goethe University in Frankfurt and at the European College of Parma Foundation in Italy. In 2012 she taught a course at the Academy of European Law of the European University Institute. She is a member of the Italian Bar and is married with four children.



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 IMF and the UN.



Sabine Lautenschläger

Sabine Lautenschläger has been a member of the Executive Board of the European Central Bank (ECB) since January 2014 and was also appointed Vice-Chair of the ECB's Supervisory Board in February 2014.

She represents the ECB in the Basel Committee on Banking Supervision and the Financial Stability Board. Between 2011 and 2014 she worked at the Deutsche Bundesbank, becoming the first woman to hold the position of Vice-President. Prior to that she spent many years in a number of management positions at the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin), latterly as Chief Executive Director of Banking Supervision from 2008 onwards.

Ms Lautenschläger studied law in Bonn.



Sean Hagan

Sean Hagan is General Counsel and Director of the Legal Department at the International Monetary Fund. In this capacity, Mr Hagan advises the Fund's management, Executive Board and membership on all legal aspects of the Fund's operations, including its regulatory, advisory and lending functions. Mr Hagan has published extensively on both the law of the Fund and a broad range of legal issues relating to the prevention and resolution of financial crises, with a particular emphasis on insolvency and the restructuring of debt, including sovereign debt.

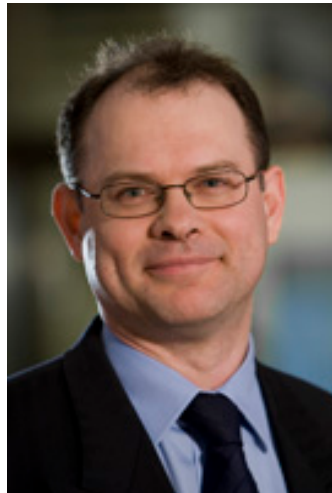
Prior to beginning work at the IMF, Mr Hagan was in private practice, first in New York and subsequently in Tokyo. Mr Hagan received his Juris Doctor from the Georgetown University Law Center and also holds a Master of Science in International Political Economy from the London School of Economics and Political Science.



Alexander Türk

Alexander Türk studied history (MA) and law (first and second State Examinations) in Augsburg, Germany. He obtained an LLM in European Law at the College of Europe in Bruges, Belgium (1994-95). He also holds a PhD from the University of London. He worked as a lecturer at the European Institute of Public Administration in Maastricht, Netherlands (1995-96) before joining the Dickson Poon School of Law at King's College London in 1996 as a DAAD (German Academic Exchange Service) Lektor.

Professor Türk is Vice-Dean for Education. He is also Director of the Postgraduate Diploma/MA in EU Law (by Distance Learning). Additionally, he is a visiting professor of Georgetown University, Washington, Pepperdine University, California, and Iowa University.



Frédéric Allemand

Frédéric Allemand is a Robert Schuman Research Fellow at the Faculty of Law, Economics and Finance of the University of Luxembourg and currently the principal investigator of the RESuME Project – a three-year research project on the political, legal and philosophical foundations of the competitiveness concept. He is also an associate researcher at the Geostrategy Centre of the École Normale Supérieure in Paris. He lectures on European affairs for Master's programmes at Sciences Po, ENA and HEC.

Before joining the University of Luxembourg in 2016, Mr Allemand spent five years as a researcher then as coordinator of the European Integration Studies Department at the Centre Virtuel de la Connaissance sur l'Europe. He also worked in the ECB's legal department, in the French Secretariat-General for European Affairs (attached to the office of the Prime Minister), in the French Senate and for several European and French think tanks.

Mr Allemand is a graduate of Sciences Po Paris and also holds a DEA postgraduate degree in EU Law. He specialises in EU institutional law and economic governance law. He has authored more than fifty scholarly publications, mainly on Economic and Monetary Union. He recently published *Gouverner la zone euro après la crise: l'exigence d'intégration* (2016). Since 2017 he has been editor-in-chief of the *Revue de l'euro*, an interdisciplinary peer-reviewed journal on Economic and Monetary Union.



