ARTICLES

THE EUROPEAN CENTRAL BANK (ECB) AS A CATALYST FOR CHANGE IN EU LAW. PART 1: THE ECB'S MANDATES

Marco Lamandini[*]
David Ramos[**]
Javier Solana[***]

Abstract

The sovereign debt crisis in the Eurozone has evidenced the shortcomings of financial supervision and regulation in the EU. In the summer of 2012, at the height of the crisis, and in the absence of a clear protector of financial stability in the Eurozone, it was the bold pledge of the President of the European Central Bank (ECB) to do "whatever it takes to preserve the euro" that managed to restrain contagion. But did the ECB really have the power to act as the safeguard of financial stability in the Eurozone?

EU Policy makers have reacted to those shortcomings by introducing deeply transformative changes in financial regulation. The birth of the Banking Union might be the paramount example. In the institutional landscape arising from the Banking Union, the European Central Bank (ECB) stands as a central player, especially as the competent authority for the prudential supervision of the most significant credit institutions in the Eurozone. Yet the scope of its new powers as the guardian of financial stability is unclear. For example, in the event of another financial crisis, could the ECB provide financial assistance to credit institutions facing liquidity problems as a Lender of Last Resort (LOLR)? In this paper, we look at the ECB's core mandates in the Treaties to delineate the scope of those new powers.

Unlike monetary policy, financial stability is not a core mandate of the ECB under the TFEU. We begin by exploring whether the ECB could perform LOLR functions within its core mandates; particularly, within its mandate of monetary policy. For that, we delve into the recent decision of the CJEU in

[*]Professor of Commercial Law, University of Bologna.
[**]Senior Lecturer in Commercial Law, Carlos III University of Madrid.
[***]Lecturer in Commercial Law, University of Glasgow. A working version of this Article was prepared for the ECB Legal Research Programme. The views expressed in this paper are those of the authors and do not necessarily represent those of the ECB.

Gauweiler and others v. Deutscher Bundestag and Bundesregierung, and propose a framework to define the scope of the ECB's monetary policy mandate. We then examine the prudential supervision powers conferred on the ECB under the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM), and explore the possible limitations arising from the distribution of competences at the vertical and horizontal levels. We conclude with an analysis of the limitations that may arise if the ECB's powers on prudential supervision were to clash with its monetary policy mandate.

INTRODUCTION

Recent changes in the institutional environment of the EU have created a sort of *economic superhero* in the European Central Bank (ECB). In July 2012, as a result of an improbable chain of events, the President of the ECB, Professor Mario Draghi, entered "uncharted waters"[1] by pledging to do "whatever it takes to preserve the euro."[2] In practice, this positioned the ECB as the ultimate guarantor of the single currency, financial stability, and the EU as we know it. This pledge was based on the ECB's sheer credibility. After frantic legislative activity, the pledge was accompanied with more tangible powers, which resulted in the Banking Union, with its Single Supervisory Mechanism (SSM) and Single Resolution Mechanism (SRM), and its overhaul of competences.[3] The result? The ECB has been given unprecedented powers that place it at the center of the EU's economic constitution and governance.

With great power comes great responsibility, and there is a need to assess the limits that will check the ECB's new powers. These limits stem from two different sources: first, the mandates of the ECB and the division of competences envisaged in the Treaties, the Statute of the European System of Central Banks (ESCB) and of the ECB (the Statute),[4] and the SSM/SRM rules;[5] second, fundamental rights. In this paper, we explore the limits arising from the first source. We explore the limits arising from fundamental rights in a second Article.[6]

Article 127 TFEU defines a series of "tasks" to be carried out by the ESCB.[7] For the purposes of this paper, we shall refer to these tasks as "core mandates." These core mandates include monetary policy, foreign exchange operations (in accordance with article 219 TFEU), management of the official foreign reserves of the Member States, and the promotion of the smooth operation of payment

---

[1] In April 2015, when renewed fears of a Greek debt default threatened to bring about the country's exit from the euro, Mario Draghi used the term "uncharted waters" to describe the situation where the instruments legally available to the ECB to tackle such a crisis would not be enough. *See* Sam Fleming & Chris Giles, *Draghi says Eurozone has tools to deal with Greece crisis*, FIN. TIMES, Apr. 18, 2015, http://www.ft.com/cms/s/0/517ba66c-e5ef-11e4-ab4e-00144feab7de.html#axzz3wZpWg6F0. We use the term here in retrospect: when the Eurozone debt crisis erupted, there was some level of uncertainty about the availability of certain instruments, such as outright monetary transactions, to the ECB for the purposes of reining in contagion in the Eurozone. The CJEU clarified this issue in its *Gauweiler* decision. *See infra* Part I.B.1.a.

