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**The Single Supervisory Mechanism or “SSM”,  
Part One of the Banking Union.**

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**Abstract**

The Regulation on the Single Supervisory Mechanism mandates the European Central Bank to exercise prudential supervision on the most significant banks located in the Euro area, whether directly by the Bank’s own services, or indirectly by the national prudential supervisors but under the general guidance of the ECB. The paper gives a detailed analysis of the new regime, its scope, the consequences for the existing supervisory systems, especially the home-host attribution of competences and the cooperation between the ECB and the national supervisors, the consequences for the non-euro Member States and for the third country jurisdictions. This regime is likely to substantially modify the existing supervisory landscape. It is the first step towards the Banking Union and is to be followed by legislative instruments on Bank Recovery and Resolution Directive, the Regulations on a Single Resolution Mechanism and on Deposit Guarantee Systems. These three measures should allow dealing with defaulting banks without calling on the taxpayers.



## **The Single Supervisory Mechanism or “SSM”, Part One of the Banking Union.**

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### **Introduction**

1. The Regulation, adopted by the European legislators on 15th of October 2013<sup>1</sup> to centralise banking supervision in the euro area is one of the most significant steps in the

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<sup>1</sup> The Council Regulation 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, OJEU, 29 October 2013, L 287/63, referred to as “Regulation”. For the original proposal: Proposed Regulation conferring specific Tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, 12 September 2012, (Com 2012, 511-final) [ec.europa.eu/internal\\_market/finances/docs/committees/reform/20120912-com-2012-511\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/committees/reform/20120912-com-2012-511_en.pdf) ; See Commission Communication, A Roadmap towards a Banking Union, COM(2012) 510 final, [ec.europa.eu/internal\\_market/finances/docs/committees/reform/20120912-com-2012-510\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/committees/reform/20120912-com-2012-510_en.pdf); and a proposed regulation amending the EBA regulation, 12 September 2012, (Com (2012) 512 Final); For the main steps in the adoption procedure, Council (ecofin) of 12 December 2012, ref 17813/12, dated 14 December 2012. See Press Release: European Council, Council agrees position on bank supervision, 13 December 2012, 17739/12. See European Parliament, Thyssen Report 29 November 2012, [www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2012-0392&language=EN](http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2012-0392&language=EN); Draft European Parliament Legislative Resolution 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 (COM(2012)0511 – C7-0314/2012 – 2012/0242(CNS)) (Special legislative procedure – consultation), [www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2012-0392&language=EN](http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2012-0392&language=EN); Summary record of the plenary session of the European Parliament held in Strasbourg on 21 May 2013: Joint debate Banking union - single supervisory mechanism, 9858/13, 22 May 2013, [register.consilium.europa.eu/pdf/en/13/st09/st09858.en13.pdf](http://register.consilium.europa.eu/pdf/en/13/st09/st09858.en13.pdf). The European Parliament’s Committee on Legal Affairs and the Committee on Civil Liberties, Justice and Home Affairs have also given their opinion. Opinion of the European Central Bank 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) [www.ecb.europa.eu/ecb/legal/pdf/en\\_con\\_2012\\_96\\_f.pdf](http://www.ecb.europa.eu/ecb/legal/pdf/en_con_2012_96_f.pdf). In addition an Inter-Institutional Agreement (IIA) has been concluded on 30 September 2013, 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 (2013/2198(ACI)), OJEU, not yet reported ( P7-0302/2013). M.Barnier, Press release, An important step towards a real banking union in Europe, 19 March 2013; [ec.europa.eu/internal\\_market/finances/docs/committees/reform/20120912-com-2012-512\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/committees/reform/20120912-com-2012-512_en.pdf). For the analysis of the proposals, see Wymeersch, E., The European Banking Union, a First Analysis, <http://ssrn.com/abstract=2171785>; Gourio, A., et L. Thebault, Union bancaire européenne, Proposition de règlement du 12 septembre 2012 instituant un mécanisme de surveillance unique, Revue de Droit bancaire et financier, November 2012; Waldhoff, Chr. and Dieterich, P., Einfuehrung einer gemeinsamen Bankenaufsicht auf EU-Ebene – ein Ueberblick ueber die Rechtsprobleme, EWS, 2013, 72. Troeger, T.H., The Single Supervisory Mechanism – Panacea or Quack Banking Regulation ? Preliminary Assessment of the Evolving



creation of an internal market for financial services. It has been hailed in the press as a landmark, as a game changing decision or as a “momentous step”<sup>2</sup>. It is the purpose of the present paper to analyse the new regime and to clarify the extent to which this Regulation will modify the landscape of banking supervision over the longer term.

This decision known as the “Single Supervisory Mechanism” or SSM is the direct outcome of a process that was launched by the European Commission, whose proposal was published on the 12<sup>th</sup> September 2012<sup>3</sup> and – under the pressure of the evolving financial crisis - discussed at great speed in the Council. During its meeting of 18-19 October 2012, the European Council confirmed its support for the ongoing work and indicated that for most of the pending questions a solution was likely to be found<sup>4</sup>. According to the Treaty legal basis, introduced by the Maastricht Treaty of 1992, the procedure formally does not involve the European Parliament. As a consequence of the Lisbon Treaty of 2007 however, the Parliament has gained a larger voice in most legislative matters and therefore a consultation of the Parliament has been organised in the first months of 2013 using its leverage on the reform of the European Banking Authority regulation as an instrument to redraft some of the rules of the SSM. The Parliament got deeply involved and finally adopted an amended text on September 12, 2013, referring to the “opinion of the European Parliament”<sup>5</sup>. The Council legally adopted the Regulation on 15 October 2013.

Two further measures are still under discussion at the moment of writing: both relate to measures to be adopted vis-à-vis banks that may not be able or cannot meet their commitments. A coordinated deposit guarantee system (DGS) should alleviate the first consequences of a defaulting bank, by offering the retail depositors the reimbursement of their deposits up to a certain, uniform amount, thereby contributing to these depositors’ confidence in the banking system and especially preventing a public bank run<sup>6</sup>. Equally, if not more important are the negotiations going on in the Council and Parliament about a bank’s recovery and resolution (BRRD), that would make banks more resilient ex ante by requiring certain recovery measures, and ex post leading to their orderly resolution without intervention of the state, hence of taxpayers’ money. The proposals provide for national resolution regimes, resolution authorities and funds. On top of that for the ECB supervised banks, a Single Resolution Mechanism (or SRM) would create a centralised resolution system, with one

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Regime for the Prudential Supervision of Banks with ECB Involvement, August 16, 2013, Goethe Universitaet, Frankfurt a.M, <http://ssrn.com/abstract=2311353>; Ferran, E and Babis, V, The European Single Supervisory Mechanism, March 2013, <http://ssrn.com/abstract=2224538>; Ferrarini, G., Chiarella, L., Common Banking Supervision in the Eurozone: Strengths and Weaknesses, aug 2013, [ssrn.com/abstract\\_id=2309897](http://ssrn.com/abstract_id=2309897). Pavlova, M., The Proposals for a Single Supervisory Mechanism for Banks in the Euro Area are an Important Step in Strengthening the Economic and Monetary Union, Jan 12, 2013, <http://ssrn.com/abstract=2208080>

<sup>2</sup> See the joint statement by President Barroso and Commissioner Barnier: [europa.eu/rapid/press-release\\_MEMO-13-899\\_en.htm?locale=en](http://europa.eu/rapid/press-release_MEMO-13-899_en.htm?locale=en)

<sup>3</sup> Also the Commission’s Update: The Banking Union, 20 June 2012, giving an overview of the steps already taken by then. See: [europa.eu/rapid/press-release\\_MEMO-12-478\\_en.htm](http://europa.eu/rapid/press-release_MEMO-12-478_en.htm)

<sup>4</sup> Conclusions of the European Council, 18 October 2012, point 12. See: [www.european-council.europa.eu/council-meetings/conclusions](http://www.european-council.europa.eu/council-meetings/conclusions)

<sup>5</sup> see P7\_TA-PROV(2013)0372. The main report was submitted by the Economic and Monetary Committee on the report by MEP Marianne Thyssen, while separate letters were filed from the Legal Committee and the Committee on Civil Liberties, Justice and Home Affairs.

<sup>6</sup> This proposal has been under discussion for quite some time, focussing among other things on the creation of a pre-funded single, Europe wide guarantee system in lieu of the existing national systems, versus the continuation of the existing national systems, possibly involving some mutual support in case of need. See for the 2010 proposal: Deposit Guarantee Schemes (recast), Com (2010), 369, [ec.europa.eu/internal\\_market/bank/docs/guarantee/20100712\\_proposal\\_en.pdf](http://ec.europa.eu/internal_market/bank/docs/guarantee/20100712_proposal_en.pdf)



single resolution authority and an SSM-area wide resolution fund. Adoption is expected in the first half of 2014.

The common denominator behind these three proposals is the refusal of the political world to be further obliged in the public interest to rescue banks in difficulty and hence further increase the liabilities of the already overstretched treasuries, leading to a vicious circle of massive shifting of private liabilities to the states indebtedness, rapidly increasing state indebtedness ratios, the latter leading to ratings downgrades, triggering extreme budgetary measures, massive unemployment and, ultimately, shaking the population's confidence in the political, social and economic equilibriums on which to-day's Western Europe is built.

3. It is important to place the Banking Union in the wider perspective of the political direction in which Europe's economic and monetary systems have been evolving, at least in the euro-area. This perspective was developed in the long-term reflection by the president of the Union, Herman Van Rompuy, in his 26 June 2012 speech 'Towards a Genuine Economic and Monetary Union' where he identified the Banking Union, the Fiscal Union, a Competitiveness Union and a Political Union<sup>7</sup> as further steps in the European integration, ideas that were further analysed in the Commission communication on "A blueprint for a deep and genuine EMU- Launching a European Debate" of 28 November 2012, and resulting on the 5 December 2012 common position entitled 'Towards a genuine economic and monetary union', reflecting the opinion of the main players in this debate<sup>8</sup>. In these documents attention focuses on the cautious, if not restrictive fiscal policies that have to be adopted by the participating states<sup>9</sup>, in order to avoid a major confidence crisis as witnessed in the 2008 financial crisis while restarting the economic dynamics through a growth policy.

However, the purpose of this paper is not to analyse these wider perspectives<sup>10</sup> but to limit the analysis to the already adopted system of integrated financial supervision.

4. The creation of an integrated system of financial supervision has been discussed many times. The European Parliament has adopted motions calling for the creation of a single supervisory agency, for the securities markets and even for the banking activity, applicable to all participants or only to the most significant ones.<sup>11</sup> However, the time was not ripe for such

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<sup>7</sup> Available at [http://ec.europa.eu/economy\\_finance/focuson/crisis/documents/131201\\_en.pdf](http://ec.europa.eu/economy_finance/focuson/crisis/documents/131201_en.pdf). At a later stage, these plans may require a change of the Treaty. See for an analysis: J. Pisani-Ferry, A. Sapir, N. Véron, G.B. Wolff, "What kind of European banking union?", *Bruegel Policy Contribution* 2012/12.

<sup>8</sup> Delivered on behalf of the President of the Commission, of the Eurogroup and the ECB. See also Council Conclusions 19 October 2012, at: [register.consilium.europa.eu/pdf/en/12/st00/st00156.en12.pdf](http://register.consilium.europa.eu/pdf/en/12/st00/st00156.en12.pdf)

<sup>9</sup> In addition, reference should be made to the six fiscal measures aimed at Strengthening the Stability and Growth Pact, commonly referred to as the 'Six Pack'. See for an overview: European Commission, Building a Strengthened Fiscal Framework in the European Union: A Guide to the Stability and Growth Pact, Occasional Papers 150, May 2013, ISSN 1725-3209

[ec.europa.eu/economy\\_finance/publications/occasional\\_paper/2013/pdf/ocp150\\_en.pdf](http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/pdf/ocp150_en.pdf).

<sup>10</sup> See Darvas, Z. and Merler, S. The European Central Bank in the Age of Banking Union, *Bruegel Policy Contribution*, 2013/13, October 2013.

<sup>11</sup> Several reports or statements were discussed in the European Parliament: European Parliament resolution on the Commission communication on implementing the frame-work for financial markets: Action Plan (COM(1999) 232 □ C5-0114/1999 □ 1999/2117(COS)) calling attention to prudential regulation and supervision, OJ C 40 of 7 February 2001, p. 453; European Parliament resolution of 9 October 2008 with recommendations to the Commission on Lamfalussy follow-up: Future Structure of Supervision (2008/2148(INI)) on the report of Ieke van den Burg

[http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P6-TA-2008-0476+0+DOC+XML+V0//EN&language=EN#BKMD-15;](http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P6-TA-2008-0476+0+DOC+XML+V0//EN&language=EN#BKMD-15)

a fundamental move, and only after the financial crisis hits the governments and their fiscal policies did the willingness emerge to move towards a more effective system of financial regulation and supervision.<sup>12</sup> Several ECB directors had delivered speeches on the relationship of supervision with financial stability some even calling – in prudent terms – for a European banking supervisor.<sup>13</sup> Since the creation of the European financial agencies or ESAs<sup>14</sup>, these calls had become quite rare.

5. According to the official documents adopting the SSM, there are several reasons for introducing an integrated and single supervisory system. The ultimate objective is to restore public confidence in the financial markets as this confidence has been badly affected by the continuing crisis that in a first stage caused huge losses to the banking sector but in a second stage is now undermining confidence in sovereign debtors as well, creating a negative feedback loop to the banking sector and putting the single currency in danger. Indeed, one of the important lessons of this crisis is that private debt, in this case mostly banking debt, easily becomes sovereign debt<sup>15</sup> as lack of confidence in the financial system spills over to the

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Cross-border crisis management in the banking sector, 7 July 2010, 2010/2006(INI) - 07/07/2010 ; In December 2010, the Council (ECOFIN) adopted conclusions calling for a Union framework for crisis prevention, management and resolution. 17006/1/10;

For academic contributions see: Schoenmaker, D, Banking Supervision and Resolution: The European Dimension, Jan 2012, DSF Policy paper, nr 19; Schoenmaker, D. (2011), “The financial trilemma”, *Economic Letters*, 111 (2011), pp. 57-59. <http://ssrn.com/abstract=1340395>; Also: Governance of International Banking: The Financial Trilemma, Oxford U.P., 2013; Hertig, G, Lee, R. and McCahery, J., Empowering the ECB to supervise banks: a Choice approach, *European Company and Financial Law Review*, (2010) 171-215. Academic writing has mainly dealt with the centralisation of securities supervision: See Tumpel-Gugerell, G.: We need a European SEC, *Central Banking.com* <http://www.centralbanking.com/central-banking/speech/1407257/tumpel-gugerell-european-sec>; ECMI Commentary, ‘Financial supervision is not well served by half-baked solutions’ 2008; ECMI, ‘Does Europe need an SEC?’ 8 March 2006; Hertig G., and Lee, R., ‘Four Predictions About the Future of EU Securities Regulation’, available at, <http://ssrn.com/abstract=376720>; Lee, R, Politics and the Creation of a European SEC: The Optimal UK Strategy - Constructive Inconsistency, available at <http://econpapers.repec.org/paper/regwpaper/318.htm>; Boury, P.M., Does the European Union need a Securities and Exchange Commission, *Capital Markets Law Journal*, 2006, nr 1, 2, p 184-194

<sup>12</sup> One of the original stepping stones was laid by the de Larosière Report, The High Level Group on Financial Supervision in the European Union, 25 February 2009, available at: [ec.europa.eu/internal\\_market/finances/docs/de\\_larosiere\\_report\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf). See also de Larosière, J., Privilégier une structure légère mais aux aguets, *Banque nr 757*, February 2013, p 22.

<sup>13</sup> See W. Duisenberg, The role of the Eurosystem in prudential supervision, speech, 24 April 2002, in: *Banking Supervision at the Crossroads*, 2003, Kuppens, Th., Prast, H.M., Wesseling, S., (eds.); See: Public hearing on "After Enron: financial supervision in Europe" at the Committee on Economic and Monetary Affairs of the European Parliament 10 July 2002; Tommaso Padoa-Schioppa: EU structures for financial regulation, supervision and stability, 10 July 2002, available at: [/www.ecb.int/press/key/date/2002/html/sp020710.en.html](http://www.ecb.int/press/key/date/2002/html/sp020710.en.html); Papademos, L., Banking supervision and financial stability, 28 October 2005, available at: [www.ecb.int/press/key/date/2005/html/sp051028\\_2.en.html](http://www.ecb.int/press/key/date/2005/html/sp051028_2.en.html). In its opinion on the draft Regulation of 27 November 2012, available at: Con/ 2012/96 available at: [www.ecb.int/ecb/legal/pdf/en\\_con\\_2012\\_96\\_f.pdf](http://www.ecb.int/ecb/legal/pdf/en_con_2012_96_f.pdf), pt 4, the ECB states that “it is ready to perform”, § 1.2; Davies, H., European banking union raises unanswerable questions, *FT* 29 June 2012, referred to it as a ‘power grab’.

<sup>14</sup> The regulations on the European Supervisory Authorities are: Regulation No. 1093/2010 of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/78/EC, as amended, see nr 85 ; Regulation (EU) No. 1094/2010 of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/79/EC; Regulation 1095/2010 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 (hereafter referred to as ‘the Regulation’) OJEC, L.311/84 of 15 December 2010

<sup>15</sup> The banks in difficulties have been refinanced by the states, while often the same banks had massively invested in government bonds, strongly relying on them for solvency and liquidity purposes. See Preamble (6).



ultimate guarantor, the state and its taxpayers. One of the objectives of the Banking Union consists of breaking this link between private and public debt by keeping banks under stricter control and to avoid any speculation that at the end of the day the state and the taxpayers will step in.<sup>16</sup> In order to achieve these objectives, the banking system has to be more strongly regulated, more highly capitalised, strictly supervised<sup>17</sup> and even restructured in depth<sup>18</sup>, while the spill-over effect has to be stopped by providing adequate recovery and resolution regimes with a sufficient backstop financing facility such as a European Resolution Fund or Mechanism, protecting the state from the need to bail out private banks. Moral hazard should cease to exist in the financial sector and bank directors and shareholders should keep this clearly in mind.

6. Linked to this first objective is the concern, voiced by the ECB and other bodies that the crisis is increasingly breaking up the internal market<sup>19</sup> evidenced by the differences in interest rates, endangering the role of the euro as the single currency and slowing economic growth. The ECB sees the Banking Union as a complement to the monetary union. It draws attention to the dependence of the banking system on the sovereign's creditworthiness, while the growing fragmentation of the financial markets<sup>20</sup> traps capital and liquidity, has a negative

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This is sometimes called the “doom loop”, see Mersch, Y., The Banking Union - a European perspective: reasons, benefits and challenges of the Banking Union, speech, Berlin, 5 April 2013, Ferrarini and Chiarella, nt. 1, points to this relationship in terms of interest rates.

<sup>16</sup> See: Coeuré, B., Why the Euro needs a Banking Union, Speech, 8 Oct 2012, available at: [www.ecb.int/press/key/date/2012/html/sp121008\\_1.en.html](http://www.ecb.int/press/key/date/2012/html/sp121008_1.en.html); Constâncio, V., Towards a European Banking Union, Speech, 7 September 2012, available at: [www.ecb.int/press/key/date/2012/html/sp120907.en.html](http://www.ecb.int/press/key/date/2012/html/sp120907.en.html); Asmussen, J., Die Finanzmarktunion als Element einer stabilen Währungsunion? Speech, 4 September 2012. Available at: [www.ecb.int/press/key/date/2012/html/sp120904.de.html](http://www.ecb.int/press/key/date/2012/html/sp120904.de.html); Constâncio, V., Establishing the Single Supervisory Mechanism, Speech, 29 January 2013 available at: [/www.ecb.int/press/key/date/2013/html/sp130129\\_1.en.html](http://www.ecb.int/press/key/date/2013/html/sp130129_1.en.html); According to Y.Mersch, politically protected banks create a risk for taxpayers, hence are a moral hazard: Mersch, Y., The Banking Union - a European perspective: reasons, benefits and challenges of the Banking Union, Speech, 5 April 2013 available at [www.ecb.int/press/key/date/2013/html/sp130405.en.html](http://www.ecb.int/press/key/date/2013/html/sp130405.en.html).

<sup>17</sup> See the Commission document with ample references: Update: the Banking Union: 6 and 22 June 2012, [europa.eu/rapid/press-release\\_MEMO-12-413\\_en.htm](http://europa.eu/rapid/press-release_MEMO-12-413_en.htm) and [MEMO-12-478\\_en.htm](http://europa.eu/rapid/press-release_MEMO-12-478_en.htm); see further Commission, A Roadmap towards a Banking Union, COM (2012) 510 final, 12 September 2012 .

<sup>18</sup> See the Liikanen proposals: High-level Expert Group on Reforming the Structure of the EU Banking Sector, 2 October 2012 [http://ec.europa.eu/internal\\_market/bank/docs/high-level\\_expert\\_group/report\\_en.pdf](http://ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_en.pdf). See for the Commission proposal: Proposal for a regulation on structural measures improving the resilience of EU credit institutions, 29 January 2014 COM(2014) 43 final [http://ec.europa.eu/internal\\_market/bank/docs/structural-reform/140129\\_proposal\\_en.pdf](http://ec.europa.eu/internal_market/bank/docs/structural-reform/140129_proposal_en.pdf)

<sup>19</sup> See ECB, Financial Integration in Europe, April 2012 [www.ecb.int/pub/pdf/other/financialintegrationineurope201204en.pdf](http://www.ecb.int/pub/pdf/other/financialintegrationineurope201204en.pdf), pointing to the reduced pace of integration especially in the money and bond markets, Asmussen, J., Reintegrating financial markets, Speech 14 June 2013, <https://www.ecb.europa.eu/press/key/date/2013/html/sp130614.en.html>; Mersch, Y., Keynote Speech, 26 September 2013, measures the low level of integration to the number of bank mergers and acquisitions: 343 in the US 58 in the EU (yearly average 2005-2012)

<sup>20</sup> See for details ECB, nt. 20 indicated that not only has activity considerably been reduced due to deleveraging and reduction of positions e.g., in derivatives, but also as a consequence of discontinuing cross-border activities. This tendency along with the lack of transparency in the banks' financial statements, negatively affects the effectiveness of monetary policy decisions. Moreover banking supervisors in smaller states engaged in ring-fencing local subsidiaries and branches, making the transmission of monetary policies even weaker. See Thimann, Ch. Banking union should ease Target fears FT 10 January 2013 - in response to Sinn, H.W and Hau, H., Eurozone Banking Union is Deeply Flawed , FT 29 January 2013. On the link between ringfencing and liquidity, see: Gros, D., The Single European Market in Banking in decline – ECB to the rescue?, In Thorsten (ed.) (2012), “Banking Union for Europe – Risks and Challenges”, VoxEU eBook (<http://www.voxeu.org/content/banking-union-europe-risks-and-challenges>) at 67. Ferrarini, G., Chiarella, L., , nt.1 points to the integrative effects of integrated financial institutions. However, recently Y.Mersch signaled that



effect on the credit supply but also creates tensions with the single currency. The transmission channels for the monetary policy are functioning in a suboptimal way, leading to significant differences in the funding costs depending on the weakened position of the some sovereign debtors and their related banks. Within the Euro area financial markets have become increasingly fragmented along national lines what is often due to national or protectionists considerations. In order to cut the links of the banking system with the sovereigns and restore financial integration, a fully integrated and solidly supervised banking system based on sufficient capital ratios, effective risk management and independent supervision is needed.

7. At present banking supervision in the EU is fragmented: in each of the 28 Member States, supervisors operate, on the basis of harmonised but far from identical regulations<sup>21</sup>. The system results in considerable differences, both in supervisory strictness, authority and methodology sometimes making the exchange of views and cooperation among supervisors quite difficult and resulting in different levels of strictness, reliability or even sophistication. If all states followed comparable regulatory provisions this would certainly contribute to supporting confidence, but would still be imperfect as practices would continue to diverge: therefore, harmonised - or even better integrated - supervision may be equally or even more important than regulation. Harmonised regulation would not reduce the risk of regulatory arbitrage and of national bias, two forces that have undermined the quality of supervision, while producing considerable structural consequences in the European banking and financial system. Several of the banks that faltered have indeed shown regrettable weaknesses due to laxity in their risk management and blind pursuit of short-term returns. Contributing factors include laxity in the supervisory processes - remember the ‘light touch supervision’<sup>22</sup> -, but also the support given by national supervisors to so-called ‘national champions’, including the willingness of public authorities to support banks that are considered important players in their national economies, whether financially or otherwise. In several cases, banks that were closely associated with the political world have been allowed more flexibility, illustrating a form of moral hazard that is rarely highlighted. Divergent accounting and valuation methods – supposedly informally - deserve special mention as some supervisors’ forbearance allowed to hide significant losses. A single supervisor would at least be able to apply the rules with an even hand, in a more distant and especially neutral way, preventing national champions from being privileged and putting an end to the possibility of taking undue advantage of the differences between the national supervisory regimes. In financial supervision - comparable to taxes - there are some ‘regulatory havens’ that are actively used by the financial groups: their benefits should not come in terms of more – sometimes uncontrolled - risk, unacceptable practices, and ultimately less safety for the overall financial system. Complaints have been voiced about the lack of transparency in the banks’ accounts: this not only limits interbank lending, it also makes central bank lending and hence effective monetary policies more difficult. In an integrated system of supervision, the ECB would have better insight into the positions of the largest banks, in their transactions and in the risks they are taking.<sup>23</sup> By

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defragmentation may have started: Mersch, Y., Mastering the crux of defragmentation, Speech 29 December 2013

<sup>21</sup> In this paper *brevitatis causa*, reference is made to the supervisor being the prudential supervisor, as designated by the national law, rather than to the “competent authority”, a notion that is getting increasingly blurred.

<sup>22</sup> ‘Double forbearance’ for Sapir, A., Hellwig, M., and Pagano, M., A contribution from the Chair and Vice-Chairs of the Advisory Scientific Committee to the discussion on the European Commission’s banking union proposals, ESRB, October 2012, available at: [www.esrb.europa.eu/pub/pdf/asc/Reports\\_ASC\\_1210.pdf?1cc6d25d6a27fbc295411f0ada7fb8c6](http://www.esrb.europa.eu/pub/pdf/asc/Reports_ASC_1210.pdf?1cc6d25d6a27fbc295411f0ada7fb8c6) However, accounting matters have expressly been left out of the remit of the SSM: Preamble (19), referring to both national and union-wide accounting frameworks. Does this include accounting standards as such.?



integrating banking supervision, one would reduce surveillance and compliance costs and improve coordination where needed. The supervisor would have a better view in the cross-border externalities, what might allow for a considerably more efficient supranational approach to resolution.<sup>24</sup>

As an immediate link to the recent decision-making process, the introduction of the Banking Union was presented as conditioning the bailout of the Spanish banking system since its adoption and implementation precondition the call on the European Stability Mechanism to recapitalise the Spanish banks.<sup>25</sup> This aspect explains the urgency with which this proposal was adopted, but its implementation will inevitably cover several months if not years<sup>26</sup>.

At the same time, the mere adoption of the SSM Regulation does not save the European financial system: putting the ECB in charge of supervision does not mean that adequate tools have been created to deal with or support ailing banks. Differently from a national supervisor that can always fall back on the national treasuries, no such facilities are at present available at the ECB level. Therefore it is urgent that the next steps be finalised: strengthening the capital base, provide for adequate risk management, including for liquidity needs, introducing a bank recovery and resolution scheme with adequate funding, providing for bail-in powers but supported by sufficient but conditional external funding, workable deposit guarantee system will complement the strengthened banking supervisory regime<sup>27</sup>. Some Member State's opposition to some of these has been fierce. Beyond the technicalities, there is a fundamental political debate: there can be little doubt that the SSM - and the Banking Union in general - results in loss of national sovereignty, both to the ECB and to the European legislators. Resistance by national governments and parliaments to the SSM has been rather subdued, the threat of more financial difficulties contributing to their support<sup>28</sup>. From that perspective, it is widely recognised that centralisation of supervision as a first step in the "banking union" was the only effective option.

## 1. The regulatory objectives of a Single Supervisory Mechanism or SSM

8. The present regime of banking or prudential supervision is based on an increasingly detailed harmonisation of the prudential rules at the EU and at the national level while the application of these rules takes place at the level of the local supervisory agencies. This leads

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<sup>24</sup> Schoenmaker, D. and Siegmann, A. Efficiency gains of a European Banking Union, 2013, SSRN- id2214919; D. Gros, The Meaning of Cyprus: Moving towards banking union? CEPS, 8 April 2013

<sup>25</sup> Reference to the ESM is found in Preamble (12) See Conclusions of the European Council, 18 October 2012, pt 12. Also: Council press release Brussels, 18 April 2013 (direct rather than indirect recapitalisation); See Frankfurter Allgemeine, 18 October 2012, reflecting the German position "Qualität vor Schnelligkeit"

<sup>26</sup> At the moment of writing, and although the capital needs of Spanish banks are still reported to be considerable, Spain has taken up only 41 Bn of the 100 Bn that it was promised. The loss of sovereignty that implies a support programme explains the Spanish government's reluctance to draw on the credit line. See for an overview: Financial assistance for the recapitalisation of financial institutions in Spain, [http://ec.europa.eu/economy\\_finance/assistance\\_eu\\_ms/spain/](http://ec.europa.eu/economy_finance/assistance_eu_ms/spain/)

For action undertaken see FROB, Fondo de Reestructuración Ordenada Bancaria, or Fund for Orderly Bank Restructuring, [www.frob.es/general/creacion.html](http://www.frob.es/general/creacion.html)

<sup>27</sup> Made in Brussels, The eurozone needs a banking union, but this isn't, The Economist, 17 November 2012; A measly triumph, The Economist, December 13, 2012. Support would only cover new, not legacy liabilities. ("No insurance after the insured event has occurred"); see nr. 94.

<sup>28</sup> There is much stronger opposition to the BRRD: "Finance Minister Wolfgang Schäuble all but dashed hopes that the euro zone's rescue fund, the European Stability Mechanism, would help banks directly without making their home governments responsible for repaying the aid. Such a step was "not probable for the time being", he said. /[www.euractiv.com/euro-finance/germany-digs-heels-eu-moves-bank-news-531125](http://www.euractiv.com/euro-finance/germany-digs-heels-eu-moves-bank-news-531125), 16 October 2013



to a considerable diversity among the Member States, causing distortions in multistate banking groups, preventing a comprehensive view on the entire European banking system, increasing the contagion risks and ultimately preventing the internal financial market from being realised. Moreover, the present regime creates considerable administrative burdens and costs as banks that are active in several Member States have been confronted with the non-harmonised views of the supervisors in each of the states in which they are active, and this without reaching an acceptable overall level of effectiveness. Some banking groups may have taken this factor into account for closing down their operations in other Member States.