Deirdre Curtin

Deirdre Curtin is Professor of European Law at the European University Institute in Florence, where she holds a Joint Chair of the Department of Law and the Robert Schuman Centre for Advanced Studies. She is also Director of the Centre for Judicial Cooperation. She was previously Director of the Amsterdam Centre for European Law and Governance, which she founded in 2009, and was research leader on several innovative research projects embracing both law and political science, including Compound Constitution(s) in Europe, The Architecture of Postnational Rulemaking and ACCESS EUROPE's European Law and Governance theme.

Ms Curtin has authored and co-authored a number of scientific monographs issued by leading international publishers, including *Executive Power of the European Union* (Oxford University Press, 2009) and *The Real World of EU Accountability. What deficit?* (with Paul 't Hart and Mark Bovens, Oxford University Press, 2010), and regularly publishes articles in leading law and political science journals. She was awarded the Spinoza Prize by the Netherlands Organisation for Scientific Research (NWO) in 2007 and has been an elected member of the Royal Netherlands Academy of Arts and Sciences since 2003.



Juliane Kokott

Juliane Kokott is one of the eleven Advocates General at the Court of Justice of the European Union in Luxembourg.

Since October 2003 she has been responsible for some 900 cases and delivered more than 400 opinions. Before joining the Court she was a professor at the universities of Augsburg, Heidelberg, Dusseldorf and St. Gallen. She was also a visiting professor at Berkeley Law.

Ms Kokott is a graduate of the universities of Bonn and Heidelberg, American University/Washington DC and Harvard Law School. She has authored and co-authored a wide range of publications and has initiated and organised many high-level expert conferences and symposia.



Matthias Lehmann

Matthias Lehmann is a Full Professor and Director of the Institute for Private International and Comparative Law at the University of Bonn in Germany. He holds doctoral degrees from the University of Jena in Germany and Columbia University in New York. He also has postgraduate degrees from Panthéon-Assas (Paris 2) and Columbia University.

Mr Lehmann is particularly interested in the international and comparative aspects of banking and financial law. His Habilitationsschrift (second thesis required to become a professor in Germany), entitled *Finanzinstrumente* (Financial instruments), deals with the dematerialisation of securities. He has also published on a host of other topics including European banking supervision, cross-border bank resolution, bank structural reform and the civil liability of credit rating agencies. In addition to his post in Bonn, he regularly teaches at the University of Bordeaux, the University of Fribourg and the Universidad Pablo de Olavide in Seville. He has been a visiting fellow at the London School of Economics and Political Science and a visiting academic at Oxford University. Matthias is a member of the European Banking Institute (EBI).



Pauliine Koskelo

Pauliine Koskelo, a Finnish national, is currently a judge at the European Court of Human Rights. Between 1985 and 1995 she worked as a legal adviser and senior legal adviser at the Finnish Ministry of Justice, with responsibilities in various legislative fields. From 1995 to 2000 she worked in the Legal Directorate of the European Investment Bank in Luxembourg, first as Head of Division, then as Assistant General Counsel and finally as Co-Director.

She was appointed a Justice of the Supreme Court of Finland in 2000, going on to serve as President of the Supreme Court between 2006 and 2015.

Between 2008 and 2015 she was Vice-President of the Network of the Presidents of the Supreme Judicial Courts of the European Union. In 2008 she became a member of the Board of Trustees of the Academy of European Law (ERA) in Trier, subsequently becoming its Chair in 2011.

Since 2014 Ms Koskelo has been a member of the panel provided for by Article 255 of the Treaty on the Functioning of the European Union, mandated to give an opinion on the suitability of candidates to perform the duties of Judge or Advocate General of the Court of Justice and the General Court.



Marco Ventoruzzo

Marco Ventoruzzo holds a degree in Business and Economics from Bocconi University Milan and a J.D. from the University of Milan. He also received a Master of Laws from Yale Law School and a PhD from the University of Brescia. He attended graduate courses in business law organised by Cornell Law School at Sorbonne University in Paris, and a course on American law at Michigan University organised under the AILE program. He is a lawyer admitted to practise before the Supreme Court, a certified public accountant and an auditor enrolled in the Registry held by the Ministry of Justice.

He is a Full Professor with tenure at Pennsylvania State University – Dickinson School of Law, where he lectures on corporations, securities regulation and international business transactions, and a Full Professor of Corporate Law at Bocconi University, where he is also the Director of the Department of Legal Studies. From 2012 to 2013, while on leave from Bocconi University, he was a Director of the Max Planck Institute Luxembourg, and he remains an External Scientific Member of the Institute. He is also a Research Associate of the European Corporate Governance Institute (ECGI).