[2] *See* Mario Draghi, President of the European Central Bank, Speech at the Global Investment Conference in London (July 26, 2012), https://www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html (last visited Jan 11, 2016).

[3] For a brief description of the political process leading to the Banking Union, see *infra* Part II.A.1.

[4] Protocol (No 4) on the Statute of the European System of Central Banks and of the ECB, Oct. 26, 2012, 2012 O.J. (C 326) 230 [hereinafter Statute of the ESCB and of the ECB]

[5] Council Regulation 1024/2013/EU, Conferring Specific Tasks on the European Central Bank Concerning Policies Relating to the Prudential Supervision of Credit Institutions, 2013 O.J. (L 287) 63 [hereinafter SSM Regulation]; Parliament and Council Regulation 806/2014/EU, Establishing Uniform Rules and a Uniform Procedure for the Resolution of Credit Institutions and Certain Investment Firms in the Framework of a Single Resolution Mechanism and a Single Resolution Fund, 2014 O.J (L 225) 1. [hereinafter SRM Regulation].

[6] *See* Marco Lamandini, David Ramos & Javier Solana, *The ECB as a Catalyst for Change in EU Law. Part II: SSM, SRM and Fundamental Rights* 23 COLUM J. EUR. L. (forthcoming 2017).

[7] The ESCB is composed of the ECB and the national central banks of all EU Member States. It must not be confused with the Eurosystem, which comprises the ECB and the national central Banks of those EU Member States that have adopted the euro. *See* Statute of the ESCB and of the ECB, *supra* note 4, art. 1.

systems. *Prima facie*, EU primary law does not confer the ESCB any specific competences on financial stability, i.e. prudential supervision and Lender of Last Resort (LOLR) functions. Any powers in that regard would have to come from other legal sources.

Pursuant to article 127(6) TFEU, the Council might confer on the ECB certain tasks "concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings."[8] These tasks, however, will need to be granted to the ECB by means of secondary legislation, such as the SSM Regulation. Powers for the protection of financial stability, like the provision of LOLR assistance to individual financial institutions, do not have an apparent grounding in the EU Treaties.

Experience shows that, if a central bank is to be effective, it must have a significant amount of independence in decision-making, which confers a degree of discretion.[9] Furthermore, in times of crisis, governments and courts may be less squeamish about the process as long as stability is preserved. Today, in the wake of the recent sovereign debt crisis in the Eurozone, an analysis of the limits to the ECB's newly conferred powers is pertinent. This is not to say that the system was ill-founded or is impervious to change; it would be unrealistic to think that, after momentous reforms, the ECB's new role may not give rise to a new constitutional equilibrium of competences. The *economic constitution*, however economic it may be, is a constitution nonetheless. Thus, *competences* and *discretion* need to be carefully delineated to prevent departures from the rule of law, as is the case in fields where there is a confluence between Member States and the EU. This process of delineation offers a unique opportunity to explore the meaning of *discretion* in different institutional contexts, thanks to the diversity of powers now available to the ECB, and the diversity of constitutional and legislative foundations for those powers.

In Part II, we explore the boundaries of the ECB's mandate of monetary policy as defined in the Treaties, and their implications when the ECB exercises its powers for financial stability purposes, with a special reference to the recent *Gauweiler* case.[10] In light of this analysis, we explore the possibility of fitting LOLR powers within the ECB's core mandates. In Part III, we examine the limitations of the ECB's new powers relating to prudential supervision in the context of the Banking Union, and their implications when the ECB uses those powers to "regulate," or, rather, to exercise the options conferred by prudential rules to harmonize prudential regulation. In particular, we focus on the possible limitations of those powers arising from the vertical and horizontal distribution of competences within the SSM and the SRM. In Part IV, we explore the possible scenarios where the ECB's monetary policy mandate and new supervisory powers might come into conflict. Part V concludes.

---

[8] Treaty on the Functioning of the European Union, art. 127(6), Oct. 26, 2012, 2012 O.J. (C 326) 1 [hereinafter TFEU].

[9] *See, e.g.*, Alberto Alesina & Lawrence H. Summers, *Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence*, 25 J.M.C.B. 151, 151–162 (1993).

[10] Peter Gauweiler & Others v. Deutscher Bundestag, Case C-62/14, EU:C:2015:400.

I. THE CORE MANDATES OF THE ECB AND THEIR IMPLICATIONS FOR FINANCIAL STABILITY

A. *Is Financial Stability Part of the ECB's Mandate?*

Unlike central banks that have a broad constitutional mandate, or those with *financial stability* recently added to their mandates,[11] the ECB's constitutional mandate is rather narrow. Article 127(2) of the TFEU enumerates the basic tasks the ESCB will carry out: (i) "to define and implement the monetary policy of the Union," (ii) "to conduct foreign-exchange operations consistent with the provisions of Article 219," (iii) "to hold and manage the official foreign reserves of the Member States," and (iv) "to promote the smooth operation of payment systems."[12] For the purpose of this paper, we will refer to the tasks expressly enumerated in article 127(2) TFEU as *core mandates* or *core competences* of the ECB because they are grounded on EU primary law.