Regulation, as adopted at the level of the European Union usually takes the form of directives that have to be transposed by the Member States into their national legal system. Not only does the text of the directive itself gives rise to sometimes considerable differences in formulation<sup>29</sup>, the more so as 22 languages are used and are considered legally equivalent, and as we all know, '*traduttore, traditore*'. Also, in the transposition into national law, quite a number of differences are introduced, some made necessary to conform to the national legal system, others due to more fortuitous or political factors. Particularly older directives leave quite an amount of flexibility for national rules to be adapted to local or specific circumstances, some objectively justified, others more directly aiming at a competitive advantage. The European Commission verifies whether implementation is adequate and obliges Member States to adapt their legislation if the discrepancy with the directive is too significant<sup>30</sup>. As a consequence, 'harmonisation', as conceived at the EU level reveals relatively important differences in outcomes. In recent times, the EU has moved increasingly towards 'maximum harmonisation' what means in practice that a directive provision may not be transposed in more stringent terms than stated in the directive. Increasingly, the European legislators and the Commission adopt 'regulations', especially in the fields of banking<sup>31</sup> and securities regulation: regulations are directly applicable in the national legal order, do not require transposition and once adopted and promulgated, are immediately applicable in the different national jurisdictions. Hence regulations create uniform law. A regulation can therefore be expected to lead to the same application and interpretation, the latter being ultimately unified at the level of the European Court of Justice. In practice however, even regulations give rise to some factual differences in application due to local supervisory practices. Recent regulations have allowed Member States to adopt complementing national, but necessarily divergent legal provisions.

9. It will not come as a surprise that the former supervisory system results in substantial differences not only in terms of applicable regulation but also, if not mainly, in actual supervisory practices: each national supervisor has its own approach, methods, traditions, formulas, etc., often leading to quite substantial differences in outcomes. In some cases, this results in significant regulatory arbitrage: it does not only occur in the smaller Member States which take advantage of favourable tax provisions, of tighter secrecy rules and of higher administrative 'efficiency', a notion sometimes close to "lighter touch"

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<sup>29</sup> According to constant case law of the ECJ, no particular language has precedence, but the meaning has to be derived from the comparison of the different versions: for a recent example in an insider trading case, see ECJ, 28 June 2012, C-19/11.

<sup>30</sup> This action is based on art. 258, TFEU and further supported by preparatory and enforcement activity undertaken by the ESAs: see Wymeersch The European Financial Supervisory Authorities or ESA's, 232-320 in: Financial Regulation and Supervision, A Post crisis analysis, (Wymeersch, Hopt, Ferrarini, Eds) Oxford U P, 2012, 486 p.

<sup>31</sup> Regulations are increasingly used alongside directives: see the CRD IV directive, and the Capital requirements regulation or CRR, OJEU, 27 June 2013; also: the proposals for MIFID 2 and Mifir. In addition, numerous regulations are adopted as implementing measures based on Articles 290-291 of the TFEU.



supervision<sup>32</sup>. Streamlining efforts are made to better coordinate national supervisory practices by developing common guidance, regulatory practices, common interpretations, etc. and by coordinating national supervisor's action, particularly within the colleges of supervisors for cross border groups. The European Supervisory Authorities – in the present case, the European Banking Authority (EBA) - are designed to play a significant role in the field of regulation preparing the implementing regulations for adoption by the Commission. Their action supports the coordination of supervision, but without being able to substitute for the national supervisors.<sup>33</sup> During the crisis, it became apparent that national supervisors – who are primarily responsible and accountable to their national political bodies - have a tendency to mainly take into account national interests, e.g. by showing flexibility in the imposition of strong measures on their domestic banks. As a result, banking supervision has remained a patchwork of different practices, based on a common general framework, but far from reflecting the needs of an integrated financial market.

The SSM decision aims at putting an end to this diversity by centralising prudential supervision in the hands of one authority that will be able to ensure that the rules are applied in all cases and in the same way<sup>34</sup>. Regulatory arbitrage and national champions should disappear, while strictness in supervisory practices is likely to restore confidence in the banking system. Moreover, the SSM will contribute to creating a more level playing field, thus aiming to reverse financial institutions taking advantage of differences in national supervisory regimes or by making the conditions for cross-border activity more effectively equivalent.

Although the introduction of the SSM decision will undoubtedly make banking supervision more effective and contribute to the integration of the banking market in the Euro area, it will not suffice to create a fully integrated internal market for financial services. There will continue to exist numerous factors that will shape the different national financial markets, such as differences in financial techniques and traditions – compare the mortgage markets in the different Member States - but also the underlying legal regime e.g. in terms of company law, not to mention the tax differences. In the field of securities and insurance, different national supervisors will continue to be active, while national rules addressing the products or services offered by banks or securities houses increasingly address local concerns, often driven by reasons of investor protection, leading to more segmented markets.

For quite some time to come, the European financial space will not be comparable to a national one.

## **2. The Concept of a Single Supervisory Mechanism** in the context of EU banking regulation

10. The SSM Regulation is the first part of a multi-layered approach that aims at creating a safe banking landscape in the euro area and protecting the public against further

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<sup>32</sup> The Regulation, Preamble 12 refers to “non-prudential considerations”.

<sup>33</sup> See e.g. art. 31 of the ESMA regulation; for an analysis, see Wymeersch, nt. 31.

<sup>34</sup> Nevertheless, some parties defended that all banking supervision should remain national, see: German BVR, VOEB, Finanzgruppe Sparkassen und Giroverband, Gemeinsames Positionspapier zu einem einheitlichen Aufsichtsmechanismus fuer Kreditinstitute im Sinne der Gipfelerklaerung der Mitglieder des Euro-Waehrungsgebiet vom 29 June 2012, available at: [www.google.com/search?client=safari&rls=en&q=Gemeinsames+Positionspapier+zu+einem+einheitlichen+Aufsichtsmechanismus&ie=UTF-8&oe=UTF-8](http://www.google.com/search?client=safari&rls=en&q=Gemeinsames+Positionspapier+zu+einem+einheitlichen+Aufsichtsmechanismus&ie=UTF-8&oe=UTF-8). Bankenverband lehnt Banken-Union ab, Deutsche Mittelstands Nachrichten, 28 June 2012 available at: [www.deutsche-mittelstands-nachrichten.de/2012/06/44845/](http://www.deutsche-mittelstands-nachrichten.de/2012/06/44845/)

banking crises. The SSM should however not be analysed on its own but against the backdrop of European banking regulation in general, as the latter has developed over the last 40 years.

The concept of creating a single - or at any rate strongly integrated - system of banking regulation and supervision is a project on which the European Union has been working since the early seventies, the first directive going back to 1973<sup>35</sup>. Directive after directive the system has been developed, dealing with a wide variety of aspects of prudential banking regulation. Originally, these measures were adopted to implement the Treaty Freedoms, especially the freedom of exercising banking activity on a cross border basis, by way of branches, subsidiaries or of the direct provision of services. As a consequence, the mutual recognition of banks from other Member States based on the equivalence of their prudential supervision has been the key element in opening up the borders. These objectives are to be achieved by the „approximation of the laws and regulations” (see Article 114 e.s. TFEU) with a view of putting in place largely equivalent regulatory regimes in the different Member States while at the same time removing domestic obstacles to cross border establishment and transactions. Approximation of laws is not an objective on itself. As formulated in Article 114 (1) of the TFEU, the „approximation of laws“ is the instrument to achieve the creation of the internal market<sup>36</sup>. The integration in the markets into one single internal market is expected to take place as a consequence of the similarity, if not identity of the applicable rules, especially of the substantive rules. But even with comparable rules, the legal and especially the supervisory regimes remain quite different, being national in essence, and coordinated application is based on the cooperation between the competent authorities in the Member States concerned. This is the basic regime applicable in the EU’s financial regulation: coordination in supervision takes the form of cooperation between national supervisors, in more recent measures complemented by a system of colleges of supervisors, in which decisions are reached essentially on a cooperative basis, but without proper decision making power for the college. Only for group-wide own funds and institution specific liquidity requirements, the leader of the college – the consolidating supervisor- may be entitled to impose decisions on a group wide basis, and these will be “determinative”.<sup>37</sup>

This basic regime is supplemented by a more elaborate system of centralised rulemaking: the European Supervisory Authorities – in fact “regulatory” authorities – are in charge of preparing regulations for the Commission, and are called upon to resolving conflicts between national supervisors<sup>38</sup>. Up to now, the attention has mainly been focused on the role of the ESAs in the regulatory process, leading to what is often referred to as the „European rulebook“, a set of largely uniform rules applicable in all the Member States. The implementation of these rules remain however national, and differences or frictions will continue to exist.

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<sup>35</sup> See directive 73/183/EEC of 28 June 1973, now repealed

<sup>36</sup> See for the definition: “The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties. “ Article 26 (2) TFEU

<sup>37</sup> see Article 113, Directive 2013/36/EU 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, OJEU, 27 June 2013 L 176/338, usually referred to as CRD IV. One wonders whether the transposition of this directive will also reveal that in more than 100 cases, national options and discretions have been used, as was the case with its predecessors. For a pre- CRD IV analysis of the stages in the models for supervision and the gradual development of the centralised supervision in the SSM: ‘The current European Supervisory Architecture’, see Ferrarini and Chiarella, nt .1

<sup>38</sup> See for an analysis of the powers of the ESAs, Wymeersch, nt. 31. The BRRD would considerably increase the number of matters in which national supervisors could call on the conflict resolution competences of the EBA.



Said basic regime suffers from an essential weakness: supervisory decisions remain national, and being diverse, will not end the differentiated treatment depending on the location of the financial activity. Competition between regulators, inspired by national preferences, cuts across the integration objective. In case of crisis, decisions have proved to be mainly inspired by the national interest, sometimes even disregarding the interest of other Member States, although the latter were also affected. In the Euro area, where banking activity directly impinges on monetary objectives, an additional step had to be taken, implying in essence centralisation of decision-making and submitting all banks to the same supervisory regime. The Single Supervisory Mechanism introduces an integrated supervisory mechanism, supervision being exercised by the ECB, whether directly or by the national supervisors under the general guidance of the ECB.

11. But only supervision is centralised: the basic rules according to which supervision will be exercised are to some extent national rules implementing directives, therefore allowing for some legal differences. The many implementing rules contained in the Rule Book will however consist of directly applicable European rules, developed by the European Commission, acting on proposals submitted by the ESAs, in this case the EBA. As a consequence, single supervision will be increasingly based on identical rules. These rules will however not be proper to the SSM area: they apply in all Members states, and conflicts between supervisors if any will be arbitrated by the EBA. The ECB will have some regulatory competences, but it is still unclear whether these will be rather limited.

The most recent layer in the overall scheme consists of the planned recovery and resolution regimes, in the planned directive on Bank Recovery and Resolution and in the Single Resolution Mechanism, both still under consideration at the moment of writing. Basically the approach followed is the same as in the SSM: the national rules will be harmonised through a directive, obliging Member States to introduce at least the minimum rules and instruments to successfully pursue the resolution of a bank and to appoint a body that will be in charge of resolving ailing banking institutions but leaving a certain freedom to transpose the directive into their national legal systems. Here again, coordination between national resolution authorities is provided for through the usual instruments of cooperation and supervisory colleges. National resolution funds will support national resolutions, and in some rather exceptional cases, cross border resolutions as well. But in the absence of a clearly defined central decision making process, the coordination of the national decisions will essentially take place through coordination, in “resolution colleges”, based on consensus, with the non-consenting partners adopting their own resolution approach.

With respect to the Euro area, a further degree of centralisation is needed to ensure that the single supervision would be not jeopardised by a decentralised resolution regime. This is the subject of the proposal for a Single Resolution Regulation<sup>39</sup>, in which a single resolution authority – different from the ECB – will apply a single resolution framework, inspired on the generally applicable regime. In addition, a single resolution mechanism would allow financial support to be granted in a coordinated way. Its final form is still very controversial.

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<sup>39</sup> Proposal for a Directive establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010, 6 June 2012, Com (2012) 280 final. See: [ec.europa.eu/internal\\_market/bank/crisis\\_management/index\\_en.htm](http://ec.europa.eu/internal_market/bank/crisis_management/index_en.htm)





Both pre- and post SSM, one sees the same pattern: traditional harmonisation directives and regulations are applicable to all Member States, along with coordination between national supervisors. In the Euro area, prudential decision-making is exercised by a single body, based on increasingly uniform rules. The relationships between the two patterns are governed by the coordination provisions of the traditional directives— including the rules on the colleges - being applicable to issues involving both the single supervisor and the national supervisors. Voluntary Memoranda of Understanding will further refine this system<sup>40</sup>.

The further layer in the complex construction is the deposit guarantee system, to day organised and financed on a national basis. Whether and how that will be centralised as well is still open for discussion<sup>41</sup>.

Finally, the role of the ultimate financiers in case of a banking crisis should be added: the role of the EFSF and of the ESM, along with the position of the national resolution funds, including the European Resolution Fund should further be mentioned. They will enable resolution authorities to find a backstop for insolvent banks without necessarily involving national taxpayers.

### 3. Supervision versus regulation

12. The present regulatory and supervisory scheme can best be analysed as based on a fundamental divide between regulation and supervision. Although in practice this dividing line may be less evident as would appear from the distinctive terminology - even the SSM Regulation sometimes uses confusing terminology<sup>42</sup> - it points to one of the significant features of the SSM with considerable consequences for the institutional setup.

The regulation of banks<sup>43</sup> in the European Union has, up to now at least, essentially, been based on national legal provisions that are, however, derived from the European harmonisation directives, and therefore presents large, substantive similarities, and at the same time some diversity, and this not only on points of detail. Moreover – and apart from different legislative techniques - the generally applicable legal and regulatory framework may be different<sup>44</sup>.

Future centralised supervision will have to take account of these ‘underlying’ differences flowing from the national laws and regulations that remain outside the remit of that supervisor. The SSM Regulation takes due account of this double-layered system that consists of national banking regulation in each of the jurisdictions involved, but applied by a single supervisor that stands above the national level. This duality in the system is likely to

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<sup>40</sup> This would mainly apply to conflicts resolution according Article 19 EBA regulation. Preamble 12, Article 3(1) and Preamble (33) for MOU with securities supervisors

<sup>41</sup> See Commission proposal for a directive on Deposit Guarantee Schemes (recast), Com (2010), 369, see: [ec.europa.eu/internal\\_market/bank/docs/guarantee/20100712\\_proposal\\_en.pdf](http://ec.europa.eu/internal_market/bank/docs/guarantee/20100712_proposal_en.pdf)

<sup>42</sup> See Article 1 (2), Regulation referring to ‘prudential regulation of credit institutions’. The ESA are mainly regulatory bodies, and have limited competences in individual supervision.

<sup>43</sup> In the present paper the word ‘banks’ will be preferred to ‘credit institutions’ but only *brevitatis causa*. The precise scope of the proposed reform refers to “credit institutions” as defined in the directives on banking. The same reasoning applies to the use of “supervisor” instead of “competent authority”.

<sup>44</sup> This may refer to company or governance features, to civil and contract law, to accounting, enforcement techniques, etc. But one may also mention differences in the way the directives are implemented, in some jurisdictions essentially by formal law, in other administrative circulars or similar statements.



make the task of the ECB quite complex, and lead to tension over the interpretation of the national banking laws.

By way of example, mention can be made of the differences in the definition of “credit institution”, defined in directive 2006/48 as ‘*an undertaking whose business it is to receive deposits or other repayable funds from the public and to grant credit for its own account*’. Some Member States include in their definition institutions that do not receive deposits, or deposits from the public, but nevertheless grant credit, e.g., leasing or factoring firms. Should these be included in the ambit of the European supervisory regulation? The answer flowing from the new Regulation is negative as it only refers to “credit institutions” in the sense of the directive<sup>45</sup>, what may create tension in terms of consolidated supervision<sup>46</sup>.

13. Over time, however, the national banking laws are expected to converge due to the increased use of European regulations and maximum harmonisation directives, resulting in what is now commonly referred to as the “European Single Rulebook”<sup>47</sup>. However, the idea of having a common rulebook is a rather conceptual one, as it refers to a set of directives, regulations, implementing acts and maybe even recommendations, guidance, Q&As and other similar non binding instruments, which being conceived in a comprehensive approach, will be more in line with each other, reflecting an integrated regulatory system as applicable in the same way throughout the Union. However, although the first important chapter have been written - the CRD IV, CRR and the BRRD - the Rulebook will remain under development for quite some time. It is likely to be opposed by Member States that prefer to maintain their own practices, exceptions and methods. As long as regulation and supervision were national, these differences did not create internal tensions, but led to significant cross-border friction, e.g. by way of regulatory arbitrage. In the future the opposite is likely to occur, which will affect the effectiveness of supervision, as the single supervisor will be obliged to act on the basis of divergent ‘underlying’ national regulations in different Member States. In addition, as explained later, two regimes of supervision will apply, and these will not necessarily be fully adjusted to each other<sup>48</sup>.

14. The remit of the ECB as supervisor will be limited to prudential supervision and in that sense the ECB will replace the national supervisors as ‘competent authority – or designated authority<sup>49</sup> – ... as established in the relevant Union Law’.<sup>50</sup> It will be subject to the supervisory Guidelines and Recommendations of the European Banking Authority.<sup>51</sup> The ECB appears here as essentially a prudential supervisor, with limited rulemaking power and playing a passive role in EU wide rulemaking. The Regulation recognises that the ECB may adopt regulations, but only to the extent necessary for carrying out its tasks.<sup>52</sup> With respect to its own supervisory activities and the coordination with national supervisors competent for the less significant banks, the ECB can adopt ‘regulations, guidelines and general instructions’,

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<sup>45</sup> Article 2(3), Regulation

<sup>46</sup> In the future according Article 106, CRD IV.

<sup>47</sup> See the Conclusions of the European Council of 18 October 2012, pt 7, stating that ‘*it is of paramount importance to establish a single rulebook underpinning the centralised supervision.*’ The idea of the single rulebook goes back to ideas and proposals launched by Tommaso Padoa-Schioppa, nt 13.

<sup>48</sup> See nr. 34

<sup>49</sup> These are the authorities in charge of setting the countercyclical buffer rates, see art 126, CRD IV.

<sup>50</sup> Article 9 (1), Regulation

<sup>51</sup> Article 4 (3) 2<sup>nd</sup> §, Regulation

<sup>52</sup> Article 4 (3) 2<sup>nd</sup> §, Regulation. This rulemaking power will be limited to SSM internal procedures, but in many respects will be subordinate to Commission regulation, and EBA recommendations: see nt. 153.

addressed to these national supervisors.<sup>53</sup> A general rulemaking power would have upset the balance with the European Commission and with the EBA, and introduced a new unlevel playing field within the EU. This topic will be developed later.<sup>54</sup> All this does not mean that the ECB will not play a role in EU regulation: as representing a large number of national banking systems, it can be expected to weigh heavily on the rulemaking process, whether at Commission level or in the EBA.

15. The Regulation contains no definition of what constitutes “prudential” supervision: it includes a list of subjects or matters regarding which the ECB will carry out its supervisory activity<sup>55</sup>. Although this list seems to have been framed in limitative terms, it constitutes the core activity of any prudential supervisor. The question therefore arises whether the ECB could act in fields that have not been included in the list. The Preamble to the Regulation<sup>56</sup> makes it clear that these matters would remain within the remit of the national authorities, being whether the national prudential supervisors, or any other national authority. Examples mentioned relate to the application of the rules on consumer credit, or on money laundering that often do not belong to the remit of existing national prudential supervisors<sup>57</sup>.

But, in practical terms, the dividing line will often be blurred: the application of the rules on money laundering reveals important prudential features as violations illustrate poor risk management undermining the confidence in the banking institution. Will the ECB have to rely on the willingness of the national supervisors to require these rules to be effectively applied? Similar difficulties can be expected in the field of Mifid, with respect to the rules protecting securities clients: widespread misselling practices have shown to have significant financial consequences and in some cases may even lead to the downfall of the bank. In fact this issue is not a new one: it is well known in all states with a twin-peaks supervisory system where overlaps between the two lines of supervision are frequently found and which in the past was one of the reasons for integrating supervision into one institution<sup>58</sup>. The findings of e.g. the securities supervisors are often of prime importance to the prudential supervision in terms of operational risks or of potential liabilities. The Regulation rightly reminds that the two levels of supervision – and not only the ECB - should cooperate, as appropriate.<sup>59</sup>

16. The creation of a multi-state prudential supervisor will not put an end to the role of the existing national supervisory bodies: the system will be a two-tiered one, whereby the national supervisors continue their activities for the ‘less significant banks’ but also act on behalf of the ECB and -within the overall SSM structure - will contribute to the supervision of the more significant ones. They will moreover maintain their competences in fields such as prudential rulemaking as members of the EBA, as well for non-prudential matters, as will be

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<sup>53</sup> Article 6 (5) (a) Regulation. It would not seem that these regulations would have effect beyond the regulatory addressees. The suggestion of the ECB, Opinion, nt. 1, Pt 3. to rely on Articles 132, TFEU or 34.1- the latter a duplication of Article 127 (6), TFEU - of the ESCB Statute would allow the ECB to adopt regulations but only within the limits of its statutory remit.

<sup>54</sup> see nr 88 e.s

<sup>55</sup> see Article 4 (1) Regulation. The ECB thinks in terms of “specific regulations and manuals of supervisory practices”, see V. Constâncio, The nature and significance of Banking Union, London 11 March 2013, available at: [www.ecb.int/press/key/date/2013/html/sp130311.en.html](http://www.ecb.int/press/key/date/2013/html/sp130311.en.html)

<sup>56</sup> Preamble (28) referring to verifications and other duties mandated by the securities and other directives.

<sup>57</sup> Preamble (26); see also Article 1, Regulation

<sup>58</sup> See about this evolution, Wymeersch, E. The structure of Financial Supervision in Europe: About Single, Twin Peaks and Multiple Financial Supervisors, EBOR, 8:2, 2007, 239-306, ssn 946695. Since then the system has evolved considerably for banking supervision, as the latter has been increasingly centralised at the central banks.

<sup>59</sup> See Article 6, Regulation, dealing with “cooperation within the SSM”,



illustrated below<sup>60</sup>. At least for an unspecified period of time, the SSM will be characterised by a strong element of cooperation between the ECB and the national level.

17. The duality in the overall system, whereby national bodies are in charge of setting the rules and one overarching supervisor is designed to ensure their application, is likely to cause tensions.

An institution like the ECB acting at the European level may have some difficulty in applying national laws, the latter being sometimes deeply rooted in legal tradition. In principle, it would be logical to submit the reading of these laws to the specific legal order, as applied by the national regulator and national courts. If differences of analysis arise, a conflict might arise between the ECB and a supervised bank. In principle the national supervisor would not be competent as not being in charge of supervision. Hence the dispute resolution system provided in art 19 of the EBA regulation may not be applicable, as this provision applies to conflicts between competent authorities.<sup>61</sup> Conflicting views on the application of national law may not be tried before the national jurisdictions, but only by the ECJ, as the latter is the only jurisdiction that is entitled to decide on recourse against an ECB decision<sup>62</sup>. Hence the compatibility of the national law with the European rules as applied by the ECB would be the main, if not the only issue to be submitted to the Court.<sup>63</sup> This may seem unworkable due to the already considerable overload of the Court's agenda<sup>64</sup>. Non-supervisory conflicts involving national laws and regulation implementing EU law will also in the future have to be brought before the national jurisdictions.

In some instances, the Regulation derogates from the strict position that the ECB has no "locus standi" before the national jurisdictions: the Regulation allows the ECB to appear in a national court to obtain an authorisation for certain investigatory acts<sup>65</sup>. In this last case, the appreciation of the court is limited to the verification whether the proposed act is arbitrary or excessive. But the necessity of the action will not be put into doubt, as this can only be challenged before the ECJ<sup>66</sup>.

Coordination will be highly desirable in order to prevent the ECB's reading of certain provisions to be different from that of the national supervisor applying the same provision to the banks subject to its direct supervision, triggering level playing field issues within the same Member State.

The answer to this state of affairs is twofold: in the shorter term, more and more rulemaking will take the form of regulations, especially the implementing regulations based on the Articles 290 and 291 TFEU which over time might result in the European Rulebook, erasing local differences.

But it is also urgent to further streamline the applicable national banking laws in the sense of more uniformity, limiting special, derogatory regimes to cases when the overall

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<sup>60</sup> See nr 46.

<sup>61</sup> See further under EBA, nr. 85.

<sup>62</sup> Art 263, TFEU ; see also art 24(11), Regulation.

<sup>63</sup> Article 4(3), Regulation; see also preamble 34, referring to the primacy of EU law.

<sup>64</sup> One may wonder how this strict attitude is in line with Article 71 CRD IV which provides in a general right of appeal obviously before national jurisdictions. Banks subject to the SSM would be at a disadvantage, as appeals can only be brought before the ECJ.

<sup>65</sup> See Article 13, Regulation.

<sup>66</sup> See Article 13 (2), Regulation introducing a limited review, reserving the lawfulness assessment to the ECJ.



effectiveness would be in danger. Over time and under the increased pressure of the SSM and the more frequent use of EU regulations, this tension between the two levels of regulation is likely to disappear. In the meantime however, the ECB will ‘apply relevant Union law, and when this is composed of directives, the national legislation transposing those directives’<sup>67</sup>.

As regulations are directly applicable in the national legal order, one might expect that at least that feature will cease to create differences of interpretation. But the overall national legal system may continue itself to be felt, e.g. when general rules of administrative law<sup>68</sup>, or principles of contract law, of company law, of criminal law may have an influence on the reading of these uniform provisions. This is however not specific to banking supervision but is found in all fields of European action.

18. What constitutes national law implementing EU directives should also be further analysed: mostly, the formal nature of the national provisions will indicate what is national law. However, this question may arise when implementing statements have been adopted by the national supervisor under the form of a circular, a guidance, a statement, or in whatever other soft law form: will the ECB be bound to follow these instructions? Formally, the question could be answered by analysing the binding nature of the statement. It is well-established case law<sup>69</sup> that directives can be implemented otherwise than in formal legislation, and that circulars or other statements may be sufficient, provided that they are enforceable in court directly or indirectly. The same reasoning could be followed here, but only to the extent that the national implementing statement – e.g. the circular - is based on a delegation that is rooted in a formal law at national level and that its content is enforceable in law.

The Regulation mentions the case where a directive authorises Member States to exercise an option: if the option is exercised, the response given in that jurisdiction should be respected by the ECB, but if the option is given to national competent authorities, the way that option was exercised should, according to the Preamble, not be binding on the ECB.<sup>70</sup> This statement seems not compatible with the previously mentioned principle relating to the freedom of Member States to choose the way the directive is implemented.<sup>71</sup> The action of the ECB is limited to supervision and does not include rulemaking that is reserved to the national competent authority.

19. With respect to sanctioning as a strong enforcement tool, regulation 2532/98<sup>72</sup> relating to the sanctioning procedure applied by the ECB in monetary matters has been

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<sup>67</sup> Article 4(3), Regulation

<sup>68</sup> E.G. rules on privacy, to the extent that these are not covered by the Council Framework Decision 2008/977/JHA of 27 November 2008 on the protection of personal data processed in the framework of police and judicial cooperation in criminal matters OJ L 350, 30 December 2008

on the protection of personal data processed in the framework of police and judicial cooperation in criminal matters, OJ. 30 December 2008. Also Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data, OJ 23 November 1995

<sup>69</sup> See ECJ 19 December 1989 C-322/88 on the binding nature of Commission recommendations.

<sup>70</sup> Preamble (34)

<sup>71</sup> Article 288 TFEU “A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods.”

<sup>72</sup> Council Regulation (EC) No 2532/98 of 23 November 1998 concerning the powers of the European Central Bank to impose sanctions, OJ 27 11 1998, L 318/4, applicable on the basis of art. 15 Regulation. This regulation is based on Article 132(2) TFEU and allows the ECB to impose fines on undertakings for failure to comply with its regulations and decisions. See nr 57.





declared applicable. Hence the ECB can apply certain sanctions itself provided the breach relates to a directly applicable Union act (essentially a regulation or a decision) and provided that act confers sanctioning powers to the national competent authority. Up to now, in the field of banking, there have not been many Union acts providing for pecuniary sanctions. Therefore a complementary provision allows the ECB to act indirectly and require the national competent authority to start sanctioning proceedings on the basis of the national laws transposing EU directives, including the provisions of national law that are not based on Union law but complement the Union's supervisory system. On that basis the ECB could request national proceedings e.g. based on money laundering legislation, or on violations of the securities laws.<sup>73</sup>

Enforcement e.g. of the fines would take place with the assistance of the national central banks<sup>74</sup>. The proceeds from the fines will belong to the ECB.<sup>75</sup>

#### 4. The choice for the ECB

20. The choice for the ECB as the institution best placed for exercising the SSM function, although not uncontroversial, is not a surprise. On the one hand many of the national central bank are already in charge of prudential supervision in their own jurisdiction. The alternative, i.e. to put the European Banking Authority in charge of actual supervision was politically and legally objectionable: prudential supervision on Euro area banks could only be exercised by an Euro area supervisory body; more specifically on the basis of the Meroni doctrine, it was considered that supervisory tasks and responsibilities could be delegated to an agency under the prevailing reading of European Law<sup>76</sup>. As a consequence no proper supervisory powers were entrusted to the EBA<sup>77</sup> other than the coordination of existing national supervisory action. Some e.g. in the European Parliament have proposed the creation of a special body in charge of banking supervision, but for the same legal reasons, this would have required an amendment to the Treaty, which cannot be realised in the short term<sup>78</sup>. The

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<sup>73</sup> Reference is made to the provisions mentioned in Article 4 (3), Regulation, i.e. "all relevant Union law, and where this law is composed of directives, the national legislation transposing these directives"

<sup>74</sup> Regarding matters not covered by the ECB remit but for which sanctions are provided nationally – Article 18 (5) of the Regulation – the national supervisors will act as complementary sanctioning power. But they may even take the initiative themselves. This may include sanctions imposed on natural persons: Preamble (36)

<sup>75</sup> Article 3 (9) of Regulation 2532/98

<sup>76</sup> ECJ - Meroni & Co., Industrie Metallurgiche, SpA v High Authority of the European Coal and Steel Community. - 13 June 1958, Case 9-56. Among the numerous comments on the wider issue of institutional balance: Craig, P., EU Administrative Law, OUP, 2010, 160 e.s. Especially dealing with decisions of the European agencies: see Griller, St, and Orator, A., Everything under control? The "way forward" for European agencies in the footsteps of the Meroni doctrine, 1 European Law Review 2010 (34), 3-35

Yataganas, X.A, Delegation of Regulatory Authority in the European Union, The Jean Monnet Center for International and Regional Economic Law & Justice at NYU School of Law, <http://centers.law.nyu.edu/jeanmonnet/archive/papers/01/010301-04.html>; See for the Meroni doctrine as applied to the financial agencies, i.a. Wymeersch, nt. 29. § 9.102, and § 9.14. Whether the Meroni doctrine prevents the ECB to take discretionary decisions but not political ones, was supported by Brantner, F. Giegold. S and Repasi, R, Legal issues of the Single European Supervisory Mechanism, available at: [www.sven-giegold.de/wp-content/uploads/2012/10/Legal-issues-of-the-Single-European-Banking-Supervision\\_Giegold-Brantner-Repasi.pdf](http://www.sven-giegold.de/wp-content/uploads/2012/10/Legal-issues-of-the-Single-European-Banking-Supervision_Giegold-Brantner-Repasi.pdf), essentially on the basis of the argument that there are sufficient checks for the surveillance of the way these powers are used. Recent case law has further interpreted the Meroni doctrine, see further nr.25 e.s.

<sup>77</sup> Another course has later been followed for ESMA's involvement in the field of credit rating agencies: see Regulation (EC) No 1060/2009 of 16 September 2009 on credit rating agencies, L 302/1 17.11.2009, and subsequent regulation.