Mr Ventoruzzo has been a visiting professor at numerous law schools and universities: (Fudan University, Shanghai, China; Faculty of Law, University of Hamburg, Germany; Esade Law School, Barcelona, Spain; National Law School of India University, Bangalore; Faculty of Law, University of Chile, Santiago; LSU Law School, Baton Rouge, Louisiana, USA). He has also lectured and given talks at several institutions including the University of Oxford's Faculty of Law, University of Pennsylvania Law School and Fordham University School of Law. He is a member of the editorial boards of the following journals: Oxford Journal of Financial Regulation, European Company and Financial Law Review, Rivista delle Società, Rivista del diritto societario, Rivista dei Dottori Commercialisti.



Benoît Cœuré

Benoît Cœuré has been a member of the Executive Board of the European Central Bank (ECB) since 1 January 2012. He is responsible for International and European Relations, Market Operations and the Oversight of Payment Systems. He is the Chairman of the Committee on Payments and Market Infrastructures (CPMI) of the Bank for International Settlements, a position he has held since October 2013.

Prior to joining the ECB he served in various policy positions at the French Treasury. Between 2002 and 2007 he was the Deputy Chief Executive, then Chief Executive, of the French debt management office Agence France Trésor. From 2007 to 2009 he was France's Assistant Secretary for Multilateral Affairs, Trade and Development, co-chair of the Paris Club and G8 and G20 Finance Sous-Sherpa for France. From 2009 to 2011 he was Deputy Director General and Chief Economist of the French Treasury.

Mr Cœuré is a graduate of the École polytechnique in Paris. He holds an advanced degree in statistics and economic policy from the École nationale de la statistique et de l'administration économique (ENSAE) and a BA in Japanese. He is an affiliate professor at Sciences Po in Paris.



Peter Praet

Peter Praet has been a member of the Executive Board of the European Central Bank (ECB) since 2011 and is responsible for the Directorate General Economics.

Before joining the ECB he was Executive Director of the National Bank of Belgium (2000-11), where he was responsible for International Cooperation, Financial Stability and Oversight of Financial Infrastructures and Payments Systems.

Between 2002 and 2011 he was also a member of the Management Committee of the Belgian Banking, Finance and Insurance Commission (CBFA), where he was responsible for prudential policy for banking and insurance.

Prior to this Peter Praet served as Chief of Cabinet for the Belgian Minister of Finance (1999-2000), Chief Economist at Générale de Banque and Fortis Bank (1988-99), Professor of Economics at the Université libre de Bruxelles (1980-87), and an economist at the International Monetary Fund (1978-80).

He earned a PhD in Economics from the Université libre de Bruxelles in 1980.

Peter Praet has served on several high-level international committees, including the Basel Committee on Banking Supervision, the Committee on Payment and Settlement Systems, the Committee on the Global Financial System and the European Banking Authority. Between 2000 and 2011 he was first alternate of the Board of Directors of the Bank for International Settlements.



Hubert Legal

Hubert Legal studied at the Ecole Normale Supérieure (1974-79) and the Ecole Nationale d'Administration (1986-88).

He has been a member of France's Conseil d'Etat since 1988. Following his initial appointment as an auditeur, he was promoted to maître des requêtes in 1991 then to Conseiller d'Etat in 2005. He served as a commissaire du Gouvernement (public rapporteur) in the Litigation Section between 1991 and 1993.

Between 1989 and 1993 he was Chargé de mission with the Legal Service of the French Ministry of Foreign Affairs. He then spent five years in New York as Legal Counsellor of the French Permanent Representation to the United Nations (1993-97). Between 1997 and 2001 Mr Legal was a Legal Secretary at the Court of Justice of the European Communities in Luxembourg. He was then appointed a Judge at the Court of First Instance of the European Communities (2001-07), serving as President of the Fourth Chamber of the Court of First Instance from 2003 to 2007.

Between September 2007 and March 2008 he was a rapporteur in the Litigation Section of France's Conseil d'Etat. From April 2008 to March 2011 he was a Director in the Legal Service of the Council of the European Union, Directorate 1A in charge of Coreper I matters (internal market, environment, transport), coordination and codecision.