Tasks relating to the protection of financial stability, such as measures of financial assistance to individual institutions as part of the LOLR function, or tasks relating to prudential supervision, are not included in article 127(2).[13] The recent conferral of supervisory powers on the ECB under the SSM Regulation was effected via secondary legislation in accordance with article 127(6) of the TFEU. Indeed, article 127(6) of the TFEU provides that, "in accordance with a special legislative procedure," the Council may grant the ECB specific tasks "relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings" by means of regulations.[14] The SSM Regulation is one such regulation.

The SSM Regulation refers expressly to "financial stability" as a "goal" of prudential supervision.[15] As a result, we can affirm that financial stability has become part of the ECB's responsibilities. However, the SSM Regulation does not frame financial stability as a "competence" of the ECB. This could cast doubt on the ECB's ability to use its financial stability responsibility to exercise new powers. Since financial stability does not form part of the ECB's core mandate, it should not constitute, in principle, a separate and autonomous constitutional basis for the exercise of powers beyond those contemplated under the SSM Regulation. As a result, the ECB's potential powers relating to financial stability, like the provision of LOLR assistance to individual financial institutions, do not appear to have a clear grounding in the EU Treaties.

In light of this conclusion, a different question would be whether the ECB's core mandates, primarily, monetary policy, could serve as a source of new powers for the ECB to stand as the guardian of financial stability. We will explore this question in detail in the following sub-sections. We will look first at the possibility

---

[11] *See* DIEGO VALIANTE, KAREL LANNOO, COSMINA AMARIEI, DAVID RAMOS MUÑOZ, MARTA GARCIA DE VICUÑA UNDA, MARCO LAMANDINI, ALESSANDRO POMELLI & FRANCESCA PELLEGRINI, COMMISSION STUDY ON EXEMPTIONS FOR THIRD-COUNTRY CENTRAL BANKS AND OTHER ENTITIES UNDER THE MARKET ABUSE REGULATION AND THE MARKETS IN FINANCIAL INSTRUMENTS REGULATION 48–50 (2014) for a comparative overview.

[12] TFEU, art. 127(2).

[13] *Id.*

[14] *Id.*, art. 127(6). *See also* Statute of the ESCB and of the ECB, *supra* note 4, art. 25(2).

[15] *See, e.g.*, SSM Regulation, *supra* note 5, art. 1, rec. 27, 30, 55.

of the ECB fitting LOLR powers within its monetary policy mandate, and then look at the possibility of fitting those powers into other core mandates.

B. How Far into "Uncharted Waters"? Fitting Unconventional Measures into the Monetary Policy Mandate

A central bank's "unconventional measures" try to ensure financial stability beyond inflation. LOLR functions are a prominent example of such unconventional measures. In the recent *Gauweiler* case, the Court of Justice of the European Union (CJEU) and the German Federal Constitutional Court (FCC), which was the referring tribunal, explored, for the first time, the boundaries of the monetary policy mandate that the EU Treaties confer on the ECB. We will begin by analyzing this landmark decision and its implications for the definition of the scope of the ECB's monetary policy mandate (1). In light of that analysis, we will then examine whether such monetary policy mandate could fit financial stability purposes other than those directly related to prudential supervision. In particular, we will examine the possibility of the ECB performing LOLR functions within its mandate of monetary policy (2).

1. *Gauweiler*, or the Contours of Monetary Policy

a. The Facts of the Case

Even for those accustomed to the EU's complex and litigious institutional history, the FCC's request to the CJEU for a preliminary ruling in *Gauweiler* was momentous: the case could have potentially derailed the euro. The year 2012 was a difficult one for some EU countries: speculation about public finances in Greece, Portugal and Ireland rose the bond yields for the governments of these countries. Some of those fears spread to larger countries like Spain and Italy, putting the very existence of the euro at risk.[16] As a result of these fears, the interest rate set by the ECB, which was at one of the lowest levels in its history, did not translate into lower costs of funding for the affected countries.

The President of the ECB committed to do "whatever it takes to preserve the euro."[17] His famous pledge preceded the announcement of the Outright Monetary Transactions (OMT) program. Under the OMT program, the ECB committed to buy debt from distressed countries on the secondary markets until interest rates returned to a level that allowed monetary policy to be effective. The Governing Council of the ECB approved the OMT program with a majority of votes, albeit with opposition from the German Bundesbank. The decision was announced on September 6, 2012 (the OMT decision).