<sup>78</sup> See Council Press release, 18 April 2013, 8001/13, available at: [www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ecofin/136846.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/136846.pdf); indicates that the members states are "ready to work constructively on a proposal for treaty change" and that "the ECB regulation should be appropriately adjusted ... should art 127(6) be amended"

only body that could intervene without a change of the law is the ECB, since the Treaty – as modified by the Maastricht Treaty - already contains a provision allowing the ECB to exercise prudential responsibilities. Moreover it was obviously preferable to rely on the strong reputation of the ECB rather than on the creation of a new body, a process that would have been time and energy consuming, triggering numerous rivalries and appetites, and might have had a negative impact on the financial markets. Coherence of financial policies, a strict necessity in these unstable times, calls for strong unitary leadership to avoid relying on weaker instruments of coordination such as the supervisory colleges, or the home-host division of competences.

But this choice has raised some eyebrows, some considering that the decision concentrates too much power in one institution, the accountability of which therefore having to be strengthened, others referring to potential conflicts with the monetary function that should remain protected by strong independence safeguards, the latter not to be extended to the supervisory function. The final Regulation therefore contains considerable political safeguards in terms of public accountability, but less in terms of protection of individual rights<sup>79</sup>. Finally the relationship with the EBA and the latter's pre-eminence in matters of standard setting has been reinforced, in some cases potentially raising fears about threats to the effectiveness of the prudential supervision<sup>80</sup>.

21. Under the overall heading “*monetary policy*”, Article 127 (5) and (6) of the Treaty on the Functioning of the European Union (TFEU) enumerates the basic tasks of the European System of Central Banks (ESCB), comprising the Central banks of the 28 Member States, and the ECB, stating:

(5) 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.

(6) 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. (Author's emphasis)

While the first cited provision refers essentially to activity in the field of formulation and conduct of policies of which the *ESCB* is put in charge, the second one addresses supervision as such and charges the *ECB* with the prudential supervision of banks. The phrasing is somewhat unclear as it refers ‘*conferring tasks.... concerning policies relating to prudential supervision....*’ but the overall analysis allows the ECB to carry out activities (“tasks”) provided these are related to or flowing from prudential policies. Some have questioned this interpretation stating that the ECB can only develop activities relating to policies, not to actual supervision. *Ex absurdo*, one cannot reasonably consider that this provision has been inserted in the Treaty, with the strong political guarantees it actually contains - the unanimous decision of all Member States - if it only refers to tasks relating to policies, such as preparing studies or reports with a view to the adoption of prudential rules by

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<sup>79</sup> See e.g., the ECON chairperson MEP Sharon Bowles's blog: Sharon Bowles MEP hails victory for making ECB accountable in historic agreement for a Banking Union, March 19, 2013. See further nr 74.

<sup>80</sup> Reference could be made to the European Supervisory Handbook, Article 8, (1) and Preamble (7) of the amended EBA regulation. The handbook is legally not binding, but will be the subject of peer reviews and assessments, see nr 86

other bodies. In fact the ECB has been undertaking such studies since many years, and presents them in several existing committees, such as the EFC, the FSC and EBA, where it participates as an observer in an advisory capacity. The latter activity would rather come under the basis of Article 127 (5) TFEU.

22. Some have remarked that the prudential matters referred to in Article 127 (6) cannot exclusively concern the euro area members only but should apply to all EU members<sup>81</sup>. The argument is based on the concept of the monetary union in the Treaty that was meant to be applicable to all Member States, but with an - officially temporary – “derogation” for those Member States that would not apply for the monetary union.<sup>82</sup> On this basis, Member States as the UK, or Sweden have obtained a “temporary derogation”. Art 137 TFEU expresses this idea and defines to which Articles the “derogation” would apply. Article 127(6) is not included in this list as it obviously was a highly controversial last minute addition on which agreement could not be reached until parties accepted the maximum safeguard, i.e. the requirement of a unanimous decision. Nor is § 6 included in the Protocol No 15 relating to the UK and Northern Ireland<sup>83</sup>. Article 25(2) of the Statute of the ECB duplicates the text of Article 127(6) but it is not listed among the provisions that do not apply to the Member States with derogation.<sup>84</sup> All these references would support the thesis that the Regulation could not be restricted to the euro area states. This argument has to be taken seriously, as it has also found support among certain market participants<sup>85</sup>.

However the main argument pointing in the opposite direction is that Article 127 is part of the ESCB’s powers and that, per hypothesis, those are only applicable to the euro Member States, now that the original idea of applying Article 127 to all EU Member States has de facto been abandoned<sup>86</sup> and that the powers given to the ECB - in monetary and hence in prudential matters as well – can only be applied to the euro area Member States. Placing the supervisory matters under the heading of monetary policy illustrates the close link of

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<sup>81</sup> This idea is expressly mentioned in the preamble (11) but referred to “ the extent that this is institutionally possible”. See Micossi, St., *Indagine conoscitiva in relazione all’esame degli atti comunitari n. COM(2012) 280, n. COM(2012) 511 e n. COM(2012) 512, concernenti la risoluzione delle crisi e la vigilanza prudenziale degli enti creditizi*, [www.assonime.it/AssonimeWeb2/dettaglio.jsp?id=26288&idTipologiaDettaglio=375](http://www.assonime.it/AssonimeWeb2/dettaglio.jsp?id=26288&idTipologiaDettaglio=375). It has been argued that from the German side, the reference to “policies” was introduced to avoid the ECB being active in the field of prudential supervision. See: Carmassi, j., Di Noia, C., and Micossi, S., *Banking Union: A federal model for the European Union with prompt corrective action*, Assonime, Note e Studi, 12/2012, CEPS Policy Brief, No. 282, 18 September 2012; On political grounds, see Froehlich, U., *Pressekonferenz der Deutschen Kreditwirtschaft*, 25 July 2013, regretting the exclusion of London; Also: Speyer, B., *Banking Union: Do it right, not hastily!*, Deutsche Bank DB Research, 23 July 2012, warning for competitive distortions. Some have even defended the idea to include all EU Member States, except the UK and Denmark, the “27 minus” solution, as all Member States are obliged by Treaty to introduce the Euro: *Präferenzen für ein Modell ‘27 minus’ Handfester Streit zwischen Deutschland und Frankreich: Präferenzen für ein Modell*, *Frankfurter Allgemeine Zeitung*, 18 October 2012.

<sup>82</sup> The formulation is more refined: the derogation refers to Member States for which the Council has not decided that they fulfil the conditions, therefore designating those that have not applied as Member States ‘with a derogation’.

<sup>83</sup> Point 4 which reads as follows: ‘Articles 119, second paragraph, 126(1), (9) and (11), 127(1) to (5), 128, 130, 131, 132, 133, 138, 140(3), 219, 282(2), with the exception of the first and last sentences thereof, 282(5), and 283 of the Treaty on the Functioning of the European Union shall not apply to the United Kingdom. The same applies to Article 121(2) of this Treaty as regards the adoption of the parts of the broad economic policy guidelines which concern the euro area generally. In these provisions references to the Union or the Member States shall not include the United Kingdom and references to national central banks shall not include the Bank of England’.

<sup>84</sup> See art 42.1 of the ECB Statute

<sup>85</sup> See German BVR, VOEB, Finanzgruppe Sparkassen und Giroverband, nt. 35.

<sup>86</sup> Not a system of “derogation”, as mentioned in Article 137 TFEU, but an opt in has in fact been provided.

prudential supervision with monetary policy, which is exactly the concern which the present Regulation intends to address. The argument based on a mechanical reading of Articles 127 and 139 does not provide an answer why to Article 127 (5) has been included in the derogatory regime, while it deals with the ‘smooth conduct of policies pursued by the competent authorities relating to the prudential supervision’. It would have been more logical not to except countries like the UK from these policies than to include them for the active supervisory measures under Article 127 (6). The absence of a reference to Article 127 (6) in the above mentioned transitional provisions can be understood as unnecessary since the decision on the basis of that provision has to be unanimous in any case: an exception from a rule that is not applicable would not have added much value. It seems that from the beginning Article 127(6) has been conceived to open the possibility to centralise prudential supervision of banks in the hands of the ECB<sup>87</sup>.

It seems clear on the other hand that the Regulation was not intended to base the SSM on the enhanced cooperation provisions of the Treaty on European Union, although it does not seem that this approach would have been prevented, even within the ambit of Article 127 (6).<sup>88</sup>

But generally speaking it is difficult to deny that the wording of Article 127 (6) is not exceptionally clear, and deserves to be clarified and refined through a later revision of the Treaty.

23. The choice for the ECB also implied that the Banking Union would be build for and around the euro: this was the currency under threat that needed support from a strong supervisory regime. But this choice implied that the non-euro countries could not be included: with the opt-in described below much of this argument has become moot. More serious is the argument that by limiting the SSM to a certain number of states, a two-speed Europe would be created, whereby the single internal market would be split. The risk to the integrity of the internal market is cited in UK publications.<sup>89</sup> The fragmentation of the European financial markets is a pre-existing concern that the Banking Union aims to reverse.

The separation of the monetary from the prudential tasks has been a much discussed subject leading to underline the strict safeguards for the ECB’s independence – from both angles, i.e. for monetary and supervisory purposes as well –, equal treatment, non discrimination and a strict refusal of any interference from the monetary side<sup>90</sup>. Apart from an explicit provision in the Regulation, the creation of a Mediation Panel allows the national supervisors to resolve differences of views between the Supervisory Board and the Governing Council, stemming from the ECB’s double competences i.e. monetary and prudential.<sup>91</sup>

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<sup>87</sup> Constâncio, V., The nature and significance of Banking Union, London, 11 March 2013, nt.56. quoting Tommaso Padoa-Schioppa, T.: “EMU and banking supervision” Lecture in the London School of Economics, on 24 Feb1999. It is mentioned that the reference to “policies” was introduced, at the request of the German delegation, to avoid the ECB becoming active in prudential supervision: Carmassi, J., Di Noia, C, and Micossi, S, nt. 82. Several other legal basis have been considered: see Ferran, E and Babis, V, nt.1 9i.a. Article 114)

<sup>88</sup> Article 20, TEU. See ECB, Opinion of 27 November 2012, nt 1, pt 4.

<sup>89</sup> See House of Lords, European Union Committee, European Banking Union: Key issues and challenges, 7th Report of Session 2012–13, 12 December 2012, § 138 expressing deep concern with its “troubling implications”. Seyad, S.M., The Impact of the Proposed Banking Union on the Unity and Integrity of the European Union Single Market, J. International Banking Law and Regulation, vol. 18/1, 99 (2013)

<sup>90</sup> ECB, Opinion 27 November 2012, nt. 1, § 1.10

<sup>91</sup> See Article 25 (5), Regulation; see nr 27.



The unanimity requirement in Article 127(6) was a critical factor for accepting this provision to be introduced in the Treaty. In the case of the SSM, it has proved not to be an insurmountable restriction, as the potential opponents saw their interest in supporting the proposal, as on the one hand they would not be directly involved, on the other the proposal would stabilise the financial situation on the European financial markets including their own. Legally, once the Regulation is adopted, the unanimity requirement continues to apply in case later changes are needed, maintaining a negotiation position for the non-participating states. The ECB had pleaded for introducing a provision according to which later changes could be adopted by qualified majority, in accordance with the Treaty on European Union. The suggestion has not been adopted<sup>92</sup>. The Commission has announced that it might come forward with a proposal allowing changes to be adopted by a majority vote of the Member States.<sup>93</sup>

## 5. The Single Supervisory Mechanism or SSM

24. The attribution of the supervisory function to the ECB in the Treaty itself also solves a certain number of important issues: as the organisation of supervision is put in the hands of the ECB, there can be no objection based on a forbidden delegation of powers, as the powers have been directly enshrined in the Treaty itself. Hence the *Meroni* doctrine would not be applicable within the supervisory remit of the ECB. However, the drafters of the Regulation have preferred the safe side and worked out a construction in which the final decision will be considered to have been adopted by the Governing Council<sup>94</sup>. There can also be no doubt that the decision making powers ultimately belongs to the Governing Council as the final decision making body, but the conditions on which this body is involved may be set out in the Regulation, and may be worked out in greater detail in internal regulations, the Framework and Memoranda of Understanding. The internal organisation of the supervisory activity is up to the ECB, including the way the supervision will be structured, whether additional internal decision making bodies will be involved, and what, in the end, will have to be brought before the Governing Council or even the Executive Board. Within the limits of the Regulation, the ECB is free to organise its supervisory activity and to install the necessary bodies, along with internal departments and internal procedures, in charge of preparing its decisions. According to the present Statute of the ECB, the Executive Board is responsible for the current business of the ECB, including the preparation of the meetings of the Governing Council<sup>95</sup>. Logically, this would have included the decisions in the supervisory field, but the Executive Board remains unmentioned, as all supervisory matters will be dealt with by the Supervisory Board. This would lead to the conclusion that the Executive Board is not in a hierarchical position with respect to the Supervisory board

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<sup>92</sup> Article 48 (7), TEU. But this issue – along with full participation of the non-euro participating states in ECB decision making - is mentioned for further consideration in the preamble (85) and may be the subject of an additional initiative of the Commission.

<sup>93</sup> See Commission Communication “Blueprint for a deep and genuine economic and monetary union, 28 November 2012:” Article 127 paragraph 6 TFEU could be amended to make the ordinary legislative procedure applicable and to eliminate some of the legal constraints it currently places on the design of the SSM (e.g. enshrine a direct and irrevocable opt-in by non-euro area Member States to the SSM, beyond the model of “close cooperation”, grant non-euro area Member States participating in the SSM fully equal rights in the ECB’s decision-making, and go even further in the internal separation of decision-making on monetary policy and on supervision”.

<sup>94</sup> The Panel will be composed of representatives of the Member States, acting by simple majority: for details see article 25 (5), Regulation.

<sup>95</sup> Articles 11.6 and 12.2 of the Statute



The legal service of the Council has argued that the Treaty allows delegating certain tasks but “cannot appreciably alter the (...) exercise of the powers concerned”<sup>96</sup>. Therefore the ultimate decision making power has to remain in the hands of the Governing Council, who has the “power to reject or to modify partly or fully any draft decisions submitted to it by the Supervisory Board”.

One could concur with the legal service’s opinion that the present issue is not one of delegation, but of the organisation of this function within the ECB itself. It is clear that the drafters of the proposed regulation were attentive to this issue when designating the scheme as a Single Supervisory *Mechanism*, and not an institution<sup>97</sup>, thereby indicating that the mechanism does not call for a delegation from another body. According to the same reasoning, the Supervisory Board is not a separate institution, but a step in the internal decision-making process. The Supervisory board has no legal personality and has no external competences, except for the one item explicitly mentioned in the Regulation namely reporting to the European or national Parliaments. Therefore this Board can have no powers other than preparing decisions to be submitted to the Governing Council, which has the ‘power to reject or to modify partly or fully any draft decisions’. But this fear of excessive delegation has led to the not very satisfactory arrangement for the Governing Council’s decision making in supervisory matters<sup>98</sup>.

25. The abovementioned view broadly reflects the basis of the *Meroni* doctrine as it stood at the time of the adoption of the Regulation. However in January 2014 the ECJ has delivered a decision that repositions the extent to which European institution can organise separate bodies to whom part of their own decision making power can be transferred<sup>99</sup>. In a case opposing the United Kingdom to the EU Council and Parliament involving the powers of ESMA to directly prohibit short selling in certain circumstances, the court held that this conferral of powers did not infringe the *Meroni* rule, that only prohibits to delegate a wide margin of discretion. The Court analysis based its finding on the existence of strict objective criteria<sup>100</sup> in the contested provision in the Short Selling Regulation, and the fact that its decisions are amenable to judicial review.

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<sup>96</sup> This legal opinion (9 Oct 2012, nr. 14752/12) has not been published, but several press publications discuss its content: See Barker, A., Leaked Legal opinion on Eurozone Banking, FT, 18 October 2012;

Juristische Fussangeln fuer die Europaeische Bankenaufsicht, NZZ, 19 October 2012; Juristische Bedenken gegen Euro-Bankenaufsicht wachsen, Handelsblatt 19 October 2012; Further: K.C. Engelen, Die Bankenunion is eine Falle, Handelsblatt 19 December 2012.

<sup>97</sup> The creation of a separate institution would have been contrary to the present Treaty, and an unnecessary complication of the proposed supervisory system. As the SSM is not a separate institution but only a separate business line within the ECB, there can be no discussion about the issue of delegation to a separate body, as the entire organisation is internal to the ECB; see about this issue: A Baker, Leaked legal opinion on Eurozone banking union, FT 18 October 2012 and Graham Bishop’s comments: FT story on illegality of Banking Union proposals - Graham Bishop comments, 18 October 2012.

<sup>98</sup> See further nr.66

<sup>99</sup> *United Kingdom v. European Council and European Parliament*, C-270/12, 22 January 2014, not yet reported. See opinion of advocate-general JÄÄSKINEN, 12 September 2013.

<sup>100</sup> In order to indicate that ESMA did not enjoy a “wide margin of discretion” in the *Meroni* style, the Court mentioned the strict definition of the powers, the absence of autonomous powers beyond the regulatory framework, the limited type of measures to be adopted, but also the consultation procedure and the exceptional circumstances in which the power can be used.

Another question alleged that ESMA was allowed to adopt “quasi-legislative measures of general application” as these were disallowed in 1981 ECJ “Romano” decision<sup>101</sup>. Under the TFEU, Union offices<sup>102</sup> are allowed to adopt acts of general application<sup>103</sup> (provided only clearly defined executive powers are delegated. The provisions of the TFEU<sup>104</sup> contain the indirect recognition that powers may be conferred to “bodies, offices and agencies”, implying legally binding measures to be imposed on market participants. The highly technical nature of the measures and the need of technical expertise for the office involved should be taken into consideration<sup>105</sup>. Esma was qualified not as a Commission agency, but as a Union “entity”, created by the Union’s legislator<sup>106</sup>

It was also discussed whether article 114 TFEU - the basis for approximation of laws<sup>107</sup> - was a valid legal basis for measures that are legally binding on individuals. The Court replied to this objection that approximation of general laws may not be sufficient to achieve article 114’s objective, measures of approximation should therefore be analysed “as encompassing the EU legislature’s power to lay down measures relating to a specific product or class of products as well as, if necessary, individual measures concerning those products”<sup>108</sup>.

There can be little doubts that this ECJ will have a far going impact on the future developments of the regulatory framework in the EU.

26. Some criticism has been voiced as to whether the Regulation could decide on a matter, which ultimately belongs to the internal affairs of the ECB. By conferring tasks on the ECB, the Council, in accordance with the Treaty, is the body in charge of instituting the supervisory function, defining and organising the tasks within the framework laid down in the Regulation: it is up to this body to decide how these will effectively be carried out, especially as the new organisation involves a multiplicity of interests and of stakeholders that have to be balanced, matters that go beyond -or may conflict with - the traditional ECB’s monetary interests. This is not changing the internal governance of the ECB, but introducing conditions and procedures (‘mechanisms’) with respect to the exercise of this new function.

In the same vein, the Regulation describes the involvement of national supervisors not in terms of contractually delegated parties, but as an “*integral part of the SSM*”, again identifying the SSM as the way in which this internal function within the ECB is structured implying the involvement of the national supervisors, but preventing national supervisors from being regarded as more or less autonomous players in the overall mechanism<sup>109</sup>. This feature explains the right of the ECB to address instructions to the national supervisors, and in extreme cases, to pre-empt supervision of a specific bank or groups of banks.

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<sup>101</sup> Case 98/90 *Romano* [1981] ECR 1241.” ESMA confines itself to putting into practice EU legislation, so that decisions adopted under that provision are executive and not legislative in nature”

<sup>102</sup> Along with Union bodies and agencies

<sup>103</sup> ECJ, *C-270/12*, 65.

<sup>104</sup> See article 265, 267 and 277 TFEU that expressly refers to the possibility for Union bodies to adopt acts of general application.

<sup>105</sup> ECJ, *C-270/12*, 81-82.

<sup>106</sup> ECJ, *C-270/12*, 43.

<sup>107</sup> The European legislature shall “adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market.”

<sup>108</sup> ECJ, *C-270/12*, 106.

<sup>109</sup> § 4.2.2. of the Explanatory memorandum to the Commission’s proposal. The Regulation itself states that the ECB will be exclusively competent (Article 4 (1), while defining the SSM as “composed of the ECB and national competent authorities” (Article 6 (1).

The decision to organise an SSM is adopted by the Council in a Regulation, hence in a directly applicable instrument introducing the single supervisory system in all the Member States, whether these belong to the euro area or not. According to the principle of primacy of European law, the Regulation and its provisions take precedence over the national laws and regulations. The euro area Member States, their national supervisors and the banks located there have no choice but to accept the ECB's decisions and instructions. Also, there is a well-founded expectation that the supervisory regime will apply equally in all Member States concerned<sup>110</sup> and that a level playing field will be actively pursued and attained after some transitional period.

Indirectly, the SSM regime will also affect the non-participating states, as the Regulation is binding in all Member States. However, these relations will be construed along the general lines of the cooperation between the European states, as laid down in the applicable directives. In this respect, the ECB is qualified as a "competent authority" dealing with the competent authorities of the non-participating states on the same basis, as was the case with authorities in the pre-SSM setting. More generally, third countries will have to recognise the new structure of supervision, including the division between significant and less significant institutions.

27. The adoption procedure called for the consultation of the ECB and the European Parliament. The ECB has published its opinion<sup>111</sup>. The fact that the ECB only had to be consulted but did not have to give its approval, is significant for the mind-set of the drafters of the Treaty provision: general policy decisions are the realm of the Council, as the supreme political authority within the Union. Moreover, the ECB is not likely to object, as engaging more actively in prudential supervision has been - silently - on its agenda for many years and corresponded to the objectives of the drafters of the Treaty provision<sup>112</sup>.

The situation is different for the European Parliament, which according to the Treaty did not have to be involved. The Parliament has expressed its dissatisfaction for not being involved by way of a co-decision or approval right, mentioning its fear that the Regulation might lead to a two-speed Union and lead to a further split of the European economic area. It has demanded to be involved in the appointment of the persons heading the supervisory board, in parallel with its privileges with respect to the appointment of the ECB's Executive Board members. The Parliament has obtained considerable changes, especially in terms of co-decision making on crucial appointments and of accountability<sup>113</sup>. Also it was very material in adapting the proposal on the European Banking Authority for which it had the formal right of co-decision<sup>114</sup>.

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<sup>110</sup> The Preamble (30) expressly refers to the "principles of equality and non-discrimination", as related to the objectives of unity and financial integrity. It is repeated in Article 1, Regulation with a further reference to "preventing regulatory arbitrage". The Council Conclusion called again attention to this point.

<sup>111</sup> See Opinion of the European Central Bank, nt.1.

<sup>112</sup> See the speeches and papers referred to above nt.14 to 17.

<sup>113</sup> See the agreement between the EP and the ECB, translated in the Legislative Resolution attached to the Parliament's approval of the Regulation, and referring to the agreement between Parliament and ECB : Interinstitutional Agreement, nt 1.

<sup>114</sup> Graham Bishop considered that the EP could retain its approval of the EBA regulating on amendments, and thereby maintains considerable leverage on the SSM proposal, FT story on illegality of Banking Union proposals - Graham Bishop comments, 18 October 2012. In the same sense: Véron, N., L'EBA, Arbitre des différends entre le Royaume-Uni et l'Union bancaire, Banque nr 757, February 2013, p 36



From a general viewpoint of public institutions' accountability, there can be little doubt that the EP's overall oversight should include the functioning of the SSM<sup>115</sup>. It is therefore to be welcomed that appropriate procedures have been provided for in the Regulation as adopted. These would only allow the Parliament to discuss the general policy lines developed in the ECB's supervisory activity, but not deal with individual measures. Indeed, it is a general principle of prudential supervision that it is exercised independently, and without external interference<sup>116</sup>. The accountability obligation is addressed to the ECB as such<sup>117</sup>, for which the chair of the SSM supervisory board will be the spokesman. There is no separate accountability of the SSM or of the Supervisory Board, as this would imply that the Supervisory Board or the SSM would be considered separate institutions<sup>118</sup>.

Furthermore the Parliament will continue to have a firm grip on the regulatory processes and the underlying policy setting, being whether co-legislator or actively involved in the rulemaking on the basis of the Article 290 of the TFEU. Most of the recent directives and regulations contain considerable delegations to implementing legislation that most of the time call for formal co-decision by Council and Parliament, by it by way of a "call back" a right of objection.

28. Although being an integral part of the ECB, the supervisory activity will have to be kept clearly separate from the ECB's monetary or other functions, such as the ones relating to financial stability. This point has been hotly debated as politically it was considered of crucial importance. The issue is however not uncontroversial, some considering it to be a non-issue<sup>119</sup>, others calling attention to the added value for both prudential and monetary functions to have a clear view on both sides of the fence. Reference is made to the Federal Reserve and many other national prudential supervisors where banking supervision is part of its overall mandate, pointing to the added value for the monetary institution to have at least extensive information on and a detailed insight into the major banks and their transactions<sup>120</sup>. Those

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<sup>115</sup> See the ECB- European parliament interinstitutional agreement, nt. 1.

<sup>116</sup> See BCBS, Core principle 2, refers to "operational independence", Core Principles of effective banking supervision, Consultation document, December 2011, available at: [www.bis.org/publ/bcbs213.pdf](http://www.bis.org/publ/bcbs213.pdf). Brantner Giegold and Repasi, nt. 77, argue that the Treaty independence provision is applicable to the ECB in its monetary function, but not for this additional task of supervision. This conclusion is not shared by the ECB, Opinion, nt.1, § 1.4. The Interinstitutional Agreement has worked out a procedure for confidential exchanges of information, see nr 1.

<sup>117</sup> See Article 20, Regulation,

<sup>118</sup> According to the conclusion of the European Council, "accountability takes place at the level at which decisions are taken and implemented", Pt 7 of the European Council conclusions of 18 October 2012, available at: [www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/133004.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/133004.pdf), point 6.

<sup>119</sup> See Beck, Th. and Gros, D, Monetary Policy and Banking Supervision: Coordination instead of separation, CEPS policy brief, No. 286, 12 December 2012; in the same sense: de Larosière, J., Privilégier une structure légère mais aux aguets, Banque nr 757, February 2013, p 22 declaring that in his long career he has never considered this matter to be a conflict. Mersch, Y., Keynote Speech, nt 20, mentions several synergies (Information, expertise, independence, efficiency). Comp. Coene, L, Keynote Conference on Corporate Governance and the Banking Union in a Transatlantic perspective, 17 December 2012, available at: [www.ecgi.org/tcgd/2012/presentations.php](http://www.ecgi.org/tcgd/2012/presentations.php), 3.1, stating that both lines of thinking have a common denominator, i.e. price stability. Darvas and Merler, o.c., nt.11. Strong reservation was formulation by Speyer, B., Banking Union: Do it right, not hastily! Deutsche Bank DB Research 23 July 2012, without however suggesting a workable alternative; also by Sapir, A., Hellwig M., and M. Pagano, M., nt, 23.

<sup>120</sup> The argument was discussed by Goodhart, referring to Greenspan (p.18) and Ferguson (p.30), cited in, Goodhart, C., The organisational structure of banking supervision, November 2000, Financial Stability Institute, Financial Stability Institute, November 2000 available at: [www.sadhan.net/Adls/D16/Baselcommittee/TheOrganisationalStructure.pdf](http://www.sadhan.net/Adls/D16/Baselcommittee/TheOrganisationalStructure.pdf)



arguing in favour of strict separation have defended the creation of a separate institution what would have run into insurmountable difficulties in the absence of a clear Treaty basis.

The Regulation has adopted a strict position calling for separation, without going to extremes such as setting up geographically separated bodies or departments. The practical solution consists essentially of a clearly stated principle of separation<sup>121</sup> and of a series of organisational measures: the supervisory function will be located in a clearly separate department, with a separate leadership, separate governance and management and with clear Chinese walls of secrecy<sup>122</sup> between the two sections of the Bank. The ECB will be in charge of a dual mandate to which corresponds two different lines of decision making and reporting, with different staff, separate meetings and agendas at the level of the Governing Council, and a mediation panel in case national supervisors fear interference on the basis of monetary considerations. Member States will be able to start a mediation procedure relating to decisions of the Governing Council, in order to object to draft decisions of the Supervisory board but only to the extent that these objections are based on concerns of a monetary nature<sup>123</sup>. The members of this ‘Mediation Panel’<sup>124</sup> will enter into discussion with the ECB in an attempt to find a solution. In case of persisting disagreement, the only recourse against a decision of the Governing Council would be before the ECJ.

## 6. The ECB as prudential supervisor

29. The Treaty mandates prudential supervision to be exercised by the ECB: hence its governing bodies will ultimately be in charge of and responsible for the prudential supervision in the euro area and this with the aim of ‘ensuring a coherent and effective implementation of the Union’s policy’.<sup>125</sup> This includes the duty to organise the supervision, to provide the necessary internal organisation and staff, to develop the appropriate administrative structures and procedures – especially with respect to the separation of monetary and supervisory functions - and to ensure the adequate follow-up with the euro area member central banks and the non-central bank supervisors, all in accordance with the provisions of Article 127 (6)<sup>126</sup>. Several provisions of the Regulation point to this ultimate role of the ECB and its governance bodies<sup>127</sup>.

The ECB in its supervisory capacity and the members of the Supervisory Board, will act independently, independence being formulated very broadly in relation to Union and

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<sup>121</sup> Article 18, Regulation.

<sup>122</sup> Article 37 (1) of the Regulation refers to Article 37 of protocol nr 4 and to relevant acts of the Union, referring particularly to the provision on secrecy in the directives on prudential supervision.

<sup>123</sup> Article 25 (5), Coene, L., nt. 120 refers to the use of this Panel.

<sup>124</sup> Chosen by the participating Member States – thus including the non-euro participating states – among the member of both Governing Council and Supervisory Board, therefore composed of at least 18 members. Decisions are adopted by simple majority, each member having one vote. See Article 25 (5), Regulation.

<sup>125</sup> Preamble (15).

<sup>126</sup> As mentioned above, this is not a “delegation”- what would have been objectionable -, as seems to have been referred to in the Council legal opinion, but the organisation of tasks that have been conferred to the ECB; see the Council legal opinion as referred to in Barker, A., Leaked Legal opinion on Eurozone Banking, FT, 18 October 2012; on delegation in general, see: CESR Key Principles for the Delegation of Tasks between Competent Authorities, Sept 2008, CESR/08-744(b); Wymeersch, E., Delegation as an Instrument for Financial Supervision, *Revue Trimestrielle de Droit financier* 2007, 71; <http://ssrn.com/abstract=952952>.

<sup>127</sup> See eg. Article 26 where the ECB is held responsible for devoting necessary financial and human resources to its supervisory task.



national bodies, the latter being obliged to respect that independence.<sup>128</sup> In addition, the members of the Supervisory board, although qualified as “representatives”, shall act in the interest of the Union as a whole, what is particularly important for the representatives of the national prudential supervisors. One can mention the comparable provisions in the Statute on the ECB and in the regulations on the ESAs<sup>129</sup>.

For several reasons it is obvious that this voluminous organisational task cannot be performed by the existing bodies of the ECB alone and that a separate and appropriate structure has to be created.

## 6.1 The ECB as a central player in European financial cooperation

30. Article 3 of the Regulation enumerates the different institutions with which the ECB will cooperate. Apart from the political message, according to which the ECB, in its supervisory capacity is willing to cooperate with all other bodies in charge of banking matters in the EU, this provision has a mainly theoretical function as it situates the ECB in the overall European financial construction. At first sight, there do not seem many direct legal consequences attached to these declarations of close cooperation.