Since April 2011 he has been Legal Adviser to the European Council and the Council and Director-General of the Council Legal Service.

Mr Legal is married with two daughters.



Christoph Herrmann

Christoph Herrmann studied law and economics (with a focus on banking and finance) at the University of Bayreuth (1st State Examination, Germany, 1999) and European and international economic law at the University of London (LL.M., 2001). He is qualified for the German bar and judicial bench (2nd State Examination, State of Bavaria, 2005).

Mr Herrmann holds a doctorate in European Union law from the University of Bayreuth (Dr. jur., 2002) and a Habilitation (professorial thesis, entitled Monetary Sovereignty, the Monetary Constitution and Individual Rights, published 2010) from the University of Munich (2009).

In 2006-07 he was a Jean-Monnet Postdoctoral Fellow at the European University Institute (EUI, Florence).

Since 2009 he has held the Chair for Constitutional and Administrative Law, European Law, European and International Economic Law at the University of Passau.

Mr Herrmann's research focuses on European and international economic law, in particular the common commercial policy, WTO law and EMU. He was founding co-editor of the European Yearbook of International Economic Law (EYIEL), co-author of a German textbook on WTO law and co-editor of a German commentary on EU external trade and customs law. His most recent co-publication is a short textbook entitled International and European Monetary Law (Springer, 2017).



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Federico Fabbrini

Federico Fabbrini is a Full Professor of EU Law at the School of Law & Government of Dublin City University, where he leads the Brexit Research & Policy Institute: www.dcubrexitinstitute.eu.

He holds a PhD in Law from the European University Institute, and before moving to Ireland he held academic positions in the Netherlands and Denmark.

Mr Fabbrini is the author of two books, *Economic Governance in Europe* (Oxford University Press, 2016) and *Fundamental Rights in Europe* (Oxford University Press, 2014), and the editor and co-editor of seven volumes including *The Law & Politics of Brexit* (Oxford University Press, 2017).



Luis Romero Requena

Luis Romero Requena has been Director-General of the European Commission's Legal Service since June 2009. He was previously the Director-General of the Directorate-General for Budget (2002-09), a Director in the Directorate-General for Budget (1999-2002) and Chief Adviser to the Directorate-General for Environment. Before joining the European Commission Mr Romero Requena was Financial Counsellor at the Permanent Representation of Spain to the European Union (1986-96).

He was educated at the Escuela de Hacienda Pública (1979-80) and the Ecole Nationale d'Administration, Paris (1984). He has a Master's in Law from the University of Deusto, Madrid (ICADE).



Eilís Ferran

Eilís Ferran is the Pro-Vice-Chancellor for Institutional and International Relations at the University of Cambridge, responsible for the University's human resources policy and strategy as well as oversight and development of the University's international engagement. She is also Professor of Company and Securities Law in the Faculty of Law and a Professorial Fellow at St Catharine's College.

She served as Chair of the Faculty of Law from 2012 to 2015. Her main research interests are corporate finance law, financial regulation and general company law. She is a Fellow of the British Academy.



Maria Chiara Malaguti

Maria Chiara Malaguti is a Full Professor of International Law at the Università Cattolica Sacro Cuore (Milan/Rome, Italy). She is currently legal adviser to the Italian Ministry of Foreign Affairs on trade matters and to the World Bank on the modernisation of payment systems, financial markets and governance. She chairs the UNCITRAL WG1 on Micro, Small and Medium-Size Enterprises and is part of the Italian defence team in all currently pending investor-state arbitration procedures against Italy.

Until 31 July 2003 she was a senior expert in the Payments Systems Division of the European Central Bank, advising the Securities Settlement Systems Section on legal matters. Prior to this she held a consultancy role at the European Monetary Institute in 1996, dealing with issues concerning financial markets and global governance.

Ms Malaguti holds degrees in law and economics, an LL.M. from Harvard Law School and a PhD from the European University Institute (EUI) in Florence, Italy. She has authored a number of publications focusing mainly on financial markets, the harmonisation of law and sovereign debt.

She was previously a legal assistant and chief of cabinet at the European Court of Justice and still practises as an attorney in Rome.