A group of German citizens challenged this decision before the FCC.[18] They submitted that: (i) the OMT decision was an *ultra vires* act since it did not fall

[16] A bail-out of one or two of the first three could be managed by the recently created European Stability Mechanism (ESM). The latter two were "too big to bail."

[17] Draghi, *supra* note 2.

[18] Technically, the FCC did not analyze Mr. Draghi's words but the subsequent release announcing the OMT program to purchase bonds from troubled euro zone Member States in order to achieve the necessary stability and restore the "monetary policy transmission" channel. *See* European Central Bank Press Release, Technical Features of Outright Monetary Transactions (Sept. 6, 2012), https://www.ecb.europa.eu/press/pr/date/2012/html/pr120906_1.en.html. The lack of detail was due to the fact that OMT had not been clearly delineated at the time when the FCC decided over it. In fact, the ECB never elaborated on the specific details of the OMT program: the release intended to show

under the mandates conferred on the ECB; (ii) that the program would violate article 123 TFEU, which expressly prohibits the ECB's financing of national governments; and (iii) that the OMT decision undermined the principle of democracy entrenched in the German Basic Law and therefore impaired German constitutional identity.[19] On these grounds, the applicants alleged that the German Federal Government and the German Bundestag had not complied with their duty to work towards the repeal of the OMT decision or, at least, to prevent its implementation.[20]

The FCC declared itself competent to examine the case, but it stayed the proceedings to refer several questions to the CJEU:[21] (a) whether the OMT decision fell outside the scope of the ECB's monetary policy mandate (articles 119 and 127 TFEU, and articles 17 to 24 of the Statute); and (b) whether it violated the prohibition of monetary financing (article 123 TFEU).[22] The reference was an odd one: rather than asking the CJEU to determine the legality of the OMT program, the FCC was requesting confirmation of its determination that the program was illegal.

Several Member States objected to the admissibility of the case before the CJEU. The FCC was asking the CJEU to agree with it, without promising to uphold the decision. The challenged OMT decision was merely a preparatory act and did not have any legal effects. Therefore, at the moment, only the press release and President Draghi's statement could be challenged. However, the CJEU finally declared the request admissible and went on to interpret the said Treaty provisions.[23]

The key to understanding the controversy lies in the nature of the monetary mandate. In democratic countries, decisions of policy, including economic policy, are adopted by democratically elected or accountable bodies. Entrusting a central bank with key policy decisions is justified on grounds of credibility: a central bank will be less likely to let its decisions be hijacked by short-term considerations, and to engage in inflationary policies, provided it is independent.[24] Such

---

the ECB's willingness to act in order to restore markets that had been severely hit by volatility. In this sense, the FCC challenged 'a policy that never was.'

[19] *See Gauweiler*, EU:C:2015:400, ¶ 6.

[20] *See* Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court] Jan. 14, 2014, 2 BvR 2728/13 (Ger.), ¶ 5. An English translation of the decision is available at http://www.bverfg.de/e/rs20140114_2bvr272813en.html.

[21] Based on its own established caselaw, the FCC declared itself competent to examine whether acts of European institutions and agencies had transgressed the latters' powers or affected the constitutional identity of the German Basic Law. *See* BVerfG, 2 BvR 2728/13 (*OMT*), ¶¶ 22–31. Yet, this was the first time the FCC made a reference to the CJEU. *See* Udo Di Fabio, *Karlsruhe Makes a Referral*, 15 GERMAN L. J. 107, 107–110, (2014).

[22] Alternatively, if the CJEU considered that the OMT decision could not be the object of a preliminary ruling pursuant to the TFEU, art. 267(b), the FCC asked the CJEU to interpret arts. 119, 123 & 127 of the TFEU, as well as Statute of the ESCB and of the ECB, *supra* note 4, arts. 17–24, to determine whether they would support government bond purchases such as the ones envisioned in the OMT decision. *Gauweiler*, EU:C:2015:400, ¶ 10.

[23] For a detailed analysis of the different grounds on which several EU Member States, as well as the ECB, challenged the admissibility of the FCC's request for a preliminary ruling, see *Gauweiler*, EU:C:2015:400, ¶¶ 19–30.

[24] *See* Finn E. Kydland & Edward C. Prescott, *Rules Rather than Discretion: The Inconsistency of Optimal Plans*, 85 J. OF POL. ECON. 473, 473–491 (1977); *see also* Herbert E. Taylor, *Time inconsistency: a potential problem for policymakers*, BUS. REV. Mar.-Apr. 1985 at 3–12 . For a more recent study, see Alesina & Summers, *supra* note 9.

independence, in turn, will only be real, and justifiable, if the mandate and tasks are limited. If *monetary* policy is open-ended, the central bank can end up engaging in the same political trade-offs that lead to short-termism and inflation, and/or undermine democratic legitimacy. This creates a tension that has no easy answer. From an economic perspective, avoiding the time inconsistency problem requires "rules rather than discretion,"[25] such as an inflation target of 2%. However, to implement those *rules* that regulate the *ends* pursued, the central bank needs a degree of independence, and of *discretion* as to the operational *means* to achieve that outcome. Nonetheless, this does not entirely solve the problem. From a legal perspective, the rule of law entails that *ends do not justify means*, but the parameters controlling the central bank's action are unclear.