The institutions with which close cooperation will be pursued are:

- the three European Supervisory Agencies, the European Systemic Risk Board (ESRB) and the national supervisors which all form part of the European System of Financial Supervision (EFSF); this type of cooperation had already been included in the regulations relating to the three supervisory agencies;
- with present or future authorities in charge of banking recovery and resolution plans, at the national level, and later at the European level as well;
- the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM), especially in regard of granting financial assistance, as the latter will trigger direct ECB supervision.
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Special attention deserves the cooperation with the securities supervisors, as the banks' activities in the securities markets will considerably influence these banks' prudential position: therefore, the cooperation will be the subject of specific MOUs. No mention is made of coordination with insurance supervisors: this will take place within the existing procedures of the directive on financial conglomerates, the ECB being the coordinator or one of the coordinating supervisors according to the rules of “supplementary supervision”, and coordinated within the Joint Committee of European Supervisory Authorities.

With the non-participating Member States, the ECB will conclude Memoranda of Understanding (MOU) about the way this cooperation is organised.

In addition, a separate MOU is also called for with non-participating Member States that house global systemically important institutions. It is especially the UK or Sweden that are considered here<sup>130</sup>.

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<sup>128</sup> The practical meaning of this requirement is unclear and largely theoretical. For a similar provision in the ESA regulations, comp Article 2, EBA Regulation. As to the international standard on prudential supervision, see BCBS, nt.117

<sup>129</sup> See for the ESAs, Articles 1(5) and 46 ESA Regulation, dealing with independence. Compare: the ECB, Statute Article 7.

<sup>130</sup> Article 3 (6), Regulation.

Almost nothing is said in the Regulation about the cooperation with third countries, whose banks directly conduct very important operations within the EU. This matter remains governed by the national provisions, where applicable implementing European directives.<sup>131</sup> In these cases the ECB will not intervene as the SSM only relates to banks established in the euro area, extended to the banks of the non-euro participating states. However, significant subsidiaries crossing the thresholds mentioned below may trigger the ECB's competence.

Under the heading "international relations" the ECB may enter into contacts and administrative arrangements with supervisors and administrations from third countries, and with international institutions as well, but these will not pre-empt any national action nor create legal obligations for Member States or for the Union. A similar provision is found in the EBA regulation<sup>132</sup>. Formal international action is within the competence of the Commission and of the national supervisors. In the past national supervisory cooperation was often practised at a more pragmatic level without creating explicit legal obligations.

## 6.2. The scope of the SSM: only credit institutions

31. As stated in the Treaty, the ECB's prudential supervision would apply to banks – more precisely "credit institutions", to be understood in the sense used in the directives, meaning "*an undertaking the business of which is to receive deposits or other repayable funds from the public and to grant credits for its own account*"<sup>133</sup>. Other financial institutions are not subject to the SSM, although the Treaty, in its Article 127 (6) would allow "other financial institutions" to be included in the SSM's remit.

Insurance firms have been expressly excluded in the Treaty itself, what is probably the result of successful argumentation about the insurance's specificity. However with the increasing congruity between banking and insurance supervision, and the recognition of their systemic significance<sup>134</sup>, it is likely that sooner or later the debate will start about a more integrated form of supervision.<sup>135</sup>

Certain institutions may be qualified as 'banks' under national law although they do not receive deposits and therefore do not qualify as banks under the EU laws<sup>136</sup>; hence they

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<sup>131</sup> See Article 47 and 48 CRD IV essentially providing for a prohibition on granting a more favourable regime to branches of third country banks, and authorising the Commission to submit proposals to the Council.

<sup>132</sup> European Banking Authority, Regulation, nt.15, article 16

<sup>133</sup> See art. 2 (3), Regulation referring to Article 4 (1) of CRR.

<sup>134</sup> See IAIS, Consultation on G-SIIs, Global Systemically Important Insurers: Proposed Policy Measures [http://www.iaisweb.org/index.cfm?pageID=988&lyrHighlightWord=systemic%20&searchvalue=systemic](http://www.iaisweb.org/index.cfm?pageID=988&lyrHighlightWord=systemic%20&searchvalue=systemic;); *Compiled Comments 2 January 2013*; Caruana, J., Insurance and financial stability: a Basel view <http://www.bis.org/speeches/sp130408.htm>; PWC, The supervision of global systemically important insurers – G-SIIs; The Geneva Association Systemic Risk Working Group: Systemic Risk in Insurance An analysis of insurance and financial stability, 2010, available at: [http://www.genevaassociation.org/portals/0/Geneva\\_Association\\_Systemic\\_risk\\_in\\_Insurance\\_Report\\_March2010.pdf](http://www.genevaassociation.org/portals/0/Geneva_Association_Systemic_risk_in_Insurance_Report_March2010.pdf).

<sup>135</sup> In the same sense: TheCityUK, Report Report of TheCityUK seminar on the European Banking Union January 2013, at p.8; Speyer, B., Banking Union: Do it right, not hastily! Bank DB Research, 23 July 2012 (a gap in the new arrangements")

<sup>136</sup> See Preamble (22), stating clearly that these bodies stay under national supervision. According to French law, specialised financing institutions – leasing, factoring and similar – are subject to prudential supervision, without

would be excluded from the SSM. Only the European definition of ‘credit institution’ should prevail, as otherwise the Member States would be able to determine the scope of the SSM. However these institutions might be included in the ECB’s action as being part of a supervised group.

Some public sector institutions are also excluded from both the prudential regulation and the ECB’s supervision: these include state subsidised specialised institutions such as the Kreditanstalt fuer Wiederaufbau, or the Caisse de Dépôts et consignations<sup>137</sup>. Investment firms would also be exempted, as these would be supervised according to the Mifid 1 or in the future Mifid 2, although they are partially subject to CRD IV.

Several categories of financial institutions that are not formally qualified as banks will not be subject to the SSM. This may raise eyebrows as some of these institutions are clearly significant and may even be systemically relevant. Central Clearing Counterparties<sup>138</sup> or CCPs are critical building blocks for the clearing of securities and derivatives. With a few other important players - Central securities depositories, but also stock exchanges or multilateral trading facilities (MTFs) - they belong to the so-called market infrastructure, the systemic nature of which is not contested. However to the extent that they are not run as a bank, they would be excluded from the SSM.<sup>139</sup> The Regulation states this explicitly for CCPs<sup>140</sup> but one can assume that this relates to all other non-bank institutions. Some of these infrastructures in the securities field have adopted banking status for all or part of their business: this would result triggering direct ECB supervision, provided the quantitative and other criteria are met on a consolidated basis. The holding company heading this group may then be qualified as a financial holding company thus also triggering the SSM if a two least two subsidiaries, with banking status located in different participating Member States form part of this group which owns considerable cross border assets or liabilities.<sup>141</sup>

Similar exemptions apply with respect to broker-dealers, which are organised as investment firms under the securities directives (esp. Mifid)<sup>142</sup>. If they would have organised themselves as banks, they would be subject to banking supervision, provided their activity meets the conditions formulated in the definition of “credit institution”. Equally important are money market funds that have a quasi-banking function, at least for some depositors. As most of these are organised as UCITS, there is no connection with the SSM, although in some respects their financial activity is akin to that of a deposit-taking bank, and often many times larger in terms of volume. In these cases, the national securities supervisor – prudential or market supervisor – will remain competent.

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receiving deposits from the public. See for the list: [/www.acp.banque-france.fr/controle-prudentiel/les-assujettis-au-controle.html](http://www.acp.banque-france.fr/controle-prudentiel/les-assujettis-au-controle.html)

<sup>137</sup> Article 2 (5) of the CRD IV; for Belgium the “Institut de reescompte et de garantie” is mentioned although it has been dissolved since many years.

<sup>138</sup> These will be regulated in accordance with the future CSD Directive, see: Proposal for a Regulation on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/ECCOM(2012) 73/2

<sup>139</sup> Article 1 (2) in fine, Regulation, excluding all non-banking institutions, such as Central Counterparties or CCPs. The solution might be different for CSDs, some of which are functioning with a banking licence.

<sup>140</sup> Article 1 (2), Regulation.

<sup>141</sup> See art 6 (4) (3), Regulation. This entity might qualify as a financial conglomerate according to art 2(14) of the financial conglomerates directive, 2002/87/EC of 16 December 2002; adde: art 106 of the CRD IV proposed directive on supervision on a consolidated basis

<sup>142</sup> See for further details, Wymeersch, The banking union’s single supervisory mechanism and the securities business, Journal of Securities Operations & Custody Volume 5 Number 3



The limitation of the SSM to credit institutions does not mean that it will not be concerned by the supervision on non-banking activities that remain nationally supervised: often these activities will have a direct impact on the risk profile of the banking group, and therefore will be of direct concern to the banking supervisor as well<sup>143</sup>.

### 6.3 The scope of the ECB's supervisory mandate.

32. Pursuant to Article 127(6), the ECB will be in charge of the prudential supervision of all credit institutions located in the participating Member States, i.e., the euro area states, and the non-euro area participating states, in the latter case on the basis of their voluntary adherence. There has been quite some controversy about whether *all* credit institutions should be subjected to the ECB's supervision, or whether it should be limited to the most important institutions<sup>144</sup>. The argument for restricting the ECB's role was essentially related to the number of institutions to be supervised – about 5000 to 6000 in the euro area – many of which do not have a significant impact on the euro area's financial position and might better be supervised at the national level<sup>145</sup>. However, it was argued that the failure of even a smaller institution may have a knock-on effect on the entire financial system, while the possible shock to public confidence may lead to a wider crisis than that affecting the initially involved smaller institution. Northern Rock and the Spanish *cajas* were often cited as examples in support of this opinion. Politically, the restrictive thesis was essentially defended in Germany, where many smaller local banks are active, their political support being considerable. Technically, it is evident that these 5000 to 6000 banks could not be supervised from one location, which would have called for a small army of supervisors, creating significant problems in term of differences in culture and in language, and probably being hugely inefficient, and moreover expensive. On the other hand, allowing smaller banks to be exclusively supervised by the local supervisor might have created risks in terms of level playing field and regulatory arbitrage and even have created contagion with respect to systemic risks. For all these reasons an intermediate solution had to be worked out. The matter is however quite complex.

#### 33. The Regulation is based on the following balance:

- the larger credit institutions and the more risky ones will be directly supervised by the ECB; there will be some cooperation with the local prudential supervisors
- the smaller institutions will be supervised locally but according to guidelines that will be determined by the ECB; in any case the ECB can take over the supervision from the local supervisor.

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<sup>143</sup> See supra nr. 30 This might be relevant for investment funds, especially money market funds (see Proposal for a regulation on Money Market Funds , 4 September 2013, COM/2013/0615 final - 2013/0306 (COD) \*/) and Alternative Investment Fund Managers (Directive 2011/61/EU, 8 June 2011 on Alternative Investment Fund Managers).

<sup>144</sup> See for e.g. Zavvos, G., Towards a European Banking Union: Implications for Peripheral Euro Area Member States, Bratislava Lecture 14 November 2012 (on file with author) pleading for a single system with only auxiliary assistance from the national supervisors; also Troeger, nt.2, 12. This model has been substantially changed in the final Regulation, almost up to the reverse where the decisions are taken by the national supervisors subject to ECB objection. But see preamble § 16. An extensive interpretation is also adopted in Sapir, A., Hellwig, M., and M. Pagano, M, nt. 23.

<sup>145</sup> See German Finance Minister Wolfgang Schäuble writing in Financial Times, 31 August 2012 argued that 'we cannot expect a European watchdog to supervise directly all of the region's lenders – 6000 in the eurozone alone – effectively'.

This system allows maintaining the comprehensiveness of the SSM including - at least in principle - all banks, directly or indirectly, as implied in the Treaty provision. The SSM is further based on a system of cooperation between the two levels of supervision, whereby local supervisors acting as “ancillaries” or assistants to the ECB action in respect of the directly supervised institutions, while exercising supervisory functions in their own right but according to the overall guidance provided by the ECB. Both approaches are fully part of the SSM, and do not constitute forms of delegation of responsibilities<sup>146</sup>.

The definition of “significant”<sup>147</sup> credit institutions that are subject to direct ECB supervision is an essential component of the system and is based on three criteria: size, state support and minimal local presence, leading to the classification of banks into four groups. All institutions that are “less significant” are in principle subject to direct national supervision.

Size is the most important criterion:

A credit institution – individually or – where applicable -group wise - will be considered significant and hence be directly supervised by the ECB if whether:

- its total assets exceed 30 billion euro;
- its ratio of total assets over the GDP in its participating state of establishment exceeds 20%;
- or it is identified pursuant to a notification by the national supervisor as being of significant relevance to the domestic economy. The ECB should analyse the situation, on that basis confirming its significance. This process allows shifting significant institutions to the more comprehensive level of European prudential supervision.

These ratios will be calculated on the basis of a methodology designated as “Framework”, to be developed by the ECB. The calculations have to be undertaken on a consolidated basis<sup>148</sup> at the highest level in a given participating state, and encompass the parent credit institution, the financial holding company or the mixed financial holding company<sup>149</sup>. As a rule, the calculation will only take into account parent and subsidiary entities, not extending the rule to the networks of banks or to horizontal groups<sup>150</sup>. Only the activities in the participating Member States should be taken into account.

There is an exception clause: “particular circumstances justified in the methodology” may lead the ECB to conclude that a certain institution should remain under national supervision. An explicit particular circumstance is the volume of assets: the national regime

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<sup>146</sup> See on this point the difference with the non-euro participating states, nr.81.

<sup>147</sup> The regulation uses a confusing terminology by calling the smaller banks “less significant” with the consequence that the larger ones, have to be designated as “not considered less significant” For clarity reasons we will use “more” and “less” significant.

<sup>148</sup> For non-euro area subsidiaries, the question will be raised whether the calculation should take place, state per state, or on a euro-area consolidation basis. The regulation being based on an approach per state, the first interpretation seems preferable

<sup>149</sup> For these see definition in Article 4, Directive 2006/48. Consolidation will take place in accordance with the existing provisions of the prudential directives

<sup>150</sup> For entities affiliated to a central body: see the limited waiver in Article 10 CRR,

As to the consolidation of the accounts of horizontal groups: see Article 1(2) of directive 83/349 of 13 June 1983, as amended by Article 2(1) directive 2003/51, whereby due to IAS, horizontal groups have been removed from the consolidation rules.



will apply if these do not exceed 5 billion euro. This may also be the case for a bank that is a subsidiary of a much larger mixed financial group, for which the threshold is crossed at the consolidated level. One could argue that other exceptions should also be based on objective factors, such as volume of turnover or the nature of the business, excluding purely discretionary decisions. These exceptions might allow securities firms or asset managers that are run under the form of a bank, or banks in run-off to be excluded from the SSM.

The regulation also includes in the ECB mandate ‘branches’ of banks originating from non-participating states<sup>151</sup>. This addition is difficult to understand, as branches would normally be included in the consolidated statement and hence come under the supervision of the head office of the “non-participating” bank, making the addition of the branches superfluous. The addition might make sense if the provision only referred to credit institutions originating from non-participating states with ‘significant’ branches in the euro-area. But no qualification of this kind is included in the provision which corresponds to another provision that clearly declares the SSM applicable to branches or to the cross border provision of services by banks from a non-participating state, here again without any quantitative threshold.<sup>152</sup> It is even mentioned that the ECB shall carry out the task of the national supervisor in accordance with EU law. In the absence of a volume criterion, one should conclude that all these branches would come under direct ECB supervision, whatever the volume of their business. The reason justifying this extremely wide scope is difficult to understand.

The second criterion relates to banking groups from participating states that are considered of ‘significant relevance’ as having established banking subsidiaries in several participating Member States, as cross-border contagion risks may be increased in such cases. The relative importance of cross border relations has to be taken into account, but not the overall volume of assets of the group. The numerical thresholds will further be established in the methodology. This seems to be the hypothesis that comes the closest to an opt-in into the centralised supervision, although the decision to change to direct ECB supervision is exclusively taken by the latter.

The third criterion triggering the ECB’s intervention is the existence of public support irrespective of the size of the institution. Support from the EFSF or the ESM is expressly mentioned, and ECB supervision would be a condition for obtaining the support. Support by Member States - except indirectly from the ESM or EFSF- will not lead to ECB supervision, but national supervision will continue to apply, unless the national supervisor consider that the bank is of “significant relevance’ and invites the ECB to take over the supervisory duties.<sup>153</sup> In cases where assistance has been exclusively national, the ECB will only cooperate closely with the body granting the assistance.<sup>154</sup>

The fourth criterion can be designated at ensuring a minimal ECB supervisory presence in all participating Member States: the three most significant credit institutions in each Member State will come under ECB supervision, unless justified ‘by particular

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<sup>151</sup> Article 6 (4) first subsection, in fine, Regulation.

<sup>152</sup> Article 4 (2), Regulation.

<sup>153</sup> On the basis of Article 4 (4) (2) (iii). The text of art 6 (4) (4), Regulation is not ambiguous in this respect; but art 6(5)(b) provides that the ECB can pre-empt national supervisors for banks *indirectly* supported by EFSF or ESM, what may include national support programmes. The option lies with the ECB and will depend on the conditions at which national support was granted.

<sup>154</sup> Article 3 (5), Regulation. This also means that supervision should remain national.

circumstances', for which a minimum volume of total assets may be used as a plausible guideline. This provision will be of particular importance for the smaller Member States, where few independent banks are located, but where ECB supervision on the largest players may help avoid unhealthy developments.

34. All other credit institutions will be considered “less significant” and come under the direct supervision of the national supervisors, applying the basic regime laid down in the directive. Hence the usual cooperation techniques will apply, including the installation of supervisory colleges where applicable. On the basis of this classification between more or less significant banks, the supervisory competences of the two levels have been differentiated, the Regulation containing detailed provision about the ECB’s supervision, but leaving the national supervision on the “less significant banks” largely governed by the national prudential laws and regulations implementing the EU directives. Both levels of supervision will however be coordinated into the overall SSM as the ECB remains ultimately responsible for the effective and consistent functioning of the entire SSM<sup>155</sup>. Therefore the ECB has received precise coordination powers consisting of:

- the right to issue regulations, guidelines and general instructions addressed to the national supervisors along with its own obligation to oversee the functioning of the entire system;
- directly exercise the supervision on a nationally supervised bank, whether on its own initiative or on the request of the national supervisor: this action can be undertaken to ensure the “consistent application” of the supervisory standards, or in case of financial assistance from the ESM or the ESFS<sup>156</sup> It would allow the ECB to step into cases where the supervision has proven to be substandard and is an important disciplining instrument.

35. The relationship between the ECB and the national supervisors has been described in terms of ‘cooperation’ between the two levels of supervision. It relates partly to the significant institutions, which are directly ECB supervised but regarding which the national supervisors will support the ECB’s action, and the ‘less significant institutions’ that are supervised nationally but according to general guidelines of the ECB. The Regulation contains detailed provisions about what these two levels of supervision include.

The role of the national supervisors in the ECB led action should not be underestimated: there will be joint teams<sup>157</sup>, acting with an ECB mandate and composed of a team leader with ECB status seconded by team members originating from the national supervisors. The latter is needed, not only for language and culture reasons, but also to be able to build on the pre-existing knowledge and expertise of the former national supervisors. Important also in the role of the national supervisors in the implementation and enforcement phase: apart from the role on authorisation, as detailed below, the national supervisors are called upon for investigations, inspections, information gathering, for imposing and effectuating sanctions, and assisting the ECB when a judicial authorisation is needed for onsite inspections. Finally, the national supervisors will take part in the decision making at the Supervisory Board. These different aspects illustrate the meaning of the Single Supervisory *Mechanism*: it is a new way of dealing with prudential supervision for a considerable number of banking groups, located in different states, involving a principal supranational supervisor but with involvement of the previously competent national supervisors.

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<sup>155</sup> See Article 6 (1), Regulation.

<sup>156</sup> Article 6 (5).

<sup>157</sup> Article 31(2); see nr. 94.



## 6. 4 Home-Host issues

36. The scope of the SSM with respect to cross-border banking groups deserves some further analysis. The main effect would be that in the ambit of the banking groups submitted to ECB supervision, national supervision would be discontinued, at least in terms of final authority, the latter being exercised by the ECB only. This aspect is pervasive to the SSM regime and flows from the overall set up. Moreover it should be reminded that centralised supervision will be exercised taking into account the applicable banking supervisory laws that remain national and therefore require local knowledge and expertise.

The following analysis is based on a subdivision opposing the SSM regime in the participating states – further distinguishing between the ECB's and the national supervisory competences – versus the regime applicable in the non-participating states. The regime applicable to third country banks active in the European Union deserves a separate paragraph. It should be noted that the analysis only deals with the principal attribution of supervisory competences, the latter to be read against the background of the cooperation mechanism to be discussed later.

### a- The SSM regime

#### (i) Branches and services

37. The significant banking groups whose head office is located in the participating states will come under ECB direct supervision with respect to all euro-area activities, whether taking place through branches or by way of the provision of services. If, in quantitative terms, the group qualifies for direct ECB supervision - to be determined on a consolidated basis - supervision of the ECB will uniformly extend over this entire group, whereby due to the banking supervisory directives in place, national provisions of banking law will play a declining role<sup>158</sup>. In this respect this part of the SSM regime is a mere application of the existing home country rule, the ECB playing the role of home supervisor, fully in charge of both home and host activities. Hence home state supervision and mutual recognition will not be applicable anymore<sup>159</sup>. As explained further, the same principle will apply to branches – and services - of banks from non-participating states.

The ECB will also be in charge of the obligations of the home supervisor with respect to SSM supervised banking groups that establish branches or offer services in non-participating states, e.g., with respect to the notifications obligations<sup>160</sup>.

#### (ii) Subsidiaries

38. According to the pre-SSM regime, subsidiaries are separate banks, and hence are supervised by the supervisor in the state where they are located, usually called the home supervisor of the subsidiary. This regime will continue to apply for subsidiaries of less significant banks. The supervisory coordination will take place in the colleges of supervisors.

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<sup>158</sup> Article 16 and 26 of Directive 2006/48 of 1 June 2006. These rules are applicable in all EU Member States. The host state retains provisional responsibility for the liquidity of branches: see Article 41, Directive 2006/48 of 1 June 2006. CRD IV will extend the powers of the host supervisor for branches and services: see Articles 41, CRD IV and 142 for the transitional regime.

<sup>159</sup> Soussi, B., Un système qui concerne tous les états, Banque nr. 757, February 2013, p. 32. Nor the different measures of notification under CRD IV.

<sup>160</sup> Article 4 (1) (b), Regulation. But this obviously only refers to banking groups under the ECB's direct supervision, as this task is placed within the framework of Article 6(6).



Branches or services offered by these subsidiaries will be included in the remit of the home supervisor of the subsidiary.

With respect to subsidiaries of significant banking groups that qualify for the SSM regime, these will be directly supervised by the ECB, and hence included in the overall supervision of the banking group, and this irrespective of their individual quantitative importance. The calculation taking place on a consolidated basis, the national supervisors would therefore not maintain any direct supervisory competence. The ECB will take the place of the previously competent national authority<sup>161</sup>. Subsidiaries of banking groups that do not come under the ECB's remit will be further supervised nationally, i.e. by the supervisor where the subsidiary is located, and in addition according to the limited regime of consolidated supervision as exercised by the supervisor of the holding structure of which that subsidiary is part. A college of supervisors will be constituted.

There are some significant consequences flowing from this new regime. One of these is the likely disappearance of the relative differences between branches and subsidiaries, however only in term of prudential supervision.<sup>162</sup> As subsidiaries are separate legal entities, the ECB will normally insist that these are separately and adequately capitalised. Differences as to the location of activities whether in branches or in subsidiaries will in some respects become less relevant, at least as far as the supervisory regime is concerned. As a consequence, it may become more interesting to exercise the activity as a branch, as this would avoid the burden of having to manage separate entities (own capital requirements, separate liquidity management, boards, auditors, different regulators, etc.). But other considerations may plead for maintaining a subsidiary: taxation, labour law, minority shareholders, local culture are among these. Bankers complaining about the diversity of the supervisory systems – having to deal with tens of national supervisors – might belong to the past. The regime will also contribute to the integration of the European financial area: national supervisory measures, - e.g. a refusal by the local supervisor to fund the parent for the case of need<sup>163</sup> – will not apply anymore, the more so as these practices were subject to criticism from the point of view of free movement of capital. But not all subjects would come under the SSM regime<sup>164</sup>; questions of banking secrecy other than for supervisory purposes, taxes e.g., are outside the prudential remit of the ECB and would remain a national matter, although the pressure to reduce their effectiveness in an integrated European banking market would certainly increase. Therefore the previously applicable provisions about home-host relations will continue to apply for matters outside the purview of the ECB<sup>165</sup>.

#### b- the regime of national supervision

39. The less significant groups will further be governed by the existing scheme, based on home versus host supervision. As mentioned above, branches and services will be of the competence of the home supervisor, while subsidiaries will be supervised by the host, i.e. of the state where the subsidiary is located. For medium size groups that are active in several EU states, this regime is likely to be quite burdensome, as they will have to deal with a multitude of supervisors. There can be little doubt that this will put the medium size groups of banks at

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<sup>161</sup> See Article 9 (1), Regulation. Troeger, nt. 2 p.18

<sup>162</sup> Indeed, underlying banking law may still contain some differences that the ECB will have to respect. Other factors may continue to play an important role in decisions as to where additional operations will be established.

<sup>163</sup> See on the topic of intragroup support arrangements, BRRD proposal article 16.

<sup>164</sup> See Article 17 (2), Regulation.

<sup>165</sup> Article 1 (5), Regulation.

a clear disadvantage as they will continue to be confronted with the present fragmented supervisory landscape for all their activities whether located in participating or in non-participating states. An adequate response might be to convert the subsidiary into a branch, hence triggering a uniform – but national – supervisory regime, as recently some banking groups have done. As to whether the ECB may claim competence, this will depend on the structure of this medium size group: the ECB may consider its network of subsidiaries significant and hence apply the first tier SSM regime to the group, provided there are considerable cross border relations.<sup>166</sup> The rule can also be seen as a tool to avoid medium size Europe-wide groups by merging separate entities, thereby circumventing the ECB's competence. The rule may be avoided by converting the subsidiaries into branches, after which national supervision will be maintained<sup>167</sup>. But there will be no opt-in into the SSM: only the ECB will decide on the basis of the said criteria.

#### c- Regime for the non-euro participating states

40. The ECB will exercise supervision on these banking groups on the same terms as applicable in the euro-area jurisdictions. Whether the ECB will be competent, or the national supervisor in that state depends on the quantitative and other criteria mentioned above, whereby the consolidated data at the level of the parent will determine whether ECB or national supervision will apply.

In case of inward investment by a significant group, the ECB will be in fully charge of the parent company and of the branches, services and subsidiaries wherever located in the SSM area, being all participating states.

A comparable national regime will be applicable to the less significant groups, where the supervision will be exercised by the national supervisors, of the home state for the parent and its branches and its service provision, and of the home state for the subsidiaries

#### d- Regime for the Non-participating states

41. The basic regime as laid down in the directives would apply to banks established in non-participating states: this would apply to branches and service provision in other non-participating states. With respect to their subsidiaries in the SSM area, the home supervisor of the state where the subsidiary is located will be competent and, when applicable, will be a member of the college for those subsidiaries that are not significant. The ECB will not be involved, even if the banking group crosses the consolidated quantitative thresholds mentioned above. In the field of prudential supervision, it is uncommon to provide for delegation of specific tasks, but a legislative clause allowing such delegation might be a valid alternative to the SSM regime for non-euro states<sup>168</sup>.

In the rare case that this subsidiary would cross the quantitative thresholds – on subconsolidated basis – the ECB would be in charge as the subsidiary is a separate legal entity established in the SSM area. For that hypothesis, the ECB and the home supervisor of this

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<sup>166</sup> Could the branches of the parent be included in this calculation? The Regulation mentions the ECB competence only with respect to subsidiaries but the assessment on a consolidated basis should prevail.

<sup>167</sup> As firms will often prefer to be subject to the unitary regime, this technique may open the possibility for some form of opt-in into the SSM or in the national supervision.

<sup>168</sup> See nt. 127 for the objections against delegation of tasks or responsibilities.



group would have to conclude an MOU, organising i.a. their respective roles in the college of supervisors<sup>169</sup>.

The Regulation contains a different approach for branches established and services offered in the SSM area by banking groups originating from non-participating states. According to the generally applicable directives, the home supervisor would be competent, while the host could only intervene for some limited matters<sup>170</sup>. The Regulation declares that “the ECB shall carry out, within the scope of paragraph 1 – i.e. the list of prudential supervisory duties – the tasks for which the national competent authorities are competent in accordance with relevant Union law”<sup>171</sup>. This would mean that all branches and all rendering of financial services, irrespective of their importance or volume, would be directly supervised by the ECB and this in accordance with the standards applied by the ECB. The opposite rule applies when SSM banks branch in non-participating states, as these will come under the ECB home competence as exercised in accordance with relevant Union law<sup>172</sup>.

The reason for this exceptional regime is not explained in the Preamble: it may have been a concern about the operation of banks from a less regulated environment, raising issues of investor protection or financial stability. This fundamental derogation from the home-host scheme and from the freedom of establishment should have been motivated on the basis of the public good, unless the interpretation should be that the rule merely refers to the limited powers of national supervisors with respect to branches, e.g. on liquidity requirements<sup>173</sup>.

Banking groups located in the SSM area may offer their services and establish branches in non-participating states in accordance with the existing provisions of the directives; the ECB competent for the group c.q. the national supervisor will be competent.<sup>174</sup> For subsidiaries of SSM groups located in a non-participating state, the local supervisor will be in charge, but on the basis of the rules on consolidated supervision, the ECB c.q. the national supervisor will organise the college in which the supervisor of the non-participating state will take part.

#### e- Coordination

42. Coordination among competent supervisors – the ECB and the supervisor of the foreign parent or subsidiary – will take place following the existing procedures for home-host supervision as laid down in the EU directives and along the lines of supervisory coordination in colleges of supervisors. If the head office of the significant banking group is located in the euro area, the ECB will be lead supervisor, and invite to the supervisory college, the supervisors from the non-participating jurisdictions where the subsidiaries are located. In the opposite case, where a subsidiary in the euro-area is part of a banking group principally located in a non-participating jurisdiction, normally the supervisors where these subsidiaries are located will take part in the college, the college being headed by the non-participating EU state, the ECB being invited as member of the college. In the hypothesis that a subsidiary is

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<sup>169</sup> Article 3 (6), Regulation, makes this mandatory for states housing the systemically important institutions. For the other non-participating states, an MOU in general terms will be concluded: Preamble (14).

<sup>170</sup> See CRD IV, Article 40 e.s, see also the regime for the significant branches (Article 51)

<sup>171</sup> Article 4 (2), Regulation irrespective whether there will be one or several branches. By incorporating one of these, supervision may shift to the national level, provided this group is “non-significant”.

<sup>172</sup> Article 4 (1) (b), Regulation, applying general directive principles.

<sup>173</sup> On the basis of Article 52 (1) TFEU.

<sup>174</sup> See Article 6 (4), Regulation.



crossing the thresholds, the non - participating supervisor will be consolidated supervisor, in charge for the group, and the ECB only for the euro-area subsidiary. The competence of the ECB will be respected by the non-participating supervisor, as the Regulation is binding on all EU Member States.

For conglomerate groups, the application will be *mutatis mutandis*, with application of the Financial Conglomerate Directive where needed, it being understood that the Treaty has expressly excluded insurance supervision from the application of its Article 127 (6).