Joseph Weiler

J.H.H. Weiler is a University Professor at New York University School of Law and a Senior Fellow at the Harvard Center for European Studies. Until recently he was President of the European University Institute (EUI), Florence. He was previously Manley Hudson Professor of International Law at Harvard Law School. He also served for many years as a member of the Committee of Jurists of the Institutional Affairs Committee of the European Parliament.

Professor Weiler is editor-in-chief of the European Journal of International Law (EJIL) and the International Journal of Constitutional Law (ICON). He is an Honorary Professor at University College London and the University of Copenhagen, and Co-Director of the Academy of International Trade Law in Macao, China. He holds a PhD in European Law from the EUI. He is the recipient of doctorates honoris causa in law, political science and theology from the universities of London, Edinburgh, Sussex, Rome, Macerata, Bucharest, Athens, Navarra and Ljubljana, and from Humboldt University of Berlin, San Pablo CEU University (Madrid), Democraticus University (Greece) and the Catholic University of America (Washington DC).

He is the author of several books and articles in the fields of European integration, international and comparative constitutional law and human rights law, notably *The Constitution of Europe – Do the New Clothes have an Emperor* (Cambridge University Press, translated into eight languages), and a novella entitled *Der Fall Steinmann*.



Roberto Ugena Torrejón

After receiving his law degree and a degree in Business Administration from the Comillas Pontifical University in Madrid, Roberto Ugena Torrejón started his career working for the prestigious law firm Uría Menéndez. He then joined the Banco de España, where he worked his way up to become Head of the Legal Department.

Mr Ugena Torrejón is currently Deputy Director General of the Directorate General Legal Services, with responsibility for the Supervisory Law Division and the Legislation Division.



Sabino Cassese

Sabino Cassese is Justice Emeritus of the Italian Constitutional Court and Emeritus Professor at the Scuola Normale Superiore di Pisa.

He teaches at the LUISS School of Government in Rome. Justice Cassese graduated summa cum laude in law from the University of Pisa in October 1956.

He was formerly an assistant professor at the universities of Pisa and Rome, and since 1961 has been a professor at the universities of Urbino, Naples and Rome. He was a member of the Italian Government from 1993 to 1994, and between 2005 and 2014 he served as a Justice at the Italian Constitutional Court.

Justice Cassese has received a doctor honoris causa degree from eight universities: Aix-en-Provence (1987), Cordoba (1995), Paris II (1998), Castilla-La Mancha (2002), Athens (2002), Macerata (2002), the European University Institute (2010) and Sapienza in Rome (2016).



David Ramos Muñoz

David Ramos Muñoz is a senior lecturer in Commercial Law at the Universidad Carlos III de Madrid and the University of Bologna. He majored in Law and Business Administration (top of his class), and practised law before undertaking a research Master's in Private Law and a PhD with a thesis on Structured Finance SPVs.

He is the author of *EU Financial Law* (with Marco Lamandini, Kluwer/CEDAM, 2016) and *The Law of Transnational Securitization* (Oxford University Press, 2010), and has also published numerous articles on financial markets law, international contracts, arbitration and fundamental rights in the *Columbia Journal of European Law*, *International and Comparative Law Quarterly*, the *Capital Markets Law Journal*, the *European Company and Financial Law Review* and the *European Company Law Review*. His research was recognised with an Excellence Award of the Social Council of the Universidad Carlos III in 2016, and he was also awarded a scholarship under the ECB Legal Research Programme. He is a member of the European Banking Institute (EBI) and the European Law Institute (ELI).

Mr Ramos Muñoz is the Deputy Director of the Master in International Advocacy at the Universidad Carlos III, coordinator of the Moot Madrid competition (<http://www.mootmadrid.es/>) and responsible for the competitive moot court programme at the Universidad Carlos III. He teaches courses on Credit and Banking, Financial Law, Corporate Law and International Business Law. He is a lawyer at the Madrid Bar, an arbitrator at the Madrid Arbitration Court and a consultant on cross-border legal issues.

A Spanish native speaker, Mr Ramos Muñoz is also fluent in English and Italian and teaches in all three languages. He also has a working knowledge of French and a basic command of Mandarin. He lives in Madrid with his wife and two children.