In the *Gauweiler* case, although the FCC and the CJEU faced these underpinning questions, each court approached them from opposite angles: the CJEU focused on central bank independence, and the FCC, on democratic legitimacy. Using different approaches, the courts reached opposite conclusions.[26] With this in mind, we turn now to explore the arguments presented by the FCC and the CJEU relating to the definition of the scope of the ECB's monetary policy.

b. Monetary Policy: A Slippery Definition under the EU Treaties

In 2012, in its *Pringle* decision, the CJEU found the European Stability Mechanism (ESM) to be a measure of economic policy, not monetary policy. In order to draw a line between these two types of policies, the CJEU relied on three factors: "[(i)] the objectives to be attained by the [ESM],… [(ii)] the instruments provided in order to achieve those objectives, and [(iii)] the close link between that mechanism [i.e. the ESM], the provisions of the FEU Treaty relating to economic policy and the regulatory framework for strengthened economic governance of the Union[.]"[27]

The FCC used this rationale to argue that the OMT decision had fallen under the scope of economic policy. First, the FCC held that the composition of the euro area, including whether all its members should stay, was a decision of economic policy. When dealing with economic policy, the ECB only has the right to be heard,[28] regardless of any indirect effects that the OMT decision might have on monetary policy.[29]

Second, the FCC argued that the instruments to be used under the OMT program were not conventional monetary policy instruments but rather amounted

---

[25] *See* Kydland & Prescott, *supra* note 24.

[26] For an analysis of the possible reaction of the FCC to the CJEU's preliminary ruling, see Georgios Anagnostaras, *In ECB We Trust ... The FCC We Dare! The OMT Preliminary Ruling*, 40 E. L. REV. 744, 759–761 (2015); *see also* Paul Craig & Menelaos Markakis, *Gauweiler and the legality of outright monetary transactions*, 41 E. L. REV. 1, 4–24 (2016).

[27] Thomas Pringle v. Government of Ireland, Case C-370/12, EU:C:2012:756, ¶ 60.

[28] *See* BVerfG, 2 BvR 2728/13 (*OMT*), ¶ 72.

[29] The FCC pointed to the Pringle case, where the CJEU had held that the mere fact that an act might have an indirect effect on the stability of the euro did not make that act one of monetary policy. *See* BVerfG, 2 BvR 2728/13 (*OMT*), ¶ 64. The FCC made an express reference to ¶ 56 in the Pringle case: "As regards, first, the objective pursued by that mechanism [the ESM], which is to safeguard the stability of the euro area as a whole, that is clearly distinct from the objective of maintaining price stability, which is the primary objective of the Union's monetary policy. Even though the stability of the euro area may have repercussions on the stability of the currency used within that area, an economic policy measure cannot be treated as equivalent to a monetary policy measure for the sole reason that it may have indirect effects on the stability of the euro." *Id*.

to "financial assistance."[30] This conclusion was reinforced by the fact that OMT was selective in nature. In the FCC's view, monetary measures must apply to all Member States indiscriminately, and any difference in their effect must result from the operation of open market forces.[31]

Third, the purchase of government bonds under the OMT program was tied to full compliance with the requirements for assistance under the European Financial Stability Facility (EFSF) or the ESM.[32] Since the CJEU had declared these to be acts of economic policy in its *Pringle* decision, any purchase of government bonds under the OMT decision would have to bear a similar characterization.[33]

In addition, the FCC rejected the possibility of regarding the OMT program as a measure to *support* economic policy. Given the laxer requirements for the purchase of bonds on the secondary markets under the OMT program, the ECB could *de facto* broaden the volume of assistance measures under ESM programs to considerable levels,[34] or even render these programs ineffective.[35] Moreover, if the ECB made purchase decisions under the OMT program independently from other EU institutions pursuant to article 130 TFEU, any such decisions would extend "beyond a mere 'support' of the economic policy in the Union."[36]

Finally, the FCC dismissed the ECB's justification of OMT as a means to restore the *monetary policy transmission mechanism*.[37] The FCC contended that the monetary policy transmission mechanism would deteriorate in "virtually every debt crisis of a state."[38] This "would amount to granting the [ECB] the power to remedy any deterioration of the credit rating of a euro area Member State," which would in turn violate the prohibition of monetary financing provided under article 123 TFEU.[39]

The arguments described above suggest that pervading the reasoning of the FCC was a mistrust of how the ECB could use its powers on monetary policy. Given the difficulty to identify "irrational" fears, the FCC's mistrust explains why it rejected the ECB's economic argument.[40] It may also explain the FCC's reliance

---

[30] The FCC referred expressly to the Pringle case, where the CJEU referred to decisions on key interest rates for the euro currency area and the release of the euro currency as two examples of acts of monetary policy. *See* BVerfG, 2 BvR 2728/13 (*OMT*), ¶ 65.