#### f- Third Country banks

43. With respect to *third country* banking groups, the Regulation remains largely silent<sup>175</sup>. Their subsidiaries or branches will be subject to the national supervisor of their place of localisation in the EU and that jurisdiction's regime will apply. This would mean that these groups could continue to operate under the liberal regime for provision of services, while their subsidiaries would be subject to the national provisions on capital, management and all other aspects of banking regulation. Only if it reaches the threshold for significance would a subsidiary qualify for ECB supervision. As mentioned above, the regime subjecting the establishment of branches or provision of services under direct ECB supervision<sup>176</sup> is only applicable to activities of groups originating from non-participating states, but does not apply to third country groups. This difference in treatment could be explained from the angle of systemic protection: protection is only offered to creditors of euro-area banks. It may create an unlevel playing field, as national regulators might be more lenient for third country banks: in this case the national supervisory regime would be competing with the SSM. But this is already the situation today.

#### g- Effects of the new regime

44. The effects of this new regime on the legal position of subsidiaries and branches located in the euro-area, including the non participating euro area jurisdictions, are likely to be quite significant: those institutions coming under the direct supervision of the ECB will have the full advantage of the new regime, and will deal with only one supervisor, applying the same rules throughout the Union. Therefore and notwithstanding the differences due to national laws, for these groups, there should be no difference between the supervisory regime of branches and subsidiaries, wherever they are located. To the extent that the new capital requirements directive (CRD IV) has strengthened the involvement of the host supervisor, the burden of two levels of supervision will not be borne by the directly ECB supervised group, but still continue for the locally supervised entities. Conversion from subsidiary to branches is likely to become more frequent, as this may result in a better use of capital, economies of scale, and considerable savings in administrative and legal costs. Formalities e.g. in terms of reporting should be centralised and significantly simplified; assessment will take place on a fully consolidated basis allowing for a better risk spreading. But these advantages only exist

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<sup>175</sup> Preamble (28) reminds that their supervision remains a national matter. With third countries, international agreements could be concluded by the ECB (Preamble (80)), but respecting the competences of the EU institutions, of EBA and of the Member States. The European Economic Area banks have to be considered third country banks.

<sup>176</sup> Article 4 (2), Regulation. Host supervision for branches and services has been redefined and extended in CRD IV: if branches are not subject to host authorisation (Article 17), there has to be close cooperation on a broad range of issues for both supervisors for branches (Article 51-53). The host can request a branch to be qualified significant (Article 52) in which case special supervision is needed on liquidity and risks. Inspection for financial stability reasons are initiated by the host, although action from the home is expected (Article 53)

at the level of the prudential supervision. Many obligations, requirements and practices stemming from local banking or other regulations will remain in place and will continue to be different from state to state. The same applies to liquidity requirements, which are still a national matter.<sup>177</sup> Over time one may hope that regulations as well as the prudential provisions and practices will become increasingly identical as part of the “Single Rule Book” while some practices will be increasingly harmonised under the impulse of the market forces.

One can expect nationally supervised banks to be subjected to a simpler supervisory regime, in line with their reduced potential impact in terms of financial risk, and this under the overall guidance of the ECB. However, if these banking groups operate in several Member States, they may be at a disadvantage as several regimes will continue to apply, assuming they do not convert subsidiaries into branches. If their subsidiaries become significant, the ECB may pre-empt the national supervision. For banking groups from non-participating Member States, little will change: only the supervision of incoming branches and services will be exercised by ECB supervision, except if they convert into subsidiaries, the latter remaining under national supervision. The Regulation provides for the conclusion of an MOU between the ECB and the supervisors of the non-participating states<sup>178</sup>.

The absence of provisions dealing with third country groups is more difficult to understand, as the present tendency to oblige them to convert into subsidiaries in order to split the risk is not reflected in the Regulation. Operating as branches - even significant ones - or through the provision of services they will continue to be supervised according to the law of the state where they are located, essentially by their home supervisor.

What is unclear is the rationale of the two provisions introducing ECB competence in regard to banks from non-participating states, operating activity through branches or services in participating states<sup>179</sup>. This is all the more puzzling as the system can readily be by-passed by creating subsidiaries rather than branches.

## 6.5. Supervisory activities of the ECB

45. “Prudential supervision” is not defined in the Regulation: it is identified through the objectives and the instruments of this type of supervision. The objectives as stated in Article 1 of the Regulation are “to contribute to the safety and soundness of credit institutions and the stability of the financial system within the Union and in each Member State, with full regard and duty of care for the unity and integrity of the internal market based on equal treatment of credit institutions with a view of preventing regulatory arbitrage”. The latter idea is repeated in the clause forbidding any discrimination, obviously a concern of the UK. This very broadly defined mandate will be implemented by using the instruments as listed in Article 4, a list that contains all the usual prudential tools, but has here been described in terms that evidently are thought of as limitative.

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<sup>177</sup> See Article 41, Directive 2006/48. See CRD IV, art 51, calling for a special liquidity follow-up by the home supervisor for branches; in case of concern, the host supervisor can undertake separate action. Disagreements between home and host will be arbitrated by EBA. The introduction in the EU of the important Liquidity Coverage Ratio ([www.bis.org/press/p130107.htm](http://www.bis.org/press/p130107.htm)) may put the monitoring of this requirement in the hands of the home prudential supervisors, and in the SSM area, that of the ECB; but the host supervisors have a way to express their concerns. See Article 140 CRD IV for the transition regime

<sup>178</sup> See Preamble (14) dealing with the effects of the ECB’s decision on branches and subsidiaries of SSM banking group in non-participating states, and vice versa. Here an MOU should intervene, including the ECB and the national supervisors. Emergency situations should also be viewed.

<sup>179</sup> Article 4 (1) (b) and 4 (2), Regulation.

Some of these prudential activities relate to all banks, significant or not, and are initiated by the national supervisors with the ultimate sanction coming from the ECB:

- authorisation and withdrawal of authorisation of banks; the detailed procedure is analysed *infra*;<sup>180</sup>
- authorisation for the acquisition or disposal of significant holdings, also subject to a special procedure to be detailed *infra*.<sup>181</sup>

For all other supervisory activities, the distinction between significant and less significant banks will apply, in the sense that these activities will be directly performed by the ECB in the case of the significant institutions while for the less significant ones, directly by the national supervisors. Most of these powers are directly based on the existing European directives and regulations, whereby for the additional matters, not provided for in the directives, the ECB will have to follow the national provisions but always in accordance with Union law<sup>182</sup>.

This list of supervisory matters and tools for which the ECB can act on its own can be summarised as follows:

- Withdrawal of the authorisation of a bank, after consultation of the national supervisor
- Supervision, as home supervisor, of the opening of a branch or provision of services in a non-participating state<sup>183</sup>
- Ensuring compliance with the core supervisory tools: own funds, securitisation, large exposure limits, liquidity, leverage, reporting and disclosure. Governance including fit and proper, risk management, internal controls mechanisms, remuneration policies, internal capital adequacy assessment processes including the Internal Ratings Based Approach. Most of these instruments are already provided for or planned in the Capital Requirement Directives (CRD) IV and CRR and their implementing measures, all belonging to the usual paraphernalia of the prudential supervisor.
- Supervisory reviews and stress tests, including the imposition of additional requirements in accordance with Union law; these measures refer to the individual banking groups and are closely related to the position of the individual groups and the corrective measures to be undertaken if needed.<sup>184</sup>
- Consolidated supervision of banking groups, financial holding and mixed financial holding companies, whether as a single or lead supervisor or as a college member for groups, including those falling outside the remit of the SSM;<sup>185</sup> with respect to

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<sup>180</sup> See Article 14, Regulation; this provision is not applicable to the creation of branches, except in non-participating states, when Article 4(1) (b) will be applicable calling for ECB intervention.

<sup>181</sup> See Article 15, Regulation.

<sup>182</sup> See Article 4 (3), explaining further that when regulations are concerned, and if these call for national implementing measures or options, these national measures will have to be applied by the ECB; see nr 18. The same would apply for “goldplating”, provided it does not infringe Union law. Union law has a broad meaning including the general Treaty principles, competition law, etc.

<sup>183</sup> See Article 4 (1) (b), Regulation. It is unclear why the ECB should be directly in charge of this matter that may concern minute institutions.

<sup>184</sup> In that sense, they will be different from the industry wide stress tests of the EBA; see nr 87.

<sup>185</sup> See See Art 119 CRD IV about the limited inclusion of financial holding companies and mixed financial holding companies in consolidated supervision, with reference in Article 108 (3) to Article 11 e.s.CRR for the



financial conglomerates, acting as participating supervisor in supplementary supervision, or where applicable acting as coordinator

- Acting as supervisor in banking recovery matters, excluding however resolution powers for which separate resolution authorities will be created at the national level, or may be set up for the entire euro area.

The ECB is entitled to receive information on all banks in the participating states, whether directly from the bank itself or indirectly through the national supervisors and this for the purpose of carrying out its tasks.<sup>186</sup> The latter would include its general oversight of the nationally supervised banks. As part of the SSM, it is logical that the national supervisors on their part will regularly report to the ECB on their supervisory activities.

In summary, these powers include all matters that are part of prudential supervision as is practiced today.

## 6.6 Supervisory activities of national supervisors

46. With respect to the less significant credit institutions, national supervisors will continue to exercise full first line supervision taking decisions and using the tools as have been listed above with respect to the ECB's direct supervisory activities. As stated in the previous paragraph, certain matters such as authorisations are reserved for the ECB, although national supervisors will play an important preparatory role<sup>187</sup>.

The national supervisors will continue to perform their supervisory activities on the basis of their national legislation, but taking into account the guidelines and instructions to be issued by the ECB as part of the latter's oversight function. To the extent that these guidelines are in line with Union acts, they would logically take precedence over nationally adopted supervisory measures. It is expected that over time this regime will be increasingly harmonised and integrated.

Specific mention is made of the right of national supervisors to obtain information on the basis of their national law, on the local banks even if these are included in the consolidated financial situation which is the basis of the ECB's supervision<sup>188</sup>. Coordination will be essential to coordinate the consolidated and the solo reporting lines. Also national supervisors remain competent for undertaking on-site inspections – solo or seconding an ECB inspection - in any of these banks, and this according to the locally applicable regulations. These powers would allow rapid intervention if needed. In both cases the ECB has to be informed about the steps undertaken. Here again cooperation will be essential<sup>189</sup>.

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details of the inclusion. The existing cooperation rules would not apply if the ECB were the sole consolidating supervisor: Article 14 (2) Regulation. Here the national supervisors could be invited as "observers", although it is not clear whether they have prudential supervisory capacity. The ECB, representing the position of the subsidiaries active in the SSM area, can be a member of a college organised by a non-participating lead supervisor.

<sup>186</sup> See Article 7 (2), Regulation applying to both significant and less significant groups; compare Article 7 (2) (b) for the non-euro participating states.

<sup>187</sup> See *infra* nr. 56.

<sup>188</sup> Article 6 (6), (2)

<sup>189</sup> See Article 6 (6) 2nd §, Regulation. See nr. 28.



## 6.7 Oversight by the ECB on the national supervisors

47. Conceptually, the activities of the national supervisors have to be seen as components of the overall Single Supervisory Mechanism and therefore the Regulation puts the ECB in charge of an all-encompassing oversight on the entire system. This idea is expressed in the Regulation granting certain coordination tools to the ECB as follows:

- The ECB will keep overall oversight of the system, especially within the “Framework” decision mentioned *infra*<sup>190</sup>;
- The ECB shall issue regulations, guidelines and general instructions for the performance of supervisory tasks by national supervisors<sup>191</sup>;
- The national supervisors shall follow the instructions of the ECB for the exercise of the supervisory duties and tasks common to the two levels of supervision<sup>192</sup> and the ECB may request them to exercise their powers under national law but for the benefit of the SSM<sup>193</sup>;
- The ECB may request reports from the national supervisors about the way they have performed their tasks<sup>194</sup>;
- The ECB will have the right to pre-empt national supervisors regarding one or more banks, whether at the request of the national supervisor or on its own initiative, and thus directly exercise the powers that previously belonged to the national supervisor<sup>195</sup>. This will especially be done “to ensure consistent application of high supervisory standards” which may refer not only to divergent applications but also to the case of national supervisors that are deficient up to the point that they do not even reach the high-level standards. Hence the ECB could whether address instructions to the national supervisor, or directly address the bank;
- The ECB may at any time, call for information from the national supervisors and from the less significant banks directly and undertake investigations, including on-site inspections.

There is no provision in the Regulation that would allow the ECB to undertake policing or disciplinary action addressed to the national supervisors. The ECB could only take over the supervision of one or more specific banks.

It is unclear to what extent the ECB will use these instruments to streamline the supervisory activities of the national supervisors. However, over time, one may expect its

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<sup>190</sup> Article 6 (7), Regulation; see nr 48 .

<sup>191</sup> Article 6 (5) (a), Regulation.

<sup>192</sup> Art 6 (3), in fine, Regulation, applicable to all banks; the differentiation between significant and less significant banks is further made explicit in Article 5 (4),

<sup>193</sup> Article 9 (2) (2) , Regulation. This is some form of “substitute supervision”

<sup>194</sup> Article 6 (5) (e), Regulation.

<sup>195</sup> It is further specified in Article 6 (5) (b) that the ECB may pre-empt the national supervisor in cases of “indirect” support by EFSF or ESM. Ferrarini and Chiarella, nt.1 point to the misalignment of incentives under the pre-SSM scheme, what will not disappear but should be effectively dealt with by the use of these instruments.

intervention to become increasingly demanding and specific, as the ultimate objective remains a level playing field in an integrated financial market.

## 6.8 The cooperation and implementation “Framework”

48. The Regulation pays ample attention to the functioning of the SSM as a cooperative scheme. It reminds both the ECB and the national supervisors of the Treaty-based duty to cooperate in ‘good faith’<sup>196</sup>. This idea is further expanded in several more specific fields such as the duty to exchange information, the obligation to assist the ECB in preparing or implementing supervisory tools and, to the extent that these relate to all banks, assisting the ECB in verification activities<sup>197</sup>. This cooperation is however of a different nature from the existing one, as laid down in the directives, in the sense that the latter is horizontal, relating to supervisor standing at the same level, where in the SSM, the cooperation is vertical and aims at ensuring the overall functioning of the SSM, under the leadership of the ECB.

There is some debate about the degree of de facto centralisation of the supervision: several observers stress that the ECB will necessarily have to rely on the national supervisors, constituting common crews for the large banks, whether under the direction of a national of the state where the bank is located<sup>198</sup>, or – in my view preferably - by someone not too closely linked to the local social and economic system, avoiding the risk of national bias and regulatory capture. On the other hand, proximity of supervision is defended by some, leading to direct interaction of the local supervisors with the bank<sup>199</sup>.

This cooperation will be further worked out in the ‘Framework’, an instrument to be developed by the ECB in consultation with the national supervisors. The legal status of this Framework will probably be that of a binding ‘general instruction’<sup>200</sup>. One can expect this document to be particularly important as it determines the relationship between the two levels of supervision and the coordination between them. The Regulation only contains some general references to the content, in a language that will have to be further expanded in the Framework document.

The minimum content of this instruction is set out in the Regulation and should include:

- the abovementioned methodology for determining the quantitative criteria for classifying banks as significant or less significant with special attention to changes in the regime, i.e. becoming subject to ECB supervision after having been supervised nationally and vice versa. A specific point of attention would be the consequence in leaving the ESM/EFSF support regime, hence leaving ECB supervision. These assessments have to be based on “substantial and non transitory changes”;

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<sup>196</sup> Article 6 (2), Regulation, referring probably to Article 4 (3) of the TEU stating: ‘Pursuant to the principle of sincere cooperation, the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks, which flow from the Treaties.’

<sup>197</sup> Article 6 (3), Regulation.

<sup>198</sup> In that sense: D. Nouy, Un superviseur adossé à la BCE est un vrai avantage, Banque nr 757, February 2013 , 24; C. Lajoie and A. Gourio, MSU, Une mécanique de précision, Banque nr 757, February 2013, 30

<sup>199</sup> Palle, S., Eviter toute relation desincarnée entre la BCE et les banques, Banque nr 757, February 2013, 28

<sup>200</sup> Article 6 (5) (a) and 6 (3), Regulation. This illustrates that the scheme is not based on a delegation to national supervisors, but on the internal organisation of the overall SSM; differently in Ferrarini and Chiarella, nt. 1.

- arrangements with respect to the exercise of powers by national supervisors and by the ECB;
- procedures for the relation between the ECB and national supervisors for the supervision of whether significant banks or less significant banks. In the latter case the Framework will contain measures for monitoring the supervision on these less significant banks. The ECB will have to be informed about material supervisory procedures – e.g. administrative or disciplinary measures, and their implementation including sanctions - regarding which the ECB can request further information and impose further supervisory duties; in material cases, before the national supervisor adopts its final decision, it must be submitted to the ECB for obtaining its opinion, although not for its approval<sup>201</sup>.

The Regulation further reminds that the ECB, when calling on national supervisors for assistance, will have to follow the provisions of the Union Acts relating to the allocation of responsibilities between competent authorities whether within one single national regime, or between different Member States<sup>202</sup>. This may relate to the designation of who will be responsible for providing the assistance or the rules of communication to be followed. It may also refer to the subject matters outside the remit of the SSM, for which the national supervisors remain competent.

## 6.9. Supervisory Powers and Instruments

### a - Principle

49. In its supervisory capacity and for the directly supervised banking institutions, the ECB shall have the same powers – and “supervisory instruments”- as the previously competent national supervisors<sup>203</sup>. These powers are rooted in Union law, what includes the national legislation transposing Union law<sup>204</sup>. The ECB may also request national supervisors to exercise their additional powers under national law, where these are not provided in the Regulation<sup>205</sup>.

From a methodological point of view it is useful to distinguish between supervisory powers and supervisory instruments, the former relating to the kind of decisions that can be imposed on banks, where the latter refer to techniques establishing whether a bank meets the requirements or not.

### b - supervisory powers

49. Prudential supervision is exercised first and foremost in a continuous, preventive manner: it aims not only at ensuring that banks meet the formal requirements laid down in the banking directives, but ultimately to ensure that the bank is run in a prudent, diligent and responsible way. In order to achieve that objective, the directives provide for numerous obligations, that are recalled in general terms in the Regulation. One could mention the provisions relating to capital requirements, to the “fit and proper” character of bank leaders,

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<sup>201</sup> Article art 6 (7) (b) (iii), Regulation.

<sup>202</sup> Article 6 (8), Regulation.

<sup>203</sup> Article 9 (1), Regulation.

<sup>204</sup> Article 4 (3), Regulation.

<sup>205</sup> See Article 9 (1) (3) Regulation.



the governance provisions, etc. These have been mentioned above. National supervisors will exercise these same powers regarding the less significant banks.

The Regulation dwells in more detail on a number of specific and important subject matters where additional detailed rules are introduced. These mainly serve for providing the dividing line between ECB and national competence.

This approach is followed for the provisions on the authorisation of banks, on the acquisition of a qualifying holding in a bank, on the imposition of administrative sanctions, on the decisions on macroprudential tools, and less clearly defined at this stage of legislative development, on bank resolution and recovery.

#### c – general supervisory instruments

50. More detailed provisions have been included in the Regulation about information gathering, investigations and inspections. Within its overall mandate the ECB can instruct supervisory activity, whether on an individual basis, or under the format of recommendations, guidance and even regulations. The latter have to be seen as formalised and generally applicable instructions relating to its supervisory activity, with a view of organising and specifying its own SSM internal arrangements. Hence they will not encroach on the competences of the EBA, on the implementing regulations but also on the EBA recommendations including the Supervisory handbook<sup>206</sup>.

##### (i) administrative and enforcement instruments

51. The Regulation contains a long list of supervisory measures that the ECB can impose on banks that are whether in breach of the requirements laid down in the directives and the national laws for their implementation, or are likely to breach these, or where deficiencies have been found in their internal organisation and strategies, business processes, or liquidity provision. There can be no doubt that these corrective instruments could also be used irrespective of an impending breach. Early intervention is often needed, in order to avoid later dilemmas<sup>207</sup>.

These instruments relate i.a. to requiring additional own funds and/or provisioning, ensuring compliance with supervisory requirements, imposing limitations to business activities or even divestments, risk reduction, reduce variable remuneration, limit dividends, impose liquidity requirements, and remove members of the management board as not being “fit and proper”. Once more this list constitutes the usual toolkit of the prudential supervisor<sup>208</sup>. Article 1 (3) of the Regulation states that the ECB shall have regard to the different business models of banks, their types or sizes but that should not prevent it from adopting measures to restrict their business, their operations or order the divestment of some of their activities<sup>209</sup>.

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<sup>206</sup> See Article 3 (3) Regulation, and this notwithstanding the statement that the Recommendations and the handbook would not be legally binding. See Article 6 (5) (a) for the regulations addressing the supervision of the less significant banks.

<sup>207</sup> See on this topic, BRRD, articles 23 e.s. on early intervention

<sup>208</sup> See Article 16 (2), Regulation.

<sup>209</sup> Especially with Article 16 (2) (2), Regulation.

(ii) - Information

52. In order to be able to effectively exercise supervision, the ECB should be able to request information about the financial institutions that are subject to direct or indirect SSM supervision either directly, or indirectly through the national supervisors. The information can be obtained directly from all institutions, including the less significant ones. The Regulation lists the entities and persons from whom the information can be requested, limiting requests for information from physical persons other than those ‘belonging to these banks’, i.e. their directors and managers but including third parties to whom functions or activities have been outsourced<sup>210</sup>. Indirectly the ECB can always request information about a particular institution from the national supervisors<sup>211</sup>. This may even be requested for specific statistical purposes but only if related to supervision. This aspect illustrates once more the all-encompassing nature of the SSM, and is a complement of the ECB’s right to pre-empt supervision at any time<sup>212</sup>. The institutions and entities that can be addressed directly by the ECB are listed in the Regulation<sup>213</sup>. The ECB shall make any information thus obtained available to the national supervisor concerned<sup>214</sup>.

A later addition to the Regulation relates to professional secrecy obligations: none of the addressees can invoke professional secrecy, and no breach will be involved if the information is supplied<sup>215</sup>. This provision will especially interest those Member States where some form of banking secrecy is still in place. But it may also apply to lawyers to whom certain functions, e.g. compliance, have been outsourced. The preamble reminds about the high level of protection that the European case law has recognised for the practising lawyers’ legal privilege<sup>216</sup>.

Information from non-participating states will have to follow the channels of communication between supervisors, as organised in the directives.

(iii) Investigations<sup>217</sup>.

53. The ECB may launch investigations into the same persons from which it can obtain information but only in the participating states. Apart from requesting the submission of documents, it may ask for oral or written explanations, or undertake interviews. Where necessary, e.g. in case of obstruction, support and assistance from the national supervisor will be solicited<sup>218</sup>. Investigations in non-participating states will remain subject to the directive provisions on administrative assistance.

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<sup>210</sup> Article 10 (1), Regulation. Containing the list of the parties from which information can be obtained

<sup>211</sup> See Article 6 (2), Regulation. National supervisors may not always be forthcoming with information, especially about the banks they directly supervise themselves.

<sup>212</sup> Article 6 (5) (b), Regulation.

<sup>213</sup> Article 10 (2), Regulation.

<sup>214</sup> Article 10 (3), Regulation.

<sup>215</sup> Article 10 (2), Regulation

<sup>216</sup> Preamble (48) referring to the ECJ case law (see Akzo Nobel case ECJ, C -550/07P of 14 September 2010 and previously the AMS case 155/59 of 18 May 1982) limiting the privilege to the case of the defense of rights), which is much more restrictive than national case law ( see eg. Belgacom case, where the Brussels court of appeal (5 March 2013, Juriustenkant, 2013, 267, with comment by Jan Bocken, J.: Adviezen bedrijfsjuristen beschermd tegen Belgische mededingingsautoriteit) admitted the privilege even for communications with in-house lawyers, although on the basis of a specific legal provision in the Belgian law.

<sup>217</sup> Article 11, Regulation.

<sup>218</sup> Article 11(2), Regulation.



(iv) On-site inspections<sup>219</sup>.

54. The ECB can conduct – even unannounced- on-site inspections at the business premises of all the legal entities from which information may be requested, including all entities included in the consolidated statement of a bank under its supervision. A formal ECB decision, designating its own officials and other authorised persons is a sufficient basis for the inspection. The competent national supervisor and its officials or delegates will actively assist the ECB inspectors, may attend the inspection and if necessary may request measures in accordance with national law. Action by the national inspectors may include sealing off premises, seizing books and records. If an inspection requires judicial authorisation, the ECB, or the national supervisor shall take the necessary steps to obtain it. Obviously the Regulation presumes that conflicts may arise and therefore gives the national judiciary the right to assess the proportionality of the coercive measures, the seriousness of the infringement or the evidence of the breach. But the judge is not entitled to receive information on the ECB's file or challenge the necessity of the inspection. The latter point can only be reviewed by the ECJ<sup>220</sup>.

#### 6.10 Specific supervisory decisions

55. In some matters, the Regulation provides for a special supervisory regime: it is based on the recognition of the role of the ECB, but with a strong involvement of the national supervisor. These are matters that apply to all banks, significant or not, but where the dividing lines between significant - less significant has not been followed, and therefore where decisions directly impinge on the powers of the national supervisors. But in most of these cases the ECB's powers have been - sometimes strictly - limited by the intervention of the national supervisors.

##### a- Authorisations and their withdrawal

56. New banks will apply for authorisation with the national supervisor, which will apply the conditions laid down in its legislation, as these may be different from those in the directives.<sup>221</sup> The national supervisor will investigate the application, and if the conditions are considered to be met, submit its proposal to the ECB. Unless the ECB opposes, the proposal will be considered adopted. The national supervisor may also reject an application, obviously without involving the ECB. The ECB can only object if the conditions in Union law are not met, thereby excluding the consideration of additional national conditions which remain applicable. It has only ten days to formulate up its opinion. Strikingly, the applicant will receive a notification of its authorisation by the national supervisor, not by the ECB, that only seems to be in charge of surveillance of the overall system. In fact, new banks will mostly be created in the segment that is subject to national supervision.

The above rules apply to the creation of any new bank as a legal entity, irrespective as to whether it will be directly supervised by the ECB or not. For banks that are nationally supervised, the previous rules will apply unchanged, but the ECB has to be involved. Hence the rule applies to the creation of all subsidiaries of banks located in the SSM area. It does not apply to the establishment of branches: within the SSM area, it is however logical that both

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<sup>219</sup> Article 12 and 13, Regulation.

<sup>220</sup> Article 13(2), Regulation

<sup>221</sup> Article 14 and Preamble (21), Regulation. One can assume that this provision only applies to banks created as separate legal persons, not to the setting - up of branches.

the ECB as competent authority, and the national supervisor where the branches will be located, be notified, as the latter has certain, although limited powers with respect to a branch<sup>222</sup>. For SSM banks establishing branches or providing services in non-participating states, the Regulation provides for exclusive competence of the ECB as the home supervisor for all banks<sup>223</sup>. For branches to be established outside the EU, the national provisions of that foreign jurisdiction will apply. For SSM banking groups, the ECB will be the competent authority, while the national supervisor will act for the other banks.

With respect to the withdrawal of an authorisation, the ECB may act on its own initiative or on a proposal of the national supervisor. In both cases this power refers to banks belonging to the SSM regime or not. Both supervisory levels will consult on the consequences of the withdrawal, such as asset transfers, provisional management, remedies for depositors, resolution measures, run-off, and similar transitional decisions. In case of a proposal to withdraw its authorisation on the initiative of a national supervisor, the ECB will have to withdraw the authorisation, taking ‘full account of the justification of the national supervisor’<sup>224</sup>. But as the withdrawal of an authorisation will often trigger the resolution of the bank, the national bodies in charge of resolution - usually not the prudential supervisors and awaiting the European Resolution Authority- will have the last word: stating local financial stability concerns, the ECB will have to wait with the withdrawal, until it judges that even after time no sufficient action to maintain financial stability has been undertaken, in which case it may withdraw the authorisation with immediate effect<sup>225</sup>.

With respect to matters not falling within in the ECB’s remit, the existing rules on authorisations governing home-host competence would further apply<sup>226</sup>.

#### b- Qualifying holdings

57. Acquisition of qualifying holdings in all banks must be notified to the national supervisor and assessed on the basis of national legislation. The proposal will be submitted to the ECB that will decide on the basis of Union law<sup>227</sup>. Obviously the same procedure does not apply to disposals of a qualifying holding that may further be subject to a procedure before the national supervisor.

#### c- Administrative penalties

58. The ECB will have autonomous sanctioning power allowing it to impose fines for breaches of directly applicable Union law to the extent that the latter provides for the power of competent authorities to impose pecuniary fines. In addition, it may request national supervisors to initiate sanctioning procedures as provided for in EU or national law for

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<sup>222</sup> See Article 14 (6) and the list of national competences in Preamble (28), obviously applicable to all banks. On the basis of Article 25 e.s of the Directive 2006/48 and in the future Article 35 CRD IV. Divestiture will be notified under art 25, CRD IV.

<sup>223</sup> Article 4 (1) (b), Regulation.

<sup>224</sup> Article 14 (5), referring to withdrawal in accordance with relevant Union law. Also Article 14 (6), Regulation for the application of national law.

<sup>225</sup> Article 14 (6), Regulation.

<sup>226</sup> Article 14 (1), Regulation.

<sup>227</sup> But the national supervisor does not approve: Article 15 (2), Regulation. The subject matter is extensively dealt with in the CRD IV, Article 14.



matters not covered by the ECB's sanctioning jurisdiction.<sup>228</sup> Differently from the proposed directive, sanctions on individuals, whether members of management board of a regulated entity, or on any person responsible for the breach may also be imposed<sup>229</sup>.

The sanctions that can be imposed by the ECB may be quite substantial:

- twice the amount of the profits gained or losses avoided
- or up to 10% of the total annual turnover, as defined in Union law. In case of a breach by a subsidiary, the basis for calculation will be the group's turnover, what may be quite excessive.
- or any other pecuniary measure as provided for in Union law.

Its decisions will be published even if appeal procedures have been started<sup>230</sup>.

All sanctions should be effective, proportionate and dissuasive<sup>231</sup>. The ECB will call on the national central banks to enforce the sanctions it has imposed<sup>232</sup>.

#### d- Macroprudential tools

59. The competence to impose macroprudential tools lies primarily with the national authorities – these are not necessarily the prudential supervisors - which can best be explained by referring to the endogenous causes of many systemic developments<sup>233</sup>. Therefore measures first have to be considered at the local level, without ruling out further action if the developments affect a broader area. The range of instruments available to national authorities goes from macroprudential buffers, in addition to the general own funds, to other measures such as loan-to-value restrictions, debt-to-income ratios, or any other instrument aimed at restoring the macro balance. The ECB, after having been informed of a proposed macroprudential measure, can communicate its objections, but without preventing the national authorities from proceeding<sup>234</sup>.

But the ECB may consider that the macroprudential concerns are not adequately addressed at the national level, or affect several Member States in which cases it may take the initiative to impose its own measures: obviously only higher or “countercyclical” capital buffers are within the ECB's remit<sup>235</sup>. These buffers would come in addition to the own fund

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<sup>228</sup> In addition, the ECB is empowered by Article 132(2) TFEU to impose fines or periodic payment penalties for enforcing its own regulations and to the extent provided in Council Act under Article 129 (4), eg with respect to the transmission of statistical information. This would not seem to be an autonomous sanctioning power, separate from the one provided in Article 18 (1) Regulation.