Seraina Grünewald

Seraina Grünewald is an assistant professor of financial market law at the University of Zurich, Switzerland.

Prior to her appointment at the University of Zurich she worked as a senior lecturer at the University of Liechtenstein and was a trainee in the Directorate General Legal Services of the European Central Bank. Ms Grünewald spent a total of almost three years as a visiting scholar at Columbia, Yale and Harvard Law Schools and participated in the International Monetary Fund's distinguished Internship Program, where she conducted research on the resolution of cross-border banks and potential burden-sharing arrangements.

She holds a JSD (Dr. iur.) from the University of Zurich, Bachelor's and Master's degrees in law from the University of Bern, and is admitted to the Swiss bar.

She is the author of one of the very first monographs on cross-border bank resolution and burden sharing in the European Union, published by Kluwer Law International in early 2014, and a number of scholarly articles in the field.



Pentti Hakkarainen

Mr Pentti Hakkarainen started his term as a European Central Bank (ECB) representative on the ECB's Supervisory Board on 1 February 2017. He also oversees the ECB Banking Supervision budget and is responsible for issues relating to internal and external audit, IT and staff training. In addition, he is a member of the Steering Committee of the Supervisory Board.

Prior to joining the ECB Mr Hakkarainen was a member of the Board of the Bank of Finland from 2002 to 2016, serving as Deputy Governor from 2008 onwards. During his time at the Bank he was responsible for financial market stability, monetary policy implementation, investment activities, risk management and control, financial reporting, legal and international affairs and macroprudential policy.

Mr Hakkarainen was Chairman of the Board of the Finnish Financial Supervisory Authority from 2008 to 2017. He has also been alternate of the ECB Governing Council, Chairman of the ESCB Budget Committee (BUCOM), a member of the Economic and Financial Committee of the European Union (EFC), alternate of the IMF Board of Governors and between 2004 and 2006 served as both a member and Chair of the IMF's External Audit Committee.

Before joining the Bank of Finland he worked in the private sector for over 17 years. This included ten years at an international industrial corporation, most of them as Finance Director. He then spent around seven years in chief executive positions at two systemically important banks before moving to the central bank in 2002.



Christian Kroppenstedt

Christian Kroppenstedt graduated from the Johannes Gutenberg University of Mainz and started his professional career in 1993 when he joined the Legal Department of the Deutsche Bundesbank.

Following secondments to the European Commission and the Federal Ministry of Finance, he joined the Directorate General Legal Services of the European Central Bank (ECB) in 1998 as a legal expert.

Mr Kroppenstedt is now Deputy Director General of the ECB's Directorate General Legal Services and is responsible for legal issues dealt with by the Financial Law Division and the Institutional Law Division.



Sir Paul Tucker

Sir Paul Tucker is chair of the Systemic Risk Council and a fellow at the Harvard Kennedy School. He was previously Deputy Governor of the Bank of England, sitting on its monetary policy, financial stability and prudential policy committees. Internationally, he has been a member of the G20 Financial Stability Board, leading its work on too big to fail, a director of the Bank for International Settlements (BIS) and chair of the BIS Committee on Payment and Settlement Systems.

His other activities include being a director at Swiss Re, a Senior Fellow at the Harvard Center for European Studies, a visiting fellow of Nuffield College Oxford and a governor of the Ditchley Foundation.



Otmar Issing

Otmar Issing has held Chairs of Economics at the universities of Erlangen-Nuremberg and Würzburg. Between 1988 and 1990 he was a member of the German Council of Economic Experts. From 1990 to 1998 he was a member of the Board of the Deutsche Bundesbank, with a seat on the Central Bank Council.

From 1998 to 2006 he was a founding member of the Executive Board of the European Central Bank, responsible for the Directorates General Economics and Research. He has received honorary doctorates from the universities of Bayreuth, Frankfurt and Konstanz as well as many other awards.

He was formerly Head of the Advisory Group on the New Financial Order appointed by Chancellor Merkel (2008-12) and a member of the High Level Group of the European Commission chaired by J. de Larosière (2008-09). In 2017 he was appointed a member of the G20 Eminent Persons Group on Global Financial Governance.