[31] *See id.* ¶ 73.

[32] *See id*. ¶ 77.

[33] In particular, the FCC characterized purchases of government bonds as envisaged under the OMT decision "as the functional equivalent to an assistance measure of the above-mentioned institutions—albeit without their parliamentary legitimation and monitoring." *Id.* ¶ 78.

[34] *See id.* ¶ 81.

[35] *See id.* ¶ 80.

[36] *See id.* ¶ 82.

[37] Central bank policy interest rates, in isolation, are ineffective to ensure price stability; markets need to react. When markets assume that policy rates should be a reference for markets, changes take place in credit markets, asset prices, and other variables, before price levels are affected. These intermediate variables are the so-called "channels of monetary policy transmission," or mechanisms. Rather than a single "channel," there are multiple channels that can transfer information. *See, e.g.*, Frederic S. Mishkin, *The Channels of Monetary Transmission: Lessons for Monetary Policy* (Nat'l Bureau of Econ. Res., Working Paper 5464, 1996), http://www.nber.org/papers/w5464.pdf.

[38] BVerfG, 2 BvR 2728/13 (*OMT*), ¶ 97. Furthermore, the FCC held that the use of purchases of government bonds as tools of monetary policy did not justify every purchase of such bonds in monetary terms. *See* BVerfG, 2 BvR 2728/13 (*OMT*), ¶ 96.

[39] *Id.* ¶ 97.

[40] *Id.* ¶ 98.

on the Bundesbank's view that bond spreads reflected market skepticism about Member States' budgetary discipline and future solvency, rather than fears of the reversibility of the euro.[41] The FCC saw the ECB's intervention as an arbitrary interference in the markets.[42] It did not discuss why the Bundesbank had proven its case better or what was the standard of proof. Like the FCC before it, the CJEU also resorted to the rationale in *Pringle* and tried to distinguish between "monetary" and "economic" policy based on the objectives of OMT and its instruments.[43] However, the CJEU reached the opposite conclusion.

Interestingly, the CJEU used the exact same paragraph, para. 56, in *Pringle*,[44] to conclude that "a monetary policy measure cannot be treated as equivalent to an economic policy measure merely because it may have indirect effects on the stability of the euro area[.]"[45] In the view of the CJEU, safeguarding both "an appropriate monetary policy transmission and the singleness of the monetary policy," which is the alleged objective of the OMT program,[46] was part of the primary objective of monetary policy as defined in article 127(1) TFEU to maintain price stability.[47]

The CJEU limited itself to finding that the instruments specified in the OMT decision fell within the scope of article 18 of the Statute,[48] and that "no provision of the FEU Treaty requires the ESCB to operate in the financial markets by means of general measures that would necessarily be applicable to all the States of the euro area."[49] The CJEU also accepted the ECB's argument that the "restoration of the monetary policy transmission mechanism" had a direct effect on price stability as the primary objective of monetary policy, but it did not provide an elaborate argument of its own.[50] The CJEU could have justified the reasonableness of the ECB's assessment by resorting to an extensive body of literature that argues that financial frictions play an important role in the business cycle and the monetary

[41] *Id.* ¶ 71. *See also id.* ¶ 13. According to the FCC, the treaties had permitted the existence of divergent spreads as a reflection of the independence of national budgets. *See id.* ¶ 71.

[42] *Id.* ¶ 98.

[43] The CJEU pointed out that, although the treaties do not define "monetary policy," they do specify the objectives and instruments available to the ESCB to conduct such monetary policy. *See Gauweiler,* C:2015:400, ¶ 42. According to TFEU, arts. 127(1), 282(2), the primary objective of monetary policy is price stability. The same provisions further stipulate that, "without prejudice" to such objective, the ESCB is to "support the general economic policies in the Union, with a view to contributing to [its] achievements." TFEU, art. 127(1). Chapter IV of the Statute of the ESCB and of the ECB specifies the instruments that are available to the ESCB to pursue such objectives. Art. 18 of the Statute of the ESCB and of the ECB describes the open market and credit operations available to the ESCB to carry out its tasks. *See* Statute of the ESCB and of the ECB, *supra* note 4, art. 18.

[44] *See Pringle*, EU:C:2012:756, ¶ 60.

[45] *Gauweiler,* EU:C:2015:400, ¶ 52.