<sup>229</sup> Article 18 (5); compare Article 18 (7a) of the proposed Regulation.

<sup>230</sup> See Article 69 CRD IV on the publication of sanctions and the centralisation of this information at EBA, only accessible to the competent authorities. The SSM regime Article 18 (6) requires all penalties to be published.

<sup>231</sup> ECB rules on sanctioning will apply: Article 18 (7) makes moreover reference to regulation 2537/99 of 23 November 1998, OJ, 27 november 1998, L.318/4 allowing for the imposition of periodic penalty payments for breaches of rules relating to the EMU. This regulation would also be available for sanctions under the present Regulation.

<sup>232</sup> This point has been addressed in Article 9 of the ECB Regulation (EC) No 2157/1999 of 23 September 1999 on the powers of the European Central Bank to impose sanctions OJ, L 264/21, of 12 October 1999.

<sup>233</sup> See art 1, (5), Regulation, referring to powers not provided in Union acts. Macroprudential tools are defined as described in the BIS statements: among its most recent statements: Operationalising the selection and application of macroprudential instruments, December 2012, available at: [www.bis.org/publ/cgfs48.pdf](http://www.bis.org/publ/cgfs48.pdf). See in the sense of primary national competence: Constâncio, V., Establishing the Single Supervisory Mechanism, nt.17; Coene, L., nt. 120, at 3.2 mentioning the need for national intervention as the euro area has not yet reached its final level of integration.

<sup>234</sup> The national supervisor shall “duly consider” the ECB's reasons: Article 5 (1), Regulation.

<sup>235</sup> See CRD IV, Article 128 e.s.; CRR, Article 440; see Darvas and Merler, nt.11, pt 10

requirements, and replace the national authorities requirements<sup>236</sup>. The ECB will decide on the basis of its own assessment, coordinate with the national authorities and listen to its reactions, but ultimately decide, taking into account the specific situation of the financial system in the Member States affected and the observations submitted by the national authorities.

The macroprudential tools have been enumerated in the Regulation, not necessarily in coordination with the CRD IV directive: the Regulation refers to additional capital buffers, countercyclical buffer rates, and any other measures aimed at addressing systemic or macroprudential risks<sup>237</sup>.

#### e- Recovery and resolution

60. Divided powers also exist with respect to recovery and resolution measures addressed to banking groups. On the one hand the prudential supervisor normally has a direct involvement in the recovery phase, and will try to avoid failure by using its prudential tools. But once in the resolution phase, the situation will trigger the intervention of an independent resolution authority, while the prudential supervisor will not be further involved as this might create a conflict of interest, leading to biased decisions but also raise concerns about the use of the resolution fund. According to the latest BRRD proposal, it would be the supervisor who would establish that the bank is “failing or likely to fail” after which the resolution authority will decide whether the bank is resolvable and starts the resolution action<sup>238</sup>.

As the Commission’s proposal on Recovery and Resolution has not yet been adopted, the Regulation only negatively addresses these issues, stating in substance that these matters will have to be taken up for consideration at a later stage<sup>239</sup>. The Regulation contains however some useful hints about the dividing lines between recovery and resolution.

As far as recovery is concerned, the ECB – as all other prudential supervisors - will be in charge of the recovery phase of the banking groups under its direct supervision. It will also advise on the resolution plan, to be drawn by under the guidance of the resolution authority. Therefore the Regulation expressly provides that the ECB will be in charge to carry out the supervisory tasks in relation to the recovery plans and early intervention and with that view cooperate with the resolution authorities<sup>240</sup>. In order to avoid financial stress or failure, the ECB can prepare the use of resolution tools, but the use of the resolution powers are clearly excluded from its mandate<sup>241</sup>.

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<sup>236</sup> This reading is based on the wording used in article 5 (2) Regulation, “instead of the national authorities” and “in addition to the own funds requirements provided in the Regulation”, superseding the requirements imposed on the basis of CRD IV, Article 131 and CRR. Article 92.

<sup>237</sup> See CRD IV, Articles 128 e.s.

<sup>238</sup> See Article 27 (1) of the Proposal for a Directive establishing a framework for the recovery and resolution of credit institutions and investment firms, Com 2012 (280/3 ( BRRD), allowing also for Member States to invert the sequence; See also: Commission Consultation on: A Possible recovery and Resolution Framework for Financial Institutions other than Banks, March 2013, available at: [/ec.europa.eu/internal\\_market/consultations/2012/nonbanks\\_en.htm](http://ec.europa.eu/internal_market/consultations/2012/nonbanks_en.htm)

<sup>239</sup> Compare Article 3 (4) and Article 4 (1) (i), illustrating the role of the ECB in resolution, respectively recovery. The same division of competences would not apply at the national level.

<sup>240</sup> See Preamble (27) and (35); see on this topic: ECB, *The Role of Central banks in Prudential Supervision*, [http://www.ecb.int/pub/pdf/other/prudentialsupcbrole\\_en.pdf](http://www.ecb.int/pub/pdf/other/prudentialsupcbrole_en.pdf)

<sup>241</sup> Article 4 (1) (i), Regulation.

The Regulation provides that the ECB will closely cooperate with the authorities in charge of resolution and contribute to the preparation of resolution plans but without being entitled to take the decisions<sup>242</sup>. When the ECB intends to withdraw a bank's authorisation, a measure that de facto will often precede resolution, the national resolution authority can urge the ECB to abstain from withdrawing the licence. But if the ECB later considers that no proper action has been undertaken, it will ultimately withdraw the authorisation. When in the context of a resolution, significant blocks of shares have to be transferred, this approval will be granted by the resolution authority not by the ECB, although the latter is competent for all other transfers of qualifying blocks outside the resolution context<sup>243</sup>. These examples illustrate the dividing line between prudential supervision and resolution.

Further coordination will be needed in the future directive on bank's recovery and resolution<sup>244</sup>.

## 7. The governance of the ECB as a prudential supervisor

61. The Treaty mandates that prudential supervision be exercised by the ECB, more precisely its Governing Council: hence its governing body will ultimately be in charge of and responsible for the prudential supervision in the participating Member States<sup>245</sup>. Several provisions of the regulation point to this ultimate role of the ECB and its Governing Council<sup>246</sup>.

62. Organising a prudential supervisory regime applicable in 18 Members States is a considerable task for which the Regulation had to create separate appropriate structures but always remaining within the ECB as a single institution. Notwithstanding the ultimate powers of the ECB's Governing Council, the regulation provides for a separate internal decision making structure that will 'fully undertake' these tasks<sup>247</sup>. It is called the *Supervisory Board*. It is unclear whether this is also a managing structure directing the internal administration that supports the ECB's supervisory activity. The terminology used for the designation of this board is somewhat confusing – e.g. when compared with a supervisory board in German or Dutch two-tier board structures – and, in that sense, does not properly cover its role and activities which mainly relate to supervisory decision-making, and not to actual supervision or management which would be the task of the ECB's administration<sup>248</sup>.

63. The supervisory function has to be exercised independently. In the case of the ECB this independence relates to different sources of influence: as a prudential supervisor the ECB's decision should not be influenced by the Union institutions, by national governments and their internal bodies – e.g. national prudential supervisors – and further by all public and private bodies.

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<sup>242</sup> Article 3 (4), Regulation.

<sup>243</sup> Article 15; Article 4 (1) (c), Regulation.

<sup>244</sup> Proposal establishing a framework for the recovery and resolution of credit institutions and investment firms COM (2012) 280/3, June 6, 2012.

<sup>245</sup> See nr. 29.

<sup>246</sup> See e.g. Articles 4 (1) or 9 of the Regulation.

<sup>247</sup> Article 26 (1), Regulation

<sup>248</sup> See also, Véron, N, Europe's Single Supervisory Mechanism and the Long Journey Towards Banking Union, Peterson Institute for International Economics, Policy Brief, December 2012, available at: [www.piie.com/publications/pb/pb12-24.pdf](http://www.piie.com/publications/pb/pb12-24.pdf), who also referred by way of comparison to the relationship between the BIS and the FSB.



The ECB in its supervisory capacity, the members of the Supervisory Board and the involved national supervisors, will each act independently<sup>249</sup>, independence being formulated very broadly as relating to Union and national bodies including their governments, and further all public or private bodies. These bodies also have to “respect that independence”<sup>250</sup>. Whether this independence also relates to the ECB itself seems to flow from that provision<sup>251</sup>. The provisions dealing with the separation of the monetary policy further indicate the independence of the supervisory functions: the prudential tasks will be executed “without prejudice to and separately from its monetary tasks and any other tasks”<sup>252</sup>. The ECB as prudential supervisor will “only pursue the objectives set by this Regulation”<sup>253</sup>. These ideas are also reflected in the composition of the Supervisory Board, where the ECB has a minority position, the board “acting in the interest of the Union as a whole”.

Apart from the theoretical or political value of these statements, one may wonder what would be the practical meaning of this independence requirement: one could readily imagine that because of blatant violations of the independence obligation, the chair could be forced to step down, but it is more doubtful how this will be applied to the representatives of the national supervisors, as the latter are member of a collegial body. As representative of the national supervisors, the latter cannot be obliged to leave, unless decided differently by the national supervisor. Or could the decisions be annulled as being inspired by national interests? And what with the representatives of the ECB? They too will not be entitled to receive instructions from the Bank as a Union institution, but as representatives could be forced to step down.

The Regulation also provides that ‘all members of the Supervisory board shall act in the interest of the Union as a whole’, what is particularly important for the representatives of the national prudential supervisors, but it will be quite difficult to enforce this obligation in the absence of full transparency as to how the members have voted in the Board.<sup>254</sup> The sanction of a breach of this provision would essentially be political.

64. In the relationship between the ECB and the Supervisory Board, the regulation designates the latter as an “internal” body<sup>255</sup>, only in charge of planning, preparing and the execution of the ECB’s supervisory tasks, but not of final decision-making.”<sup>256</sup>. Legally, the Supervisory Board will not take binding “decisions”, as these have to be adopted by the competent decision-making body of the ECB, i.e. the Governing Council. As will be explained later, the ‘negative decision making’ technique allows upholding the fiction that the decisions are made by the ECB’s statutory bodies, while in fact they will be adopted by the Supervisory Board. Its decisions will be attributed to the ECB, and should be declared enforceable as any other ECB decision, but not at the behest of the Supervisory Board, which is merely an “internal body”. Whether the Governing council could only adopt decisions of

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<sup>249</sup> Article 19 (1) Regulation, referring to ‘objectivity’. This also applies to the Steering committee

<sup>250</sup> For a similar provision in the ESA regulations, see article 42, EBA regulation.

<sup>251</sup> Article 19 First §.

<sup>252</sup> Article 25 (2).

<sup>253</sup> Article 25 (1).

<sup>254</sup> Article 26 (1), Regulation.

<sup>255</sup> Article 26 (1).

<sup>256</sup> Compare Art. 26, (8) of the Proposal for a Regulation, where the role of the Supervisory Board was stated as being based on a delegation.

the Supervisory board, but not amend them, has been put forward in a Council document<sup>257</sup> but seems incompatible with the decision-making power of the Governing Council, which is the only body in charge of decision making in the SSM.

Recourse against final decisions of the ECB is organised on the basis of a reference to an internal review body.<sup>258</sup> There is no internal nor external or judicial review against the decisions of the Board, as these are mere proposals, to be subsequently adopted by the Governing Council. Only the latter's decision – often a decision not to object - is open for this internal review. It is also appealable before the ECJ<sup>259</sup>.

On the other hand, and notwithstanding the issues raised, today's technical formulation of the internal governance cannot be declared incompatible with the Treaty as the Council Regulation can organise the supervisory function it entrusts to the ECB.

## 7.1 The Composition of the Supervisory Board and the Executive Committee

65. The composition of the Supervisory Board is described in some detail and is based on a double input, from the ECB, and from the existing national prudential supervisors.

- The Chair of the Supervisory Board, as an independent member.

- The chair will be an important independent figure. He will be appointed by the European Council<sup>260</sup>, on the proposal of the ECB with the approval of the European Parliament and after hearing the Supervisory Board. The chair's qualifications are expressly stated: he shall be chosen from among 'individual(s) of recognised standing and experience in banking and financial matters'. The Regulation provides for an open selection procedure on which the Parliament and the Council will keep an eye. It is likely that the procedures applicable to the chairperson of the ECB will be a source of inspiration<sup>261</sup>.
- The chair's function is a full time one, for five years and not renewable. This will ensure his independence.
- Strict incompatibility rules apply: he can not be a member of the Governing council nor of a national supervisor, is subject to a strict code of conduct, and to strict cooling off provisions<sup>262</sup>.
- The Regulation provides for a provision for his removal in case of serious misconduct, or when he no longer fulfils the conditions for his appointment<sup>263</sup>.
- Both chair and vice chair will be appointed by the Council acting by qualified majority of the participating Member States. The same applied to their compulsory removal, whereby special rules apply for the Vice-Chair.
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- Members related to the ECB

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<sup>257</sup> Council/ Coreper, document 6 November 2012, 15663/12, available at: [register.consilium.europa.eu/pdf/en/12/st15/st15663.en12.pdf](http://register.consilium.europa.eu/pdf/en/12/st15/st15663.en12.pdf)

<sup>258</sup> See further nr. 71 about the "administrative board of review".

<sup>259</sup> Articles 13(2) in fine and 24 (11), Regulation; in any case, due process has to be respected: Preamble (58).

<sup>260</sup> In the Council, the non-participating Member States will not be present as member, but only as observer, and are not entitled to vote. See nr. 80.

<sup>261</sup> See for further details of this procedure, the Interinstitutional Agreement entered into between the European Parliament and the ECB, detailing the steps as to how the parliament will be involved, nt 1.

<sup>262</sup> Preamble (76) where this matter is delegated to the internal code of conduct.

<sup>263</sup> The ECB added that in case of removal 'it will be within the ECB's discretion what kind of action it will take in response.'

- Five members of the board will originate from the ECB
  - The Vice chair: he will be elected from the membership of the Executive Board, so that the ECB is represented at its highest operational level<sup>264</sup>. The proposal will be approved by the Parliament, the Supervisory Board having been consulted, and he will be finally appointed by the Council. His removal will take place according to ESCB rules, and decided by the Council, with approval from the Parliament<sup>265</sup>.
  - The four ECB representatives will be appointed by the Governing Council and may or may not belong to the ECB administration; in no case should they be involved in monetary matters.
- The other members will be representatives of the national prudential supervisors, at present of the 18 euro states as in most of the Member States prudential supervision is exercised whether by the central bank or in a body closely affiliated with the central bank. Most of them will be central bankers in charge of prudential supervision in their own jurisdiction, but if not, the central bank may bring a representative of that other competent body to the meeting. This will not affect the voting rights, as these two persons will have to agree and may cast only one vote<sup>266</sup>.
- Non-euro participating states

These states are fully “participating Member States” and therefore take part in the decisions of the Supervisory Board. Like all other members they will have one vote per state.<sup>267</sup> Being full members of the board, they will also be included in the qualified majority voting system and may be part of the steering committee.

Finally, an observer of the European Commission may attend but upon invitation only; he will not have access to confidential information about individual banks. Differently from the proposed Regulation, an observer from the EBA may also be invited to the meetings, while the ECB will continue to observe the EBA meetings<sup>268</sup>. It is planned that the chair of the future resolution authority will also take part as an observer<sup>269</sup>.

The Regulation contains provisions on gender balance, and on experience and qualifications, all these being applicable to all board members<sup>270</sup>.

## 7.2 Decision-making within the Supervisory Board

66. Modelled on the pattern of the Governing Council, the decisions of the Supervisory board will be taken by a simple majority of its members, whereby all members

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<sup>264</sup> According to Mersch, Y., The Banking Union - a European perspective: reasons, benefits and challenges of the Banking Union, Speech, Berlin 5 April 2013, the appointment procedure for the vice-chair may create tension with the ECB’s independence.

<sup>265</sup> Article 26(4).

<sup>266</sup> Article 26 (6), Regulation.

<sup>267</sup> See the formulation in Article 26 (6), Regulation.

<sup>268</sup> On the basis of Article 40 (1)(d), EBA Amended Regulation; see Preamble (70).

<sup>269</sup> Preamble (70).

<sup>270</sup> Article 26(2), Regulation.

have equal voting rights, and the chair a casting vote.<sup>271</sup> Objections were raised proposing voting rights to be based on the relative importance of the states involved but were not followed up.

Some decisions of a regulatory nature will have to be adopted by qualified majority, as defined in the Treaty<sup>272</sup>. As the Treaty provisions do not apply to the ECB representatives, the four representatives will have a vote equal to the median vote of the other members. The Regulation makes no mention of the voting rights of the Chair and the Vice-Chair, although they are designated as full members of the Board and therefore are entitled to vote. The chair is entitled to vote and will have a casting vote in case of a tie. It remains unclear how his votes will have to be added up to the votes of the other members in matters when a decision by qualified majority is required: in the absence of a derogatory regime, he will be entitled to cast just one vote.<sup>273</sup> In most cases, his vote will therefore not be material, except in a tie.

Apart from the general wording about the duty to act in the interest of the Union as a whole- and not only of the SSM area<sup>274</sup>, the Regulation contains no rules relating to votes cast by national representatives in cases that directly affect banks in their national jurisdiction. Under company law, these matters would be dealt with in terms of conflicts of interest, in which case good governance would require that member to withdraw from the meeting. The Governing Council may be able to settle these matters in its internal rules, as stipulated in Article 26 (12) but without an express provision in the Regulation it seems debatable whether this kind of a matter can be arranged in internal rules.

The overall picture of the governance of the Supervisory Board remains that of a board dominated by the national supervisors whereby the ECB will have difficulty – at least in terms of voting - to impose its own view. The clause that the Board should act in the interest of the Union as a whole – although rather theoretical – may serve as guidance for the decisions in the Board. Part of the answer may lie in the final decision making power of the Governing Council, in the context of the negative decision making process, described below. But in the Governing Council, essentially the same national central banks are present, the non-euro participating Member States excluded<sup>275</sup>. It will be interesting to watch the practice develop.

### 7.3 The Supervisory Board preparing decisions of the Governing Council

67. The provisions of the Regulation spelling out the remit of the Supervisory Board have been framed in its relation with the Governing Council. In any case, the latter will – at least theoretically - maintain the final decision power, which is highlighted in several provisions of the Regulation. At the same time the relationship with the Supervisory board

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<sup>271</sup> In some Member States, dissenting voices were heard, e.g. in Germany, according to House of Lords, nt. 90, § 33. The House of Lords, § 157, stated that voting rights should be proportional to the relative significance of the financial markets in the respective Member States.

<sup>272</sup> For details about the same arrangement applicable to the ESAs, see Wymeersch, nt. 31, 11.249. On the basis of the calculation and membership as of the beginning of 2013, this would amount to 10 votes each (9<sup>th</sup> of 17 members). The ECB could therefore aspire to cast 50 votes out of a total vote of 213, deciding by a majority of 107 votes. But this figure may change due to the participation of new members or of non-euro states.

<sup>273</sup> Article 26 (6) Regulation states that “each member of the supervisory board shall have one vote”

<sup>274</sup> Article 26 (1). Equal treatment of non-participating states was stressed in the House of Lords, nt. 90 § 65

<sup>275</sup> The absence of the non-euro participating states is due, it seems, to the fact that the composition of the Governing Council being part of the Statute, a protocol annexed to the TFEU cannot be modified by a regulation. See the “legal obstacles” mentioned in House of Lords, nt. 90, nr.61



has been construed in such a way that for most practical purposes the latter will be the decision making body.

According to Article 26 (1) ‘[t]he planning and execution of the tasks conferred upon the ECB, shall be fully undertaken by an internal body’, the Supervisory Board, thereby safeguarding the Governing Council’s decision-making privilege. This is further clarified by the statement that the Board will carry out preparatory tasks and draft ‘complete draft’ decisions to be adopted by the Governing Council<sup>276</sup>.

68. The decision of the Governing Council is a negative one: the proposal of the Supervisory Board will be considered adopted unless the Governing Council objects. This means that no action will be required from the Governing Council and that a ‘no objection’ or even a silent nod will suffice. In most cases there will be no formal decision, just a mere lapse of the objection period. Objections have to be stated within 10 days, leaving little time for further reflection or analysis, and moreover have to be based on a written argumentation, especially highlighting possible monetary considerations<sup>277</sup>. As prudential supervisory matters regularly call for urgent decisions, the Governing Council will very often not be able to object in time. Although one can understand the reasons why this “negative approval” procedure had to be adopted, thus preventing the Governing Council to becoming overloaded by prudential cases, the outcome remains nevertheless overly restrictive of the ECB’s decision-making competences of the Governing Council, and may even raise objections in terms of compatibility with Article 127 (6). Is a ‘negative approval’ or a ‘silent non objection’ still a decision?

69. The whole procedure comes down to a de facto conferral of the decision-making power to the Supervisory board, subject to an objection from the Governing Council. Again, it will be interesting to follow how frequently objections are raised and on what grounds.

This process will be worked out further in internal rules relating to the Supervisory Board. The Regulation contains some of its principal elements: the objection period is limited to maximum 10 days, working days to be sure, which may be reduced to 48 hours in emergency cases. But if the Governing council rejects the decision, it may change its content or remand the matter for further deliberation to the Supervisory Board<sup>278</sup> in each case stating its reasons. To be efficient, the decision making process should be fully cleared before the Supervisory Board submits its decision to the Governing Council.

The non-euro participating states have obtained special safeguards; they can object to a proposed decision, either before it is submitted to the Governing Council or once the Governing Council has changed it, possibly triggering the opt-out procedure mentioned below<sup>279</sup>.

#### 7.4 The internal organisation of the supervisory function

70. The Supervisory Board’s activity will be supported by a Steering Committee which will prepare its meetings, but legally will not have decision-making powers. It will be composed of a certain number of the Board’s members elected by the Board on the basis of a

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<sup>276</sup> Article 26(8), Regulation.

<sup>277</sup> Article 26 (8), Regulation.

<sup>278</sup> See 26 (7), Regulation.

<sup>279</sup> See nr. 82.



'fair balance and rotation'. It will be chaired by the Chair or Vice-Chair of the Board. Only one out of maximum ten members will be a representative of the ECB<sup>280</sup>.

The regulation provides for a 'secretariat', supporting the activities of the Supervisory Board on 'a full time basis' and preparing its meetings<sup>281</sup>. Although the regulation is rather silent on the topic, the ECB will have to set up a separate department in charge of prudential supervisory matters, clearly separated from its other departments and subject to adequate rules of conduct especially with respect to professional secrecy and information exchange with national supervisors<sup>282</sup>.

The relation of the Supervisory Board with the 'secretariat' is not very clear: will it be a separate structure, or a part of the larger department that is in charge of the supervisory activities? Or is the secretariat merely the supervisory department? Beyond semantics, this raises the issue of the authority of the Supervisory Board over the supporting staff: can it rely on the staff for supervisory activities, as is the case at all national supervisors? Can the board submit requests such as for investigations or analyses? Can it give orders to the staff that go beyond the 'planning and execution' of the tasks<sup>283</sup>. Obviously the Supervisory Board has essentially been regarded as a body for preparing decisions, not as the head of an administration.

In the absence of any reference to the contrary, this would mean that the legal authority on the secretariat would not be exercised by the Supervisory Board, but by the ECB's Executive Board. It will be part of its internal organisation, which would directly affect its legal position, staff rules, remuneration and discipline, as the ECB rules will be applicable. This analysis is also in line with the provision that the ECB will establish a code of conduct dealing especially with conflicts of interest<sup>284</sup>.

In the final stages of the drafting of the Regulation, special attention was paid to the cooling-off regime of members of the Supervisory board, including the representatives of the national supervisors and of the supervisory staff. A two-year cooling-off period has been provided for, without prejudice of stricter national rules, but can be waived for private sector paid work for Board members in accordance with the rules adopted by the ECB<sup>285</sup>. Detailed information on the application of these procedures in the annual report is required<sup>286</sup>.

These aspects once again raise the question whether the Supervisory Board should be seen as an internal decision-making body and not as the independent prudential supervisor, as is required in international standards e.g. of the Basel Committee<sup>287</sup>. The competent authority and the independent supervisor is the ECB, operating according to the decision-making rules set out in the Regulation and acting on internal proposals of the Supervisory Board.

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<sup>280</sup> Article 26 (11), Regulation.

<sup>281</sup> Article 26 (9) and (10), Regulation.

<sup>282</sup> Article 27, Regulation. See nr.94 for the initial measures.

<sup>283</sup> Article 26 (1), Regulation. This would be implied in the "execution" of the ECB tasks

<sup>284</sup> Article 31 (3), Regulation. The rule extends to representatives of the national supervisors.

<sup>285</sup> Article 31 (4) stating that the "ECB will assess whether there are objections to "take on private work" The provisions does not exclude work in the private sector, but would it then exclude activities in a national supervisory body? .

<sup>286</sup> Article 31(5), Regulation.

<sup>287</sup> See BCBS principles, supra nt. 117.

As mentioned before, there has been considerable political concern about the interference between the monetary and the supervisory functions. In the Regulation this matter is addressed by separating the different objectives and activities – monetary, prudential, financial stability – leading to operational separation, separate reporting lines and separate decision making procedures. Professional secrecy obligations will further support this overall requirement<sup>288</sup>. A “mediation panel” will be created to which conflicts between the monetary and prudential tasks can be submitted<sup>289</sup>.

## 7.5 Administrative Review of the ECB decisions in prudential matters

71. The Commission’s original proposal has been complemented by the introduction of an internal review procedure for decisions: an internal “Administrative Board of Review” will be set up, before which the decisions can be challenged by anyone who is directly and individually addressed or affected by the decision, thus excluding representative or class actions. It is doubtful whether a request for review can be submitted by Member States, or by national supervisors, as only matters that are of “direct and individual concern to that person” may be open for review. Requests by the Member States normally have to be submitted to the ECJ, while national supervisors have been involved in the decision-making in the Supervisory Board and are bound by the majority expressed in that body<sup>290</sup>.

The review procedure mainly aims at safeguarding the rights of aggrieved parties, not to interfere with the prudential appreciation underlying the supervisory decision. According to the Regulation, the review only relates to the “procedural and substantive conformity with this Regulation”, and does not address its wider aspects, such as elements of decisional discretion, or wider supervisory policies<sup>291</sup>. Supervisory decisions may be challenged on many other grounds, such as conformity with Union law in general, or on the basis of unequal treatment, discrimination, a lack of motivation or *ultra vires*. It would seem that these grounds would be excluded from the board’s mandate. That may be the reason why it has been called “administrative” review.

The Regulation is not explicit whether the review addresses proposals from the Supervisory Board or decisions from the Governing Council: as the review addresses “decisions of the ECB”, only Governing Council decisions have been viewed.<sup>292</sup> As a consequence, the procedure aims at having the decision reviewed and resubmitted by the Supervisory Board, for re-decision by the Governing Council.

The review process is part of the internal decision making process and is not a judicial review. Therefore, the Board of Review can decide to have the decision replaced, abrogated, amended or simply confirmed, after which the Supervisory Board will adopt a new decision, ‘taking into account’ the opinion of the Board of Review, indicating that the Board’s decision is not binding on the Supervisory Board. The new decision – which may be a mere confirmation of the previous one - will then be resubmitted to the Governing Council and it will be deemed adopted unless the Council objects. No recourse against the latter decision is allowed, except before the ECJ<sup>293</sup>. One can expect the Council to pay special attention to

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<sup>288</sup> See Article 25 (3), Regulation.

<sup>289</sup> See nr 23.

<sup>290</sup> Article 24 (11), and this without recourse to the special procedure before the Mediation Panel, nr. 23.

<sup>291</sup> Article 24 (1), Regulation.

<sup>292</sup> This also appear from the clause that request of review will not have suspensory effects (Article 24 (8))

<sup>293</sup> See Article 24 (5), Regulation.



matters that have been submitted for review, as the Council's decision may only be submitted to the ECJ for final, judicial review<sup>294</sup>. On the other hand, an effective internal review procedure will eliminate the risk of having matters being submitted too frequently to the ECJ.

72. The composition of the Board of Review and the procedure before the Board of Review have received detailed attention.

As to the composition, five effective members and two alternates will be appointed by the Governing Council, on the proposal of the Supervisory Board, for a 5-year renewable term. They will be selected on the basis of a public call. The members will be 'individuals of high repute, with a proven record of relevant knowledge and professional experience, including supervisory experience, to a sufficiently high level in the fields of banking and other financial services'. They have to be independent and acting in the public interest<sup>295</sup>. Candidates should come from participating Member States – including non-euro states – and may not be from a national supervisor, or from institutions - national or Union - involved in the activities of the ECB, which probably refers to persons working with payments systems, or securities settlement systems and perhaps in the ESRB as well.

Procedure is important in review matters: a request for review must be filed within one month of notification of the decision to the person requesting it, or of the day it came to his knowledge. The request shall state the grounds for review. Unless the Governing Council decides otherwise, a request will not have suspensive effects<sup>296</sup>. The Board of Review will decide with a 3 to 5 majority, and this within two months of the request, after which the Supervisory Board, on the basis of the board's opinion, will draw up a new decision, and "promptly" submit a new decision to the Governing Council. In this case the Governing Council will have ten days to object, failing which the decision will be deemed to have been adopted. Differently from the regular procedure, the Governing Council will have to state its reasons, even in the case where it has not formulated objections. In these cases both the Supervisory Board and the Board of Review will have to explicitly state their reasons for their decisions, allowing for further judicial review.

The entire procedure is a quite tight one, and taking into account the complexity of the subjects, one may wonder whether the Administrative Board of Review will be able to settle the dispute in time. Nothing is mentioned about the role of the applicant's counsel arguing in support of his positions, but there can be little doubt that, here too, due process will fully apply<sup>297</sup>. Finally, decisions will obviously not be published in full, but this might be considered with a view of developing legal precedents, provided anonymity will be safeguarded

## 7.6 Financing the SSM.

73. The financing of the ECB's supervisory activity will be ensured by a separate supervisory fee, levied directly at ECB level<sup>298</sup>. The ECB fee will be based on – and limited to - its expenditure relating to its duties under the SSM. All expenditure will be covered by the supervised entities, including the branches of banks located in non-participating states.

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<sup>294</sup> But not against the decision of the Board of Review, the latter being an internal body.

<sup>295</sup> Article 24 (4), Regulation.

<sup>296</sup> Article 24 (8), but on the proposal of the Supervisory Board.

<sup>297</sup> See the general reference to due process in Article 22, Regulation.

<sup>298</sup> Article 30, Regulation



The fee will be levied at the top level of the group, be ‘proportionate and take account of the risk profile’. But national supervisors will also be allowed to continue to levy their fees for tasks not related to the ECB’s intervention, or in respect of the costs of cooperation or of acting on the ECB’s instructions e.g. for on-site inspections. Coordination of the two contributing levels will be reflected in the ‘arrangement’ that will be submitted for public consultation and take account of a cost/benefit analysis.

## 7.7 The Supervisory Board’s and the ECB’s accountability

74. As the ECB is the competent authority for prudential supervision in the Euro area, it is the ECB that is accountable to the different stakeholders, especially the European and national lawmakers, but also to the national governments and more widely the public. This idea is expressed by the statement that the ECB shall be accountable to the European Parliament and to the Council for the ‘implementation of this Regulation’, which would include the supervisory activity in its entirety. However, how this accountability will be translated in legal terms is less clear: apart from ongoing accountability, the Council with the approval by the Parliament could start a procedure for the removal of the chair or vice chair of the Supervisory Board<sup>299</sup>. A change to the Regulation would require an initiative of the Commission<sup>300</sup>. Sanctions will mainly be of a political nature<sup>301</sup>.