He is President of the Center for Financial Studies and Chairman of the Board of Trustees of the House of Finance, Goethe University Frankfurt. He is an honorary Professor of the universities of Frankfurt and Würzburg and a member of Goldman Sachs's international advisory board. He has published numerous articles in academic journals and is the author of two textbooks: *Die Einführung in die Geldtheorie* (Introduction to Monetary Theory), 15th edition 2011 (also translated into Chinese and Bulgarian), and *Einführung in die Geldpolitik* (Introduction to Monetary Policy), 6th edition 1996. His book *Der Euro – Geburt, Erfolg, Zukunft* (The Birth of the Euro) was published in 2008 and has also been translated into English and Chinese.



Kern Alexander

Kern Alexander is Professor of Banking and Financial Market Regulation at the Faculty of Law of the University of Zurich.

His research focuses on systemic risk in financial markets and bank corporate and risk governance. His academic publications include *Principles of Banking Regulation* (Cambridge University Press, 2018).

He co-authored one of the first books to critically analyse the international regulation of systemic risk in financial markets: *Global Governance of Financial Systems* (with R. Dhumale and J. Eatwell, Oxford University Press, 2006).

He has written extensively on EU and UK banking regulation as well as market abuse and insider dealing law. He is co-editor with R. Dhumale of the *Research Handbook on International Financial Regulation* (Elgar, 2012) and co-editor with N. Moloney of *Law Reform and Financial Markets* (Elgar, 2011). He has published articles in the *Journal of International Economic Law*, the *European Law Review*, the *European Company and Financial Law Review* and the *European Business Organisation Law Review*.

Mr Alexander has written several commissioned reports for the European Parliament on financial regulatory reform and the euro area sovereign debt crisis, and was a member of the European Parliament's Expert Panel on Financial Services between 2009 and 2014.

He was Specialist Adviser to the UK parliament's Joint Select Committee on the Financial Services Act 2012, and advised the UK Serious Fraud Office on its Libor investigations. He was educated at Cornell, Oxford and Cambridge Universities.



Joanne Kellermann

Joanne Kellermann has been a member of the Single Resolution Board (SRB) since its inception in 2015. As Director of Resolution Planning and Decisions she is responsible for the banks under the direct remit of the SRB in six EU Member States and also for two global systemically important banks, as well as for a number of resolution teams involved in resolution planning.

Before joining the SRB she was an Executive Director of the Netherlands Central Bank (DNB), responsible for supervision.

After gaining a Master's degree in Civil Law, she started her career as a lawyer in the Netherlands' largest law firm, NautaDutilh. Having become a partner, she specialised in banking regulation and cross-border financial transactions and then headed the firm's financial practice in London.

In 2005 she joined the DNB as General Counsel. She became a member of the DNB's Governing Board in 2007 and was actively involved in all major crisis interventions in the Netherlands' financial sector. She chaired the Financial Expertise Centre, the body coordinating the fight against fraud and financial crime in the Netherlands, and was a member of the Board of Supervisors of EIOPA.

She is currently a non-executive director of the University of Utrecht and of the Van Gogh Museum in Amsterdam.



Paul Nihoul

Paul Nihoul has been a Judge at the General Court of the Court of Justice of the European Union since 19 September 2016. His research and teaching activities focus on competition law, consumer protection and European integration. He graduated in law from the Université catholique de Louvain in 1988, and also holds a Master of Laws from Harvard University (1989) and a Doctor of Laws (1998).

He worked as a Legal Secretary at the Court of Justice of the European Communities from 1991 to 1995. He then went into academia, conducting research at the Université catholique de Louvain from 1995 to 1999. Before moving to the General Court he was a professor at the University of Groningen (1999-2001) and a full professor at the Université catholique de Louvain (2001-16).

During his academic tenure he has been a visiting professor at a number of universities. He was Chair of the Academic Society for Competition Law between 2013 and 2016, and is editor-in-chief of several legal journals.



Sionaidh Douglas-Scott

Sionaidh Douglas-Scott is Anniversary Chair at Queen Mary University of London, and formerly Professor of European and Human Rights at the University of Oxford. She is special legal adviser to the Scottish Parliament's Culture, Tourism, Europe and External Relations Committee on its Brexit inquiry. She is the author of *Constitutional Law of the European Union* and editor of the recently published Elgar Research Handbook on EU Law and Human Rights.



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