[46] *Id.* ¶ 47.

[47] *Id.* ¶ 50.

[48] *Id.* ¶ 54.

[49] *Id.* ¶ 55. We believe that the CJEU could have provided more elaborate argumentation to support the alleged irrelevance of the selective nature of the OMT program. The FCC was quick to conclude that "to safeguard the current composition of the euro currency area […] is obviously not a task of monetary policy but one of economic policy," and would thus fall under the competence of the Council. BVerfG, 2 BvR 2728/13 (*OMT*), ¶ 72. The CJEU could have argued that the ECB's mandate is to implement monetary policy under actual, not imaginary, conditions, and across *the whole* euro area. Thus, given that (1) the Council had not taken any decision to exclude any State from the euro area, (2) that, as a result of OMT, there was no identifiable risk of inflation in non-troubled Member States, like Germany, and (3) that in the case of inaction there was a clear risk of contagion of deflationary pressures, there was a rational basis for intervention and for that intervention to be selective in order to limit the side effects of unconventional measures.

[50] *Gauweiler,* EU:C:2015:400, ¶55.

transmission channel,[51] and then argued whether the OMT program could be justified on those grounds.[52] However, the CJEU preferred to rely instead on the argument that the complexity of the assessment justified granting the ECB a broad degree of discretion.[53]

In conclusion, the Court considered that both the objectives of the OMT decision and the instruments devised to attain those objectives confirmed that the program specified therein fell under the mandate of monetary policy. The Court also rejected the possibility that the ties of the OMT program to the macroeconomic adjustment programs of the EFSF and the ESM could question that assessment. First, the Court reiterated that the potential "indirect effect" of the OMT Program on the EFSF and ESM programs, for example, increasing the willingness to comply with those programs, did not make it equivalent to a measure of economic policy.[54] In fact, the Court argued that, because of that indirect effect, the OMT program could be deemed to support general economic policies in the Union pursuant to TFEU articles 119(2), 127(1), and 282(2).[55] Second, the fact the OMT program would only be implemented in Member States that are in "full compliance" with the EFSF and ESM programs disposed of the possibility, raised by the FCC, that the ESCB might bypass the EFSF and the ESM.[56] The Court emphasized that the ESCB's intervention did not depend exclusively on such full compliance, but also depended on the important condition that there exist a disruption in the monetary policy transmission mechanism.[57]

c. Democratic Legitimacy

The opposite conclusions reached by the FCC and the CJEU were a product of their diverging attitudes towards the ECB's justification of OMT: what the CJEU saw as discretion, the FCC saw as arbitrariness. The diverging attitudes

---

[51] The literature tends to support that financial frictions play an important role in the business cycles. Perhaps the earliest proponent was Irving Fisher, *The Debt-Deflation Theory of Great Depressions*, 1 ECONOMETRICA 337 (1933). Later, these views have been revisited and re-elaborated. *See, e.g.*, Ben S. Bernanke, *Non-monetary Effects of the Financial Crisis in the Propagation of the Great Depression*, 73 AM. ECON. REV. 257 (1983); Ben S. Bernanke, Mark Gertler & Simon Gilchrist, *Chapter 21: The financial accelerator in a quantitative business cycle framework*, *in* 1 HANDBOOK OF MACROECONOMICS PART C 1341 (John B. Taylor & Michael Woodford eds., 1999); Frederic S. Mishkin, *The Causes and Propagation of Financial Instability: Lessons for Policymakers*, *in* MAINTAINING FINANCIAL STABILITY IN A GLOBAL ECONOMY, 55 (1997). For a perspective that emphasizes asymmetries of information, see Bruce Greenwald et al., *Informational Imperfections in the Capital Market and Macroeconomic Fluctuations* (Nat'l Bureau of Econ. Res., Working Paper No. 1335, 1984), http://www.nber.org/papers/w1335.pdf. Moreover, other economists have offered evidence of financial disruptions introducing non-linearities in the macroeconomy that could render predictions of monetary policy models based on linear equations invalid. *See, e.g.*, Chang-Jin Kim et al., *Nonlinearity and the permanent effects of recessions*, 20 J. APPLIED ECONOMETRICS 291 (2005).

[52] The Court introduced that discussion somewhat when it used the proportionality principle as the standard of review (*see infra* Part I.B.1.d), but the issue whether a shock intervention in the secondary market for government bonds looked *prima facie* appropriate to restore the "transmission mechanism," was not explored in detail.

[53] *Gauweiler,* EU:C:2015:400, ¶ 68.

[54] *Id.* ¶¶ 58–59.

[55] *Id.* ¶ 59.

[56] *Id.* ¶ 60.