Ongoing accountability will take several forms; it will mainly involve reporting and discussions - being reports and hearings - and of written questions<sup>302</sup>. A Parliamentary “Committee of Inquiry”<sup>303</sup> may be installed. The Court of auditors will include in its review the “operational efficiency” i.e. the way the ECB has delivered in the supervisory field.

These annual reports will further be addressed to the European Council, the Euro group and the Commission, both on the past supervisory activities and on the future “evolution of the fees”, obviously a last minute addition<sup>304</sup>. The same reports will be sent to the national parliaments

Debates on supervisory issues will be organised within the European Parliament and in the Euro group: the chair of the Supervisory board ‘of the ECB’<sup>305</sup> will speak on behalf of the Board which may raise the question of whether and to what extent he can commit the ECB and the Supervisory Board.<sup>306</sup> In the Euro group, discussions will take place with the representatives of the non-euro participating states present. The hearings before the European Parliament may be held in committees, thus ensuring their confidential nature. On matters

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<sup>299</sup> On the basis of Article 26(4) or (5); see nr. 65.

<sup>300</sup> One should also taking into account the independence requirement of Article 19, Regulation

<sup>301</sup> Brantner, Giegold and Ferpasi, nt. 58 are of the opinion that constitutional doubts could be raised if the EP was not involved in controlling the ECB in its supervisory mode.

<sup>302</sup> Article 20 (6), Regulation.

<sup>303</sup> On the basis of Article 226 TFEU, but only relating to “alleged contraventions or maladministration in the implementation of Union law”. Preamble (57) extends this to the Parliament’s function of political control in the implementation of Union law.

<sup>304</sup> Article 20 (2), Regulation. In this indirect way the Parliament could monitor the fee structure.

<sup>305</sup> These words ‘supervisory board of the ECB’ in Article 20(3) and (4) are imprecise and superfluous. But there can be no misunderstanding about the meaning of this addition that it does not introduce the Supervisory Board as an additional external body.

<sup>306</sup> The answer to this question will lie in the nature of the questions: if these relate to supervisory issues within the purview of the existing supervisory framework, the Chair will normally engage the Board; but on more overarching issues, such as supervisory policies, he will have to refer to the overall authority of the ECB.

involving an individual bank or individual persons, the chair could invoke professional secrecy<sup>307</sup>.

Questions – probably in writing – may be addressed to the ECB by both the EP and the Euro group, and be answered orally or in writing.

75. With respect to the exchange of information between ECB and the European Parliament an Interinstitutional Agreement has been concluded organising the ECB's accountability in more detail<sup>308</sup>. It contains the elements to be dealt with in the annual report that will be presented by the chair of the Supervisory Board. During the start-up phase a quarterly report will be presented, with special information on the separation of the monetary and the supervisory functions. There will be two hearings of the chair of the supervisory board a year in the competent committee, when needed complemented by other exchange of views. The Agreement provides that the Parliament will receive a comprehensive overview of matters discussed and decisions reached in the Supervisory Board, obviously on a no-name basis. The Agreement further refers to written questions, issues of access to information, investigation procedures, procedure for nominating chair and vice chair of the Supervisory board and procedures for the Committee of Inquiry

The Agreement also streamlines the rules on confidential communications. On sensitive issues, confidential meetings can be held attended by the chair and vice chair of the competent parliamentary committee and the chair of the Supervisory Board, each accompanied by two assistants<sup>309</sup>. They will be held to strict confidentiality duties and no minutes will be taken nor discussions recorded. These safeguards should protect the ECB against possible criticism for disclosing highly sensitive information and is limited to the “discussions required for the exercise of the Parliament's powers under the TFEU”<sup>310</sup>.

Strikingly, accountability has been extended to the national parliaments: not only will they receive the annual reports, but they will also be entitled to formulate observations or questions on these reports or request the ECB to reply to their observations and questions<sup>311</sup>. In addition, the Chair or a member of the Supervisory board may be invited to appear before a national parliament to exchange views on the ECB's supervision of the credit institutions in that Member State. A representative of the national supervisor may also be invited. There can be no doubt that the Chair will have to express his opinion in conformity with Union law, as ‘he shall only act in the interest of the Union as a whole’<sup>312</sup>. In this context, the activity of the national supervisor with respect to the second tier of supervision may also be discussed, as this is part of the overall functioning of the SSM.

A specific form of accountability is liability for negligent or deliberately unlawful acts: the ECB had pleaded for limiting its liability to ‘qualified unlawfulness’ as is the case for national supervisors in several EU jurisdictions.<sup>313</sup> Particularly in some jurisdictions, such

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<sup>307</sup> See Article 27 (2), Regulation referring to the directive provision on the exchange of information.

<sup>308</sup> See Interinstitutional Agreement, nt 1.

<sup>309</sup> on the basis of Article 20 (8)

<sup>310</sup> Article 20 (8).

<sup>311</sup> Preamble (56) states that the ECB “may” reply to the questions.

<sup>312</sup> Article 26, Regulation.

<sup>313</sup> ECB, Opinion, nt. 1, 1.7. It is striking that Article 1 of the Regulation does not refer to depositor or investor protection; see Preamble § 23 refers to depositor protection but only as a remote objective behind safety and soundness of the banks and stability of the financial system. This formulation obviously will lead to the analysis that the European regulation has been conceived in terms that follow closely the German approach where the





reduced liability flows from judicial case law. This may have been the reason why no provision on liability has been included in the adopted Regulation. The preamble indicates that the liability of the ECB or of its ‘servants’ will be determined in accordance with the general principles common to the Member States<sup>314</sup>. This liability regime does not stand in the way of the liability of the national supervisors in accordance with national legislation. One can presume that this covers not only the supervisory activity developed by the national supervisors acting on the basis of their own national mandate, but also as contributors to the supervision organised under the guidance of the ECB in the context of the SSM.

## 7.8 The position of the Supervisory board in the SSM

76. What is the position of the Supervisory Board within the ECB structure? According to the Regulation, it is conceived as a decision making body for all supervisory matters, but subject to a final check by the Governing Council. To a certain extent, its position could be compared to that of the Executive Board, whose exclusive field of action is the monetary policy. The Statute of the ECB states that the Executive Board will prepare the meetings, implement the policies adopted by the Governing Council, take care of the internal organisation and advise the Governing Council. It may act on the basis of powers delegated by the Governing Council. Its decisions are also subject to approvals or contrary opinions and decisions of the Governing Council. On several of these points, there is a clear parallelism with the Supervisory Board.

The Supervisory Board may receive instructions or orientations from the Governing Council, and is bound to implement these within the limits of the applicable laws. It is striking that while the Members of the Board must meet an explicit independence requirement, nothing of the like applies to the Board itself, since it is part of the ECB. Moreover, at least according to the Regulation, the Board has neither a separate budget, nor a dedicated administration that make it possible to counteract proposals submitted by the ECB’s supervisory department. In this field, the pre-eminence of the Executive Board appears more clearly.

77. There are however some striking differences between the position of the Supervisory Board and that of the Executive Board.

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Supreme Court has held that protection of individual investors was not in the remit of the German Banking legislation and hence individual investors could not claim. See: Tison, M., *Do not attack the watchdog! Challenging the Prudential Supervisor: liability, Banking supervisor’s liability after Peter Paul versus (regulatory) immunity*, *Common Market Law Review*, Vol. 42, No. 3, 2005; D. Busch, *Naar een beperkte aansprakelijkheid van financiële toezichthouders?* Kluwer 2011.

<sup>314</sup> Preamble (61). The liability standard is quite different some jurisdictions admitting liability only for wilful misconduct or gross negligence, other applying the reduced liability applicable to civil servant while a third group applies the common rules on liability for mere negligence: See Nolan, D. *The Liability of Financial Supervisory Authorities* *Journal of European Tort Law*, 2013, Vol. 4, 2, 190–222; Dijkstra, R.J., *Liability of Financial Supervisory Authorities in the European Union*, *Journal of European Tort Law*, 2012, Vol 3, 3, 346–377; Athanassiou, Ph., *Bank Supervisors’ Liability: European Perspective*, *Yearbook of European Law*, Vol.30,213-254; Tison, M., “Challenging the Prudential Supervisor: Liability versus (regulatory) Immunity. Lessons from the EU experience for Central and Eastern European countries”, in M.Balling, F. Lierman, A. Mullineux (eds.), *Stability and Efficiency of Financial Markets in Central and Eastern Europe*, London, Routledge, 2004, p. 133-165; D. Busch, *Naar een beperkte aansprakelijkheid van financiële toezichthouders?* Kluwer 2011

First: its composition, as only a minority of members represents the ECB. Therefore, decisions will be strongly influenced by the views of the national supervisors represented on the Board. Except for the chairperson, the Regulation does not provide for a time limit to its members' mandate in the Board. Therefore, the question of their dismissal or end of mandate may arise. Differently from the chair, the members representing the ECB<sup>315</sup>, including the vice-chair are not appointed for a specific period of time, nor are they protected against being removed by the Governing Council. They are part of the ECB's organisation and therefore could be replaced by another person representing the ECB. As to the national supervisors' representatives, although they have to act in an independent way, in 'the interest of the Union as a whole'<sup>316</sup> and are not allowed to take specific instructions from national bodies, including the national supervisor which has mandated them, it is difficult to argue that they cannot be replaced by their principal. The absence of a clear term for their mandate points into the same direction<sup>317</sup>.

The Board will act in accordance with pre-established procedures, allowing for a large autonomy in decision-making. Most striking is the independent nature of the Board's decisions, as these are applicable unless after having been overruled by the Governing Council. This feature puts the Supervisory Board in a unique position of autonomy and strength within the ECB structure. However, one may expect that overruling will not happen too frequently and this will only apply in matters of principle. But no one can guarantee that this will be the case.

Remains the question how much the Executive Board of the ECB will be involved: in practice it will necessarily be involved in many aspects of prudential supervision, such as matters of organisation, staffing, financing etc. But in matters of prudential supervision, the Supervisory Board will act independently and without any interference from the Executive Board. There might have been some fear that monetary considerations might influence prudential decision-making and vice-versa, but these have been met<sup>318</sup>.

Also significant is the absence of external representation of the Supervisory Board: except for reporting to the European Parliament or to the national parliaments, the Board, its chair or vice chair do not act externally. One can expect that this aspect will be addressed in the internal regulation on the Board, but conceptually the Board remains very much an internal ECB organ.

All this leads to the conclusion that the Supervisory Board is a *sui generis* construction, comparable to the Executive Board but not quite at the same level, strongly embedded in the ECB structure, but with sufficient internal autonomy to ensure that the supervisory system works efficiently. Many points have not been addressed in the Regulation.

Ensuring that the Supervisory Board will act efficiently and provide a sufficient counterbalance to national interests will be the arduous task of its first leadership.

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<sup>315</sup> With the exception of the ECB representatives, including the Vice-Chair, who can be replaced at the initiative of the ECB; their term of office has not been mentioned. (Article 26(4), Regulation).

<sup>316</sup> Articles 19 (1) and 26 (1), Regulation.

<sup>317</sup> Should ECB representatives not be allowed to take instructions from the Bank itself? It would seem quite amazing that they would act against the opinion of the Governing Council, and could not be removed by that Council's decision.

<sup>318</sup> According to Article 12.2 of the Statute of ECB and ESCB, the Executive board 'shall implement monetary policy in accordance with the guidelines and decisions laid down by the Governing Council'. But Article 12.2 formulates its tasks more widely as a 'responsibility for the preparation of meetings of the Governing Council'.

## 8. The external dimension

78. Per hypothesis, the proposed SSM only applies to the euro area states, but is likely to also affect the non-Euro Member States, and as well as third countries. To determine these lateral effects, a more detailed analysis is needed. Three aspects will be dealt with here: the position of the non-euro Member States that decide to opt into the SSM, the position of the European Systemic Risk Board in the new system, and the changed regulation on the European Banking Authority as it directly affects the SSM.

### (i) The “participating” non-Euro states

79. As mentioned above the SSM essentially applies to the euro area states. However it will also affect the non-euro states and that in several respects. Most conspicuous will be the effect on the supervisory regime in some states where most banks are either branches or subsidiaries, usually of the largest Euro area banks<sup>319</sup> where the supervision may therefore shift to the SSM and, de facto, to the ECB. But even for subsidiaries of the same large significant groups, the influence of the parent company’s prudential rules will necessarily deeply impinge on the supervisory regime in these non-euro jurisdictions, The opt-in regime would therefore alleviate the down side of a supervisory system that covers only part of the Union.

There are several reasons for non-euro states to opt into the SSM. The banking groups with large operations in the SSM area might prefer to opt into the single supervisory regime, not only for reasons of simplification and cost saving, but also for reputational advantages. One can imagine that after some time, a solid supervisory regime under the leadership of the ECB and not influenced by any national bias will be preferred by the markets, what may lead to more favourable interest rates, credit ratings and equity prices. The advantages of the single regime in terms of managing these groups has been mentioned above for groups fully subject to the SSM: the same advantages, including a stronger level playing field, would benefit groups located in states that voluntarily adhere to the single supervisory system. But as was mentioned above, only the ‘significant’ groups would enjoy these benefits. Hence the structure of the national banking systems will be a determinant factor in deciding whether or not to adhere to the SSM. States even without major banking groups but with a considerable presence of branches and subsidiaries might prefer to reduce their involvement in prudential matters and by adhering to the SSM to significantly reduce the cost of supervision. Also these may have a beneficial effect on the credit rating of that state, especially in the run-up to later joining the EMU.

The Regulation provides for a regime allowing non-euro Member States to adhere to the SSM. As this implies a loss of sovereignty, the regime has to remain provisional: differently from the euro- states, who cannot choose for the SSM, and hence cannot leave it, the non-euro states would be able to leave the SSM, if the regime is not further beneficial to them or disagree with its development. In that sense, ultimate sovereignty has been safeguarded.

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<sup>319</sup> According to Zavvos, nt. 145, 72% of the banks in so-called peripheral states were foreign owned, mostly by Western European banking groups. Constancio, V., Establishing the Single Supervisory Mechanism, 7 September 2012, available at: [www.ecb.int/press/key/date/2012/html/sp120907.en.html](http://www.ecb.int/press/key/date/2012/html/sp120907.en.html), declared that the SSM would cover 80% of banking assets in the SSM area; Véron, N., nt. 115, identified 69,20% of assets in Euro area, 23,6% in UK 4% in Denmark and Sweden and 1,8% in the other states.

Member States that have opted into the SSM are called ‘participating states’ and will be treated equally as euro states, except for a few points to be mentioned below. When they opt into the SSM, the entire SSM regime will become applicable, meaning that all banks headquartered in that state will be subject to ECB supervision as far as they meet the access criteria – e.g. for banking groups owning a multistate subsidiary network, or on the basis of the criterion relating to three local banks guaranteeing to the ECB a minimal supervisory presence– while the regime for the less significant banking groups will equally apply. For the latter group, the national supervisors will further continue to be the exclusively competent supervisor, subject to the ECB’s overall instructions and pre-emption right. Therefore the main difference will be for the large groups and for subsidiaries of SSM area banks. The fear that national supervisors would become idle is unfounded: they will have to remain active in the SSM network, i.a. assisting SSM supervision and participating in the Supervisory Board and other activities organised within the SSM. They likely will be more involved in actual supervision, less in the conceptual or rulemaking process. They continue to supervise the less significant banks, and continue to be involved in the non-banking financial institutions, and for matters not subject to ECB supervision.

80. The non-euro Member States are entitled to enter into an arrangement of “close cooperation”<sup>320</sup>. The candidate Member State must prove that it has adopted measures to be able to implement the SSM system, including implementing the ECB’s mandated measures. Upon that showing the ECB will decide to admit the national supervisor to the close cooperation arrangement. From then on, all prudential supervision will be exercised according to the rules of the SSM. The two tiers of the SSM would then equally apply. The regulation is based on the Member States’ freedom: it does not oblige the non-euro Member States to enter into a close cooperation agreement, but leaves them free to do so, and later on to abandon the arrangement more or less at will. As the system aims at the uniform application of the same supervisory regime, it has been made indivisible, i.e. once a state has entered into ‘close cooperation’, all SSM rules will become applicable to all banks, preventing ‘a la carte’ application.<sup>321</sup> The ECB strongly insisted on all participating states being treated equally: they are full members of the Supervisory Board and of the steering committee. However the non-euro states are obviously not members of the Governing Council: in matters of direct concern to them, they may delegate members as observers.<sup>322</sup> This may have been a factor in offering them the opt-out mentioned below<sup>323</sup>. The same applies to the ESM: this backstop can only apply to euro states, signatories of the ESM Treaty<sup>324</sup>.

81. Entering into a “close cooperation scheme” is based on a “contractual” mechanism that will result in a Memorandum of Understanding<sup>325</sup>.

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<sup>320</sup> That is obviously different from the “enhanced cooperation” of Article 20 TEU, as was considered at a certain moment.

<sup>321</sup> But a certain flexibility is allowed: see Articles 1 (3) and 9 (3) referring Article 7(7).

<sup>322</sup> See Article 7 (2)(b), Regulation.

<sup>323</sup> See Council legal service, 14752/12, 9 October 2012, § 14. Comp. ECB, Opinion, nt 1, pt 1.8.

<sup>324</sup> See Treaty establishing the European Stability Mechanism (ESM) 2012, available at: [www.european-council.europa.eu/media/582311/05-tesm2.en12.pdf](http://www.european-council.europa.eu/media/582311/05-tesm2.en12.pdf)

<sup>325</sup> See Preamble (14) (calling special attention to branches and subsidiaries of banks from participating states active or established in non-participating states, where an MOU should provide for consultation on the effects of ECB decisions affecting these branches and subsidiaries, in clear ECB decisions addressed to SSM parents but affecting e.g. the UK branches or subsidiaries of banks from participating states. This issue does not seem



- There has to be a request from the Member State concerned; the request will be notified to the other Member States, to the Commission, the ECB and the EBA.
- The ECB will issue a decision establishing the close cooperation, provided certain conditions have been met aimed at ensuring that its decision will be abided by in the adhering state;
- These conditions aim at the application of the SSM regime in the same terms as in the euro area (i.e. the two-tiered system<sup>326</sup>) including the macroprudential matters and relating measures;
- The agreement can be terminated at the request of the Member State, which can be done with immediate effect, as mentioned below;
- As the Member State is obliged to adopt the measures enacted by the ECB, the ECB may terminate the agreement in case of non-implementation or refusal, following a specific procedure. But this right should only be used in “duly justified, exceptional cases”<sup>327</sup>;
- After termination, no new proposal for close cooperation may be considered before the lapse of three years following initial termination<sup>328</sup>. The Member State should think twice before leaving the system;
- On recovery and resolution, a parallel approach prevails, as the Single Resolution Mechanism would be equally applicable to the banks from all participating states, the applicable resolution regime being defined in the same way as for the SSM.

The preconditions for entering into a close cooperation agreement are all related to the uniform application of the supervisory rules and practices as adopted by the ECB: the basic legislation has to be in place, also ensuring that according to the national laws, provision is made for effectively applying the ECB’s ‘instructions’ and ‘guidelines’, which should be declared binding by the national supervisors. As a consequence:

- The “close cooperation” regime will be fully applicable to all banks in the jurisdiction of these participating states. All banks in the requesting Member State will become subject to the SSM regime; but here too, only the most significant banks will be directly supervised by the ECB, according to the standard established for the tier one banks<sup>329</sup>, the less significant ones will remain under national supervision; the same applies to the regime applicable to the branches and subsidiaries as exposed above;
- National legislation will ensure that national supervisors will abide by the ECB’s “instructions” and “guidelines”; these are not binding without more but have to be “adopted” by the national supervisor<sup>330</sup>. The national legislation should provide that the ECB’s decision will be effectively adopted. In case of refusal, the participation in the SSM will come under fire;

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proper to these branches of subsidiaries. See further Article 3 (4a), regulation, referring to this special MOU in general terms. However, technically, admission to the SSM is a unilateral decision of the ECB: Article 7 (2) (a).

<sup>326</sup> See Article 7 (2) (a) referring to Article 5 and 6 of the Regulation. As a consequence the entire two tier system, with significant and less significant banks becomes applicable and is notified to all Member States, whether or not belonging to the SSM

<sup>327</sup> Preamble (43)

<sup>328</sup> Article 7 (9), Regulation.

<sup>329</sup> See the reference to Article 6 in Article 7 (2)(a) Regulation, meaning that the distinction between significant and less significant banks would also apply here.

<sup>330</sup> Article 7 (4), Regulation.



- Requests for information from the ECB should be effectively implemented: this also applies to implementation of individual measures ordered by the ECB<sup>331</sup>. There is no mention of on-site inspections or other enforcement mechanisms: these would also be governed by the Regulation's provisions as part of the overall SSM.
- This adoption should take place almost immediately, i.e. within 48 hours, or even earlier. If no adoption has taken place, the ECB will first issue a warning, and if no action is undertaken within 15 days, the ECB may suspend or terminate the cooperation. This strict regime is likely to put considerable pressure on these participating states, the more so as termination may have serious consequences on that state's fiscal position. But the suspension or termination is not automatic and leaves room for a wider assessment by the ECB.

82. Once the 'close cooperation' has been established, the cooperating Member State is bound by the system for at least three years. It is logical that the system should first be tested in full, before termination can be envisaged.

But after that initial period, termination at the request of that Member State may take place at any moment and at will, and the ECB will have to decide to terminate the agreement, on the condition that 'supervisory effectiveness and legitimate interests of credit institutions' have been safeguarded<sup>332</sup>, in other words that at least a satisfactory transitional regime is in place which will however, not prevent that Member State from terminating its participation in the SSM. It is likely however that concerns about these conditions will lead to a provisional continuation of the close cooperation regime and that transitory measures should be agreed.

Termination or suspension may also be envisaged when the Member States does not take corrective action when needed, or does not meet the conditions for admission to the status of participating Member State.

A third case in which the participating status of a non-euro Member State may come under pressure is the one in which it objects against a decision proposed by the Supervisory Board to the Governing Council<sup>333</sup>. In principle, these Member States have committed themselves to abide by all decisions of the ECB. The Council will give its opinion on the objections raised by that jurisdiction, and in case it upholds the original decision, the latter will not be binding on the objecting Member State. However, it is then up to the ECB to decide whether participation in the SSM is further warranted, and whether it should be maintained, suspended or terminated. The ECB may then take into account certain elements such as the effect of the withdrawal on the integrity of the SSM, the adverse fiscal consequences on the Member States, including the withdrawing state or the consequences for supervisory effectiveness<sup>334</sup>. In this case, the decision remains in the hand of the ECB. Here again, transitional measures should be agreed.

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<sup>331</sup> See for the instructions Articles 7(1) and (4), Regulation; these instructions are addressed to the national supervisors.

<sup>332</sup> Article 7 (5), Regulation.

<sup>333</sup> See Articles 7 (8) and 26(8), Regulation.

<sup>334</sup> Article 7 (7) (4), Regulation. The effect on the other states has not been mentioned but should reasonably be included. These criteria indicate that this ECB decision is not a sanction, but an instrument to ensure to coherence of the SSM. It is inspired by the interest of the Member State, and may therefore oblige that Member State to remain in the SSM, at least if it does not demand termination itself.

The non-euro participating Member States are not members of the Governing Council: as the Regulation could not be adapted on this point without a Treaty change, some mitigating instruments have been provided: these states could send an observer to the Governing Council<sup>335</sup>, and in case the objection cannot be remedied, the termination is the *ultimum remedium*. The latter would only be used in extreme circumstances, taking into account the negative consequences on that state financial rating.

This regime requires from both sides commitment within freedom.

83. The conflict resolution mechanism is essentially based on the ultimate - decision-making - and conciliation - powers of the Governing Council. Only in extreme cases can one imagine that the parties will go to such extremities as to terminate the relationship, since it may seriously damage the reputation of the banks in that jurisdiction, but maybe also of other SSM states. The intervention of the Administrative Board of Review might have been a useful intermediate step. However it does not intervene in this type of conflicts as they only involve supervisory bodies, and not individual aggrieved parties.

#### (ii) The European Systemic Risk Board

84. The relationship of the ESRB with this new supervisory line of business within the ECB is not been mentioned in the Regulation except for stating that there will be no hinder for the ECB to act in the other supervisory bodies, including the ESRB. This raises the issue of the nature of the ESRB: is it another supervisory agency, or is it an advisory body that though not being part of the ECB is nevertheless closely related to it? The absence of legally binding powers leads to the conclusion that it cannot be assimilated to a supervisory body, and, hence, cannot be put at par with the national supervisors or with the Supervisory Board as regards the application of the banking directives. Also, the rules applicable in the ESRB context apply to all EU Member States, and will be more restrictive than those applicable under the SSM. The fact that the secretariat will be located at the ECB<sup>336</sup> does not result in the two bodies merging, as they have clearly different objectives and tools.

The ECB in its supervisory capacity has to closely cooperate with the members of the EFSF<sup>337</sup>, although technically it is not part of the EFSF under the ESRB regulation.

One might defend the opinion that the ECB as the successor of the national supervisors in the participating states, should be considered as being included in the ESFS, the network that has to 'ensure the supervision of the Union's financial system'<sup>338</sup>. However, as stated above, the national supervisors remain operational for many aspects of their national financial system, such as the non-bank financial institutions. Therefore their function cannot be considered to be absorbed by the ECB as the prudential supervisor.

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<sup>335</sup> Preamble (37); see also (43), Regulation.

<sup>336</sup> See Article 4(4) of the ESRB Regulation. No mention is made of the links between the ECB administration and the ESRB secretariat.

<sup>337</sup> Article 3 (1) Regulation; Article 1 (3) of the ESRB regulation; see for a overview of the different forms of cooperation: Constâncio, V., Implications of the SSM on the ESFS, Brussels, 24 May 2013.

<sup>338</sup> Article 1 (1) of the ESRB Regulation. The ESFS and its constituent members, especially the ESAs are planned to be subject to a review: Public consultation ESFS review: see: Public consultation, ESFS review, Background Document, [http://ec.europa.eu/internal\\_market/consultations/2013/esfs/docs/background-document\\_en.pdf](http://ec.europa.eu/internal_market/consultations/2013/esfs/docs/background-document_en.pdf); Review of the New European System of Financial Supervision, DG. Internal policies IP/A/ECON/ST/2012-23 October 2013.

The issue may be important in the application of the obligation to “closely cooperate”<sup>339</sup> and to transmit information to the ESRB<sup>340</sup>. This would mean that the ESRB – or the ECB as its secretariat - would not have free access to all information available in the ECB’s supervisory department. In that context it is useful to recall the provisions of Article 15 of the ESRB Regulation that introducing safeguards for transmitting information other than in aggregate or summary form<sup>341</sup>. Here again, a further clarification might be welcome, providing for the organisation of the information flows probably in the form of an MOU between the ECB in its supervisory capacity and the ESRB. It would be difficult to explain why the ESRB has not identified certain developments when the relevant macro information – other than individual data - was available in the other aisle of the same building.

On the other hand, the rules of the ESRB regulation would continue to apply to the ESRB requesting information from national supervisors that take part in the SSM.

With respect to the communication of information to the other ESRB members, e.g., national supervisors of different Member States, the ESA regulations provide that all ESFS members “shall cooperate with trust and full mutual respect, in particular to ensure that appropriate and reliable information flows between them”<sup>342</sup>. If the ECB can request information from the national supervisors governed by the SSM<sup>343</sup>, the reverse would apply: the ECB should provide national supervisors with the information that was specifically requested by the ECB about an individual bank or person related to that bank<sup>344</sup>. A general provision moreover allows the ECB to exchange information with national and European authorities and bodies to the extent provided for by European law especially the European supervisory directives<sup>345</sup>. But there is no general provision that enables national supervisors to request information collected by the ECB or the ESRB about the banks located in other Member States. Nor are the individual files of the ECB accessible to national supervisors; information exchange is limited by the provisions of the existing directives<sup>346</sup>. One could summarise that there will be vertical exchange of information between the ECB and the ESRB and the individual supervisors, but not among supervisors, not even through the ECB or the ESRB.

85. Some have considered that there is a contradiction with the ECB’s role in systemic matters, and its prudential tasks, or at least that this will have to be reconsidered<sup>347</sup>. However, not only is the composition of the ESRB quite different – all 28 states being represented – the powers are also substantially different: the ESRB’s power is limited to issuing recommendations and warnings, whereas the ECB has access to the full prudential toolkit. In addition, by imposing macroprudential tools, such as the imposition of additional own funds,

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<sup>339</sup> Article 3 (1), Regulation.

<sup>340</sup> Article 5 (2) limits the exchange of information received from national supervisors to “the tasks conferred on the ECB by this regulation”

<sup>341</sup> Article 15 (7), ESRB Regulation

<sup>342</sup> Article 2 (4), ESRB Regulation; see also Article 7, CRD IV.

<sup>343</sup> Articles 5(2) and 10, Regulation for SSM members

<sup>344</sup> Article 9, ESRB Regulation

<sup>345</sup> Article 27 (2), Regulation; for the ESRB, Article 15(7) ESRB Regulation would be the applicable yardstick.

<sup>346</sup> Article 27 (2), Regulation. Nor its files on monetary affairs: see Article 25 (3), Regulation.

<sup>347</sup> Coene, L, Keynote, nt. 120, 3.2; comp House of Lords, nt. 90 §159, mentioning that the impact of the SSM proposals on the ESRB have received insufficient consideration.

of countercyclical buffers or any other measures,<sup>348</sup> the ECB acts as a prudential micro supervisor but with an eye on the wider risks that may be generated by an individual bank. Individual and systemic risks are often strongly interrelated. Here, the ECB will be acting as the strong arm of the Systemic Risk Board within the SSM area, while the ESRB is in charge of analysing and identifying macro risks and call the regulators' and supervisors' attention to its recommendations and warnings. These differences in scope, tasks and tools show that there is no overlapping between the two functions.

### (iii) The relationship with the EBA

86. One of the more delicate points in the SSM reform concerns the relationship with the European Banking Authority. The explanatory memorandum to the proposal paid ample attention to the role of EBA and its continuing existence without any significant change in composition and tasks. According to the European Council 'the EBA should retain its existing powers and responsibilities'<sup>349</sup>. In the final text most of this has been dropped and transferred to the proposal modifying the EBA Regulation<sup>350</sup>. The latter has been discussed in parallel to the SSM proposal, and therefore both should be read together.

Some might have thought that it would have been logical to entrust prudential supervision to the EBA, as the latter had only started its activities in 2011, and was put in charge of inter *alia* 'contributing to (a) improving the functioning of the internal market, including in particular, a sound, effective and consistent level of regulation and supervision'<sup>351</sup>. Apart from legal reasons – the Treaty and the at that time prevailing case law under the Treaty does not allow discretionary decisions to be delegated to independent bodies<sup>352</sup> - there are serious impediments to putting the EBA in charge of the SSM: the EBA incorporates the "horizontal" cooperation of the 28 national regulators, and not only of the 18 euro-area authorities, while in the SSM there is one single authority for the significant banks acting vertically with the authority in the participating states; EBA's activities are mainly related to regulation and standard setting, not to supervision as the latter could be widely delegated to an agency; the EBA is in substance an agency of the Commission<sup>353</sup>, while the ECB will act as an independent supervisor<sup>354</sup>. One can expect the EBA to continue exercising its somewhat reformulated functions, ensuring that the regulation remains equally applicable to the 28 Member States, and thus that it does not end up splitting the internal financial market, a concern that has been vividly voiced in the European Parliament and in the House of Lords in the UK<sup>355</sup>.

## 1- Changes in the relationship EBA - National Competent Authorities including ECB

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<sup>348</sup> Article 4 (1) (e) of the Regulation referring to recovery and early intervention; see Preamble (15), referring to "macro-prudential stability".

<sup>349</sup> Council conclusions, 18 October 2012, pt 8.

<sup>350</sup> See Regulation (EU) No 1022/2013 of 22 October 2013 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation (EU) No 1024/2013, OJEU 29 October 2013, L 287/5 "amending Regulation" For the proposal: see Nt 1.

<sup>351</sup> See Article 1 (5) (a), EBA Amended regulation. This was opinion the opinion in the UK: see House of Lords, nt. 90. See Ferran-Babis, nt.1.

<sup>352</sup> This is the so-called Meroni doctrine of the ECJ, see nr.20.

<sup>353</sup> Although more independent than most other agencies

<sup>354</sup> Véron, nt. 115, proposes a political explanation: the UK wanted to have a countervailing force against an all powerful ECB. Obviously the argument has received attention in the parliament.

<sup>355</sup> House of Lords, nt. 90.

87. Apart from the numerous changes in the wording, the Amending EBA Regulation essentially modifies the balance between the EBA and its standard setting powers, and the ECB as the new powerful banking supervisor in most of the significant EU states. This rebalancing takes the form of increasing the powers of the EBA, while in some cases the relative position of the ECB as prudential supervisor is weakened. The rebalancing is however not visible in the core powers of the EBA, that will continue to be in charge of implementing regulatory work and related enforcement (Articles 10 and 17 to 19). Implementing regulations will continue to be finally adopted by the European Commission, while its enforcement actions are closely framed within Commission procedures and may ultimately result in individual decisions that will have to closely follow the wording of the directly applicable acts, avoiding much discretionary appreciation<sup>356</sup>.

The main changes to the previous EBA regulation relate to the position of the EBA in the way it exercises its competences striving at equal treatment of all supervisory bodies acting “independently and objectively and in a non-discriminatory way in the interest of the EU as a whole”<sup>357</sup>. The drafters obviously had a concern that the ECB would have been more equal than the other supervisors. Sometimes this fear has led to the opposite result: so will the ECB be represented on the Board of Supervisors of the EBA<sup>358</sup>, but without a vote, there where all national supervisors – including those of non-participating states - still have a full vote.

In this exercise of rebalancing the position of EBA and ECB, the Amending Regulation contains a considerable number of items where the EBA’s position is strengthened and this to avoid “centrifugal” forces<sup>359</sup>.

EBA is in charge of the development of a ‘European Supervisory Handbook for the whole Union’<sup>360</sup>, containing best practices in methodologies and processes might be seen as encroaching on the ECB freedom to develop its own supervisory techniques, especially as the Handbook will be included in the EBA’s peer reviews or in its assessment of supervisory practices, traditional tools allowing some ‘enforcement’ of soft law instruments. The Handbook is said to aim that supervision becomes of factor of competition between supervisors<sup>361</sup>. Reviewing the way the Handbook has been implemented may lead the EBA to advise the Commission that a ‘legislative initiative is needed to ensure further harmonisation

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<sup>356</sup> See on these topics Wymeersch, E., nt.31.

<sup>357</sup> Article 1(5), Amended Regulation

<sup>358</sup> Article 4 (c) Amended Regulation; the representative will not necessarily come from the ECB, having been nominated by the Supervisory Board. However a second representative ‘with expertise on central banking tasks’ may accompany the ECB representative (Article 4 (c.) (b) Amended Regulation)

<sup>359</sup> In that sense: de Larosière, J., *Privilégier une structure légère mais aux aguets*, Banque nr 757, February 2013, p 22. Constâncio, V., *The nature and significance of Banking Union*, London, 11 March 2013, available at: [www.ecb.europa.eu/press/key/date/2013/html/sp130311.en.html](http://www.ecb.europa.eu/press/key/date/2013/html/sp130311.en.html), considers that the stronger centralisation at the ECB will benefit the coordination role of the EBA. Troeger, nt. 2, p.5 states this “a countervail to the goal of the increasing uniformity ... of supervisory practices” p.5 and p 30 es. obviously seen as a desirable outcome. Whether that will result in having a two block coalition in the Board of Supervisors is, at least initially rather unlikely.

<sup>360</sup> See Article 8 (1) (aa) Amended Regulation

<sup>361</sup> Nouy, D., nt.199 24; Véron, N., *L’EBA, arbitre des différends entre le Royaume-Uni et l’Union bancaire*, Banque nr 757, February 2013, p 36 considering that the development of a single Handbook will be very difficult with the UK as main interlocutor. See nr. 94 about the ECB’s own declaration about these joint efforts.





of prudential definitions and rules<sup>362</sup>. The Preamble states that the Handbook will not take the form of a legally binding act and will not restrict judgment-led supervision. However, over time there is a risk that the way supervision is carried on will be dictated by the national supervisors, although the latter are not in charge anymore, at least for the significant banking groups.

The requirement to take into account different business models, types and sizes of banks<sup>363</sup> also responds to the concern that supervisors, especially the ECB, would apply a “one size fits all” approach, a fear expressed in some larger Member States. The Handbook will have to differentiate along the lines of the business models, types and sizes and changing practices.

Stress testing is likely to be another field where the two institutions will meet: as explained above, the ECB can undertake stress testing on an individual basis and as part of its regular supervision of an individual bank<sup>364</sup>. The EBA will engage in Union-wide “assessments of resilience”, obviously independently from the ECB tests, in cooperation with the ESRB, and will inform Commission, Council and Parliament<sup>365</sup>. For that purpose, EBA may address directly the banks and request national supervisors – including the ECB - to undertake on site inspections and specific examinations<sup>366</sup>.

More generally the EBA information rights have been expanded, allowing it to obtain information directly from banks, holding companies, branches and non-regulated entities within a group<sup>367</sup>.

The EBA will support the development of more efficient supervision by promoting joint supervisory plans and joint examinations in which staff of the EBA will take part.<sup>368</sup> In the colleges of supervisors, its past action will be supplemented with the right to convene the college. It will promote convergence in the Pillar 2 processes<sup>369</sup>.

All this will require the EBA to be armed with additional resources, both in terms of human resources and financial means.

## 2- Changes in the EBA Governance

88. As the balance of power between the participating and the non-participating states will be considerably affected, special attention has been paid to the governance arrangements within the EBA.

The SSM regulation<sup>370</sup> states that ECB will be participating in the EBA Board of Supervisors, referring to Article 40 of the EBA Regulation where it is stated that an ECB

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<sup>362</sup> Nouy, D., nt. 199 p 24, who sees it as an instrument to support equal competition especially between the centre and the “periphery”.

<sup>363</sup> See Article 8 (1a) (b) Amended Regulation.

<sup>364</sup> See Article 44, EBA Amended Regulation, see nr. 45 and nt.185.

<sup>365</sup> Article 22 (1a) EBA Amended Regulation.

<sup>366</sup> See Article 32 (3a) and (6) Amended Regulation. See preamble 4(c) making it clear that objections do not suspend the duty to respond. Disputes have to be brought before the ECJ. See for the ECB stress tests, nr. 45

<sup>367</sup> See Article 35 (6), Amended Regulation.

<sup>368</sup> Article 21, Amended Regulation.

<sup>369</sup> Article 20 a, Amended Regulation.

<sup>370</sup> Article 3 (2), EBA Amended Regulation.

representative will be nominated by the Supervisory Board, therefore not necessarily a person functioning within the ECB. Unless this representative would be assimilated to a national supervisor<sup>371</sup>, he will have no voting right<sup>372</sup>. But it would be rather unfortunate if the ECB representative would be a member of a national supervisor that is already represented on the Supervisory Board. The ECB representative will be sitting next to the national supervisors but will not be entitled to vote, what seems quite extraordinary.

He may be “accompanied” by someone “with expertise on central bank tasks”. The ECB representative will not speak on behalf of the 18 jurisdictions for which it has supervisory capacity, and may be confronted with divergent views from these Member States, what is certainly not conducive to well balanced regulation<sup>373</sup>. On the other hand, it is not unlikely that over time the relative weight of the ECB in this debate will substantially change the EBA dialogue as the latter might essentially focus on the relation with the supervisors of the non-participating states<sup>374</sup>.

When the Board of Supervisors discusses items relating to individual financial institutions, these are not attended by the non-voting members of the Board. Here an exception is made for the representative of the ECB Supervisory Board, as he, and the EBA chairperson and the executive director are entitled to attend that meeting<sup>375</sup>.

89. The importance of the adapted decision making procedures in the EBA’s Board of Supervisors calls for special attention, as it was one of the core elements for convincing certain Member States and the European Parliament to accept the entire SSM. The original and amended EBA regulation both stipulate that decisions are, in principle, adopted by the Board of Supervisors, i.e. by the 28 national regulators by simple majority, without distinguishing the votes of participating or non-participating Member States. This principle is maintained for all matters except the ones mentioned below.

The principle is modified in the sense that for the regulatory matters (Article 10 to 15) a qualified majority is needed, but within this qualified majority a simple majority of participating states, and a simple majority of non-participating states have to be found. Within the Union with 18 participating states, this will considerably increase the relative influence of the 10 non-participating states what may negatively affect their willingness to enter into an agreement of “close cooperation”. This regime will apply to decisions on implementing regulations, on recommendations and decisions to prohibit or suspend particular financial services<sup>376</sup>. For decisions to be taken on the basis of the provisions of “Breach of Union law” “Emergency Decisions“ and “Dispute Settlement”, a simple majority will suffice, but here

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<sup>371</sup> Article 40 (1) (b), EBA Amended Regulation

<sup>372</sup> Article 40 (1)(d), EBA Amended Regulation

<sup>373</sup> The draft regulation gave the ECB the power to “coordinate and express a common position” for the participating Member States: Article 4 (1) (1) of the draft SSM Regulation, nt 1; also Explanatory Memorandum to the Commission’s proposal 4 2 1. See ECB, Opinion, nt.1, pt 1.10, according to which the ECB will try to obtain a common opinion. This approach has been abandoned by the Parliament in the final version, restoring the full freedom of the competent authorities of the participating Member States to agree on subjects within the EBA’s competence.

<sup>374</sup> This fear was repeatedly expressed in the House of Lords Report, nt.90. The House of Lords stated that voting rights should be proportional to the relative significance of the financial markets in the different Member States. Comp. Article 10, Protocol on the Statute of the European System of Central Banks, and of the European Central Bank, [https://www.ecb.europa.eu/ecb/legal/pdf/en\\_statute\\_2.pdf](https://www.ecb.europa.eu/ecb/legal/pdf/en_statute_2.pdf).

<sup>375</sup> Article 40 (4), EBA Amended Regulation.

<sup>376</sup> See Articles 10 to 16 and 9 (5), EBA Amended Regulation on the basis of Article 44.



again within this simple majority, a simple majority of the group of participating states is needed, as well as a simple majority in the group of non-participating states<sup>377</sup>.

However, as it is expected that over time the number of non-participating states may shrink, a further guarantee has been provided, whereby if there remain only four or less non-participating states in the EU, decisions will be adopted by simple majority including at least one non-participating state. The system should be translated to the real facts and means that in any case the UK as the most likely long-term dissenter, will have to concur on the proposed measure even after all other states have joined the SSM. This effective blocking position comes down to the ECB having to negotiate directly with the dissenting state, probably with the EBA as a mediator.

A review clause has been included in the Regulation dealing with this extraordinary arrangement: as soon as there only four non-participating states left, the Commission will come forward with a report on the matter with a proposal to review it. But it is difficult to see how the system could be reviewed without a more radical overhaul of the entire distribution of powers in the European regulatory and supervisory area. Only time can tell...

### 3- Changes in the EBA legal competences

90. The amended Regulation does not introduce changes in the legal competences of the EBA in the field of developing implementing regulation, leaving unchanged the Articles 10 to 15 especially dealing with Regulatory Technical Standards and Article 16 on Guidelines and Recommendations. These will have to be adopted by qualified majority, as explained above. An issue may arise in cases in which the ECB sees a need for adopting an internal regulation, or a recommendation, when that view is not shared by the EBA members: could it act on its own. For matters within its supervisory mandate<sup>378</sup>, the answer is likely to be positive, but in matters outside its mandate, the initiative lies with the EBA.

Changes have been adopted with respect to the three other legal competences of the EBA, i.e. on 'Breaches of Union law' 'Emergency situations' and 'Settlement of disagreements' (Articles 17, 18 and 19)

91. In case of 'Breaches of Union law' by a national supervisor, the EBA is entitled to act and, under the formal control of the Commission, officially establish the breach, after which it may impose its view on the banks in that jurisdiction, but only within the limits of a directly applicable acts and in conformity with the formal opinion of the Commission<sup>379</sup>. New is the requirement that an independent panel will have to be installed<sup>380</sup>, composed of members of the EBA Board of Supervisors who are not involved in the matter, in charge of proposing a decision to the Board of Supervisors. This mechanism would submit the ECB to its peer supervisors, including the supervisors from SSM jurisdictions. As the Supervisory

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<sup>377</sup> Articles 17, 18 and 19 of the EBA amended Regulation. For the composition of the conflict resolution panel, a supermajority of  $\frac{3}{4}$  of the voting members is required, eliminating the need for the double simple majority: Article 44(1), (6), EBA amended Regulation.

<sup>378</sup> See nr 14.

<sup>379</sup> See Article 17 (6) and (7) EBA Amended Regulation; For details see: Wymeersch nt. 31

<sup>380</sup> Article 41 (1a), EBA amended Regulation. By consensus within the Board of Supervisors, and if not possible, by a  $\frac{3}{4}$  vote: art 44, (6) Amended Regulation.



Board is a - although not voting - member of the Board of Supervisors, it can not be part of the Panel, judging breaches in states other than the SSM states.

In the field of emergency action<sup>381</sup>, the Regulation already provided that the EBA may ‘adopt individual decisions requiring competent authorities to take the necessary action (...) to address any such developments by ensuring that financial institutions and competent authorities satisfy the requirements laid down in that legislation.’ Here again orders may be addressed to the ECB, as a “competent authority” although as a central bank, it will necessarily be involved in emergency matters, while the ESRB may also be involved in the decision making process<sup>382</sup>. The relationship between these three bodies – EBA, ECB, and ESRB – will have to be clarified in later discussions.

92. The third field of action of the EBA concerns “dispute settlement”, referring to disagreements between supervisors in a cross border context. The EBA intervenes in dispute resolution between national supervisors, calling on a panel similar to the one mentioned above.<sup>383</sup> In these cases the EBA may take directly applicable decisions, addressed to the competent authorities concerned or in case of non-implementation, to individual market participants<sup>384</sup>. However the room for discretion in the EBA’s decision is very limited: its action can only relate to provisions that are directly applicable, indicating that these are the rules that would be applicable in any case, but where the unwillingness of a national supervisor to enforce them stands in the way of effective application. It also means that the EBA is not applying additional rules, but merely holds the financial institutions to the existing, and already applicable rules<sup>385</sup>. One can expect more recent directive to follow a less strict reading.

Will the dispute resolution mechanism be applicable to conflicts between participating supervisors and the ECB, whether the latter is the supervisor for significant banks or when the national supervisor is the first line supervisor, under the general monitoring oversight of the ECB? As mentioned, the provision only applies to cross border disputes and therefore it could not be applied in case the ECB is the leading and legally only competent supervisor. Hence difficulties of interpretation of national law could not be dealt with on the basis of Article 19 of the EBA Regulation. The situation is probably different for cases where the supervision has remained in charge of the national supervisor, i.e. for the less significant banks. But in these cases the ECB has no effective supervisory powers, except after having pre-empted the national supervision, in which case the bank would come under direct ECB supervision. Conflicts between the national supervisor and the pre-empting ECB would therefore not qualify for the dispute resolution system, as at any moment in time one of the parties was not in charge of supervising these less significant banks.

On the basis of this analysis, the provision of Article 19 can only be applied to disputes between the ECB and supervisors of non-participating states, or between national supervisors of different states.

93. Within the SSM, there is no mechanism for settling disputes between supervisors, as the Governing Council would ultimately arbitrate differences of opinion. Its decision is

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<sup>381</sup> Article 18, EBA amended Regulation.

<sup>382</sup> See Article 18 (2), EBA Amended Regulation.

<sup>383</sup> On the basis of Article 19(4) of the EBA Amended Regulation.

<sup>384</sup> Article 19 (3) and (4), EBA Amended Regulation

<sup>385</sup> See Wymeersch, nt. 31. § 9.102.

open for review by the ECJ. As mentioned above the Administrative Board of Review can only act on the request of an aggrieved “natural or legal person”. Conflict resolution with national supervisors has not been provided for, highlighting the pre-eminence of ECB decision making for the directly supervised banking groups. With respect to their national supervisory duties e.g., for the less significant banks, the national supervisors have no legal right of appeal to the ECB. The ECB may however act as an informal voluntary mediator, if necessary using its pre-emptive powers allowing it to step in.

Whether the same reasoning should be applied in the case of disputes with the non-euro participating states is debatable: one could argue that this regime emulates that of the euro-SSM and therefore there is no room for mediation or conflict resolution in this case as well. The exit right for these participating states is an important factor for arriving at a workable solution in case of a conflict, as a termination is rather a blame for each of the parties involved. Mediation should then be voluntary.

## 9. Entry into force and Transition to the SSM

94. The new supervisory system will not become operational overnight: its full rollout may take several months if not more. The final date for full implementation has been set: 4 November 2014. However this date can be postponed if it would appear that the ECB is not fully ready<sup>386</sup>. In the meantime, Parliament, Council and Commission will have to be kept informed on a quarterly basis about progress in the implementation.

This transition period starts with the publication of the Regulation on 29 October 2013, which will then enter into force the 5<sup>th</sup> day after its publication, i.e. 3 November 2013<sup>387</sup>. From then on several work streams will become operational, although preparation has been started about one year earlier. Some of the preparatory steps have been commented on by members of the Executive Committee of the ECB and will be briefly summarised here:  
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- the leading staff will have to be appointed, consisting of 4 directors general and six deputy directors, A public call for candidates has been published. Four directorates general will be constituted as follows

- 2 Directorates General (DGs Micro-Prudential Supervision I and II) in charge of the direct and ongoing supervision of the systemic banking groups;

- a Directorate General (DG Micro-Prudential Supervision III) in charge of the indirect supervision of the less significant groups;

- a Directorate General (DG Micro-Prudential Supervision IV) will perform horizontal supervision and specialised expertise functions, such as supervisory quality assurance, methodology and standards development, enforcement licensing including sanctions, capital market risk analysis, crisis management and model validation.

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<sup>386</sup> See Article 33 (2)(4), Regulation.

<sup>387</sup> See Article 33, Regulation, 3 October being a Sunday, should it not have been the 4<sup>th</sup> ?

<sup>388</sup> Based on speeches by Mersch, Y, *Neueste politische Entscheidungen zur Bankenunion und ihre Auswirkungen auf die EZB als Aufsichtsbehörde*, Speech, 24 September 2013, *A regime change in supervision and resolution*, 26 September 2013; Asmussen, J., *Reintegrating financial markets*, Speech, 14 June 2013; Asmussen, J., *Building Banking Union*, Speech, 9 July 2013





- The operational arrangements will be prepared and published, at the latest before 4 November 2014. This would apply especially to the Framework - to be finalised before the 4<sup>th</sup> of May 2014 - and to the Supervisory Manual, that will be fully consistent with the EBA Handbook.
- Joint supervisory teams will be constituted, with mixed composition, one for each significant banking group. But on-site inspections, at least on a yearly basis, would be conducted by national teams
- The Supervisory Review and Evaluation Process (SREP) as developed by EBA will also be applied by the ECB<sup>389</sup>
- The next most important immediate exercise is the Comprehensive Assessment, including a Risk Assessment, Balance Sheet Assessment and an Asset Quality Review<sup>390</sup>. Although all banks could be included, at least the significant ones will be viewed. This assessment will call for uniform valuation bases and be comprehensive of all activity of the banking group. It will be based on the EBA criteria;
- The results will serve to determine the position of the ECB with respect to banks that it considers too weak to be included in the SSM from the beginning.
- It will also be used to feed into the stress test that the EBA intends to undertake with respect to all Union banks. Coordination will be necessary.
- It is not clear from the Regulation whether the ECB has a right of refusal of a banking group as being too weak to be included in its supervision. The Regulation only provides for a postponement of the date from which it will exercise its full supervisory duties, and that for essentially operational reasons. Therefore it would be debatable whether the ECB could declare one or several institutions unfit for being supervised according to the SSM.
- The ECB made it clear that it will not take on the job if the situation has not been mended, or sufficient backstops are in place. Recapitalisation through the market, by applying bail-in procedures, by capital contributions of the national states are mentioned. The Council of Ministers has announced that it will come forward with “adequate measures”<sup>391</sup>. As long as the SSM is not in place, the ESM is not entitled to take part in a bank’s recapitalisation, but intermediate formulas – such as promises to support recapitalisation - have been adopted in the case of Spain.
- If none of these would be sufficient, the ECB may still consider to withdraw the authorisation, on its own initiative or at the request of the national supervisor<sup>392</sup>. This decision would in principle bring that bank under the jurisdiction of the national resolution authority.

Although the directives on Recovery and Resolution and the Regulation of the SRM have not yet been adopted, the ECB has declared repeatedly that it should not be involved in Resolution, and that a separate agency should be put in charge of the resolution decision and process. But it is of the opinion that the insolvency decision itself should be of the

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<sup>389</sup> See for the EBA <http://www.eba.europa.eu/regulation-and-policy/supervisory-review-and-evaluation-srep-and-pillar-2>

<sup>390</sup> See: decision of the ECB 4 February 2014 identifying the credit institutions that are subject to the comprehensive assessment 4 February 2014 (ECB/2014/3); on AQR see also: Mersch, Y., On the road to a banking union: the way forward from the ECB’s perspective, 18 November 2013 and Mersch, Y., Mastering the crux of defragmentation, Speech, 29 November 2013

<sup>391</sup> See Council 24-25 October 2013, 139197.pdf. “Member States should make all appropriate arrangements, including national backstops, applying state aid rules.”

<sup>392</sup> Article 15 (3), Regulation. There is no explicit indication that a withdrawal could only take place if a bank no longer fulfils the minimum requirements for its authorisation.



competence of the banking supervisor, in this case the ECB<sup>393</sup>.

During the transition period, the national supervisor will remain fully in charge and could adopt all necessary supervisory measures, and this until 3 November 2014. The ECB will be entitled to receive ‘relevant’ information in order to prepare itself for its future charge. During that period, it cannot adopt supervisory measures, but may start investigations. This request for information could include the ‘comprehensive assessment’, mentioned above.

The Regulation provides for two cases where the new regime will apply before its official application. Straight from the first date of entry into force and during the entire transition period, the ECB may start general implementation with respect to any banking group, the national supervisor and the bank being duly informed. The choice for a particular group is in the full discretion of the ECB. The ECB could also launch its first investigation in these cases. However, individual supervisory decisions would still remain within the remit of the national supervisor. The second case concerns banks for which the ESM requests the ECB to start its supervision for banking groups that are planned to be directly recapitalised by the ESM<sup>394</sup>.

## 10. Conclusion

95. The Banking Union is one of the key building blocks aimed at putting the financial system in the euro area back on its feet. With the approval of the Regulation on the Single Supervisory Mechanism, the first important hurdle has been taken, but some equally if not more difficult reforms are in the waiting before one could conclude that the risks of the banking system have definitely shifted away from the taxpayers. The next crucial steps are the Asset Quality Review and the introduction of effective risk backstops: these should first be sought in the individual banking institution in the form of effective bail-in liabilities, and if insufficient in the resolution and other support funds that will be introduced within a couple of year. Beyond that support will have to be drawn from a broader base of national or international public sources. The proposals for a Recovery and Resolution directive and for a Deposit Guarantee directive - along with the introduction of a Single Resolution Mechanism for the euro area - are the next indispensable steps from that perspective<sup>395</sup>. As the SSM will not enter into full force before November 4, 2014, these instruments should have been approved by then. In the meantime, the ECB might understandably be reluctant to accept prudential supervisory duties without being assured that it will not be confronted with ailing banks, raising the dilemma that its refusal will further keep in existence the present banking supervisory system, the latter being at risk without a safety belt. Pre-entry recapitalisation

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<sup>393</sup> Assmussen J., Auf dem Weg in die Bankenunion – Bestandsaufnahme aus Sicht der EZB, Speech, Frankfurt, 4. September 2013; see article 27 (1) BRRD, where the supervisor has been declared competent for declaring that the bank is failing or likely to fail, but the resolution action is decided by the resolution authority. But national law may also declare the resolution authority is competent, after having consulted with the supervisor, provided it has the adequate tools to establish that the bank is failing or likely to fail.

<sup>394</sup> Article 33(3), Regulation.

<sup>395</sup> This point is stressed by most writers: With a slight taint of scepticism, see Huertas, Th., Banking Union: What Will it Mean for Europe? DSF Policy Paper, No. 29, November 2012; Huertas, T. F., & Nieto, M. J. (2012). Banking union and bank resolution: How should the two meet? <http://www.voxeu.org/Article/banking-union-and-bank-resolution-how-should-two-meet>, 26 August 2012; Wyplosz, C. (2012). Banking union as a crisis-management tool, considers that the SSM without RRD is a danger in itself: T. Beck (Ed.), Banking Union for Europe: Risk and Challenges (pp. 9-14). London: Centre for Economic Policy Research. [www.frsn.de/fileadmin/research/studien/2012/VoxEU-CEPR\\_Banking\\_Union\\_10-2012\\_kl.pdf#page=21](http://www.frsn.de/fileadmin/research/studien/2012/VoxEU-CEPR_Banking_Union_10-2012_kl.pdf#page=21)



should be feasible in most cases, but one can not exclude that explicit state support will be needed before certain banks can be included in the SSM.

This does not mean that this first step is less important: over the longer term and once the financial system is better stabilised, it will be considered one of the turning points in European financial history, comparable to the introduction of the euro, both powerful long term instruments in the integration of the Union. For today's purposes, it gives a strong signal to the markets that financial reform is forthcoming, and that there is room for renewed confidence.

96. The implementation of the SSM will be a daunting task. The ECB will have to discuss with many parties at the same time: apart from the regulatory discussions with the European legislators, it will have to enter into dialogue with the national central banks of both the euro area and of the non-euro area banks. There are likely to be solid discussions about the powers to be allocated to the SSM and to the European players in the field. MOUs should be initiated with the non-participating states, e.g. the UK, and with third countries, especially the US. Here again, the centralisation of competences is likely to be a game changer.

At the same time the staff will have to be hired, initially a rather limited group, often seconded from the national supervisors, later increasingly own staff. It is likely that it will take several years to find experienced staff from all involved Member States. The staff will have to negotiate official agreements about the scope of the SSM, the supervisory programmes and the relations between the ECB and the participating national supervisors.

. The SSM Regulation as it has now been adopted is the result of a number of political compromises. Some of these have somewhat diluted the original project as submitted by the Commission. But all in all, the Regulation still is a considerable achievement, taking into account the strong divergent views and the urgency with which – at least initially – the document has been negotiated between the European legislators.

At the conceptual level, the Regulation has suffered from legal restraints, among which the restrictions on delegating powers (the *Meroni* doctrine) are a major stumbling block. This constitutional concept dates from the early days of the Rome Treaties, and is in an urgent need of being updated or at least repaid. Powerful voices claim for a Treaty review, a necessary but risky exercise. A recent ECJ decision creates new hope for a more workable solution.

The SSM has also suffered from its limitation to the euro area, creating tensions with the non-euro candidates for participation in the SSM, but also leading to political rebalancing with the non euro-area. This aspect has led to the presence of three bodies in charge of prudential matters, the Commission as regulator, the EBA as coordinator and the EBC as supervisor. The scheme is not necessarily a recipe for coherence and efficiency especially as the EBA's powers have been extended and may hamper the ECB in deploying its full supervisory strength. The compromise for majority voting in the EBA Regulation does not deserve a first prize in any beauty context.

The Regulation presents some governance weaknesses, some of which were mentioned in the preceding analysis. Some of these weaknesses are due to Europe's particular constitutional organisation, where Member States keep a large part of power.<sup>396</sup> The internal

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<sup>396</sup> The comparison was sketched by Whyte, Ph, A Banking Union – it is necessary, but is it likely? 27 July 2012 Centre for European reform, available at: [www.cer.org.uk/publications/archive/bulletin-Article/2012/banking-](http://www.cer.org.uk/publications/archive/bulletin-Article/2012/banking-)

institutional built-up within the ECB is far from clear: the relationship between the Governing Council and the Supervisory Board will require quite some adroitness to avoid undermining the Governing Council authority without making the Supervisory Board ineffective. Both bodies are dominated largely by the same, national representatives: will they be able to act in the interest of the Union, as a whole, or give priority to the national interest? Will the Governing Council overcome the particular interests that may have inspired the Supervisory Board? The Governing Council's "negative voting" on Supervisory Board proposals is equally low in the beauties' gallery, and may hamper the Governing Council's thorough monitoring of the Supervisory Board's decision. The absence of representatives of the non-euro participating states has received a more or less workable answer, but the entire position of these states in the SSM remains touchy. The fact that judicial review against final decisions exclusively runs to the ECJ is only workable if the number of complaints remains limited, but knowing the lawyer's creativity, one should not be too sure.

The relationship with the national supervisors will be one of the crucial elements in the further development of the Mechanism: on the one hand there is understandably quite some concern that the national supervisors will be eliminated from the most challenging part of the supervisory tasks, on the other at least for the foreseeable future the ECB will have to rely on the expertise and intimate knowledge of the staff of the national supervisors<sup>397</sup>. At the same time, being more distant from the supervised entities, the ECB should be able to adopt a more rigorous position, putting all supervised entities on the same footing. Flexibility and change over time are the key concepts here, but at least the ultimate objectives and resulting responsibilities have been clearly laid down.

The SSM has been worked out in a formal Regulation, as the only way to achieve the same outcome in each of the 18 participating states. For the same reasons one can expect a more frequent use of regulations (see CRR, Emir, Mifir, CRA and so many others, in other words, the European Rule Book) as only these can support the integration of the financial markets. But the present regulations lead to a clear overload, excessive technicalities and formal procedures that obfuscate the issues and try to predict all hypotheses in advance, reducing the room where judgment is most needed. Will this not hamper effective prudential supervision, running the risk of introducing box ticking and formal controls? Form may win over substance. Moreover, the more detailed a regulation is, the more litigation it triggers. It might be advisable to regulate by principle, more than by fine detail.

As so many other great projects in the EU, the SSM is a path for further action and evolution. A certain number of aspects will have to be revisited over time, once more experience has been gathered with the present system and other components have been put in place. It is however essential that today matters start moving, with a view on the longer time issues but not losing out of sight the present needs for stability and confidence.

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union—it-necessary-it-likely.

<sup>397</sup> Some of these issues are being consulted on by the ECB: see Draft Regulation of the European Central Bank nestablishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) February 2014, public consultation.



To paraphrase Mario Draghi, as the euro, the SSM “*is born out of the commitment of European nations to closer integration – a commitment - ... - which, has roots in our desire for peace, security and transcending national differences*”<sup>398</sup>.

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<sup>398</sup> Draghi, M, Europe’s pursuit of ‘a more perfect Union’, speech at the Harvard Kennedy School, 9 October 2013



# Financial Law Institute

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