[57] *See Id.* ¶ 62. We reiterate here that despite relying on the importance of restoring the monetary policy transmission mechanism to justify the characterization of the OMT program as a measure of monetary policy, the CJEU supported this assessment with a rather weak justification.

cannot be explained by an *objective* distinction between *economic* and *monetary* policies, but by the different angles from which the two courts approached the issue: whereas the CJEU saw the problem in terms of the meaning of the ECB's mandate and its independence, the FCC saw it in terms of democratic representation. According to the latter, the ECB is an unelected body; hence the need for a *restrictive* interpretation of the monetary mandate.[58] Additionally, to the FCC, since OMT would result in a fiscal redistribution between budgets and taxpayers of different Member States,[59] the decision by the ECB was contrary to the Treaties[60] and would undermine democratic legitimacy.[61]

Bearing this in mind, OMT was the last in a series of decisions where the FCC appointed itself the ultimate guardian of Germany's "constitutional identity,"[62] which limits the transfer of sovereignty from Germany to the EU[63]

---

[58] *See* BVerfG, 2 BvR 2728/13 (*OMT*), ¶¶ 59–60, 63. The fact that central bank independence is also enshrined in the German Basic Law under article 88 did not change that, since the FCC has construed Parliament's responsibility over budgetary decisions as part of the fundamental right to participate in democratic elections, and thus as having "structural" or "identity" status, unlike central bank independence. *See* Dietrich Murswiek, *ECB, ECJ, Democracy, and the Federal Constitutional Court: Notes on the Federal Constitutional Court's Referral Order from 14 January 2014*, 15 GERMAN L. J. 147, 157–159 (2014); *see also* Heiko Sauer, *Doubtful It Stood: Competence and Power in European Monetary and Constitutional Law in the Aftermath of the CJEU's OMT Judgement*, 16 GERMAN L. J. 971, 975–76 (2015). This skews the FCC's views towards a narrow construction of central bank discretion, not because of EU law, but because of the limited nature of the powers conferred upon the Union by the German Basic Law.

[59] BVerfG, 2 BvR 2728/13 (*OMT*), ¶¶ 39–41.

[60] According to the FCC, redistribution effects "[were] not entailed in the integration program of the European Treaties. On the contrary, independence of the national budgets, which opposes the direct or indirect common liability of the Member States for government debts, is constituent for the design of the monetary union[.]" *Id.* ¶ 41.

[61] "Decisions on the choice of instruments for the stabilisation of the monetary union or on the composition of the euro currency area substantially depend on the democratic process in the Member States." *Id.* ¶ 40.

[62] Its first instance was the *Solange-I* case. Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court] May 29 1974, SOLANGE I-BESCHLUß BVerfGE 37, 271 2 BvL 52/71 (Ger.). That was followed by *Solange-II.* Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court] Oct. 22, 1986, SOLANGE II-BESCHLUß BVerfGE 73, 339 2 BvR 197/83 (Ger.). Then came the famous *Maastricht* and *Lisbon* judgments, named after the two landmark treaties. Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court] Oct. 12, 1993, BVerfG 89, 155, 2 BvR 2134/92, 2 BvR 2159/92 (Ger.); Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court] Jun. 30, 2009, BVerfG 123, 267 2 BvE 2/08 (Ger.).

[63] "Constitutional identity" was initially conceived as a bulwark against a subversion of constitutional values by elected representatives, but its current meaning is hard to pin down, and thus it is difficult to surmise what could trigger an *ultra vires* review. However, the FCC has given some examples. Germany cannot become part of a federal European state, or cease to be a democratic, social, and federal state that protects fundamental rights and the rule of law, unless by agency of the constituent power. BVerfG, 2 BvE 2/08 (*Lisbon*), ¶ 179. It is also unclear how this popular will would be expressed, but, apparently, art. 146 of the Constitution would have to be followed, which requires that a new Constitution is enacted if the current Constitution is replaced. *See* Monica Claes & Jan-Herman Reestman, *The Protection of National Constitutional Identity and the Limits of European Integration at the Occasion of the Gauweiler Case*, 16 GERMAN L. J. 917, 930 (2015). Yet, the constituent power would also be bound by, and could not change, certain fundamental values, such as the notion of dignity, which forms part of the "eternity" clause of the Constitution, under art. 79(3). Grundgesetz für die Bundesrepublik Deutschland [GG] [Basic Law], last amended by Gesetz zur Änderung des Grundgesetzes [Law Amending Basic Law], Jul. 11, 2012, BGBl. I at 1478 (Ger.), art. 79(3),
http://www.gesetze-im-internet.de/englisch_gg/englisch_gg.html#p0409

and includes the right to participate in democratic elections. In so doing, the FCC set itself on a collision course with the CJEU.[64]

It is understandable that the CJEU did not wish to open Pandora's box by addressing questions such as where democratic legitimacy lies, what is the meaning and protection of constitutional identity,[65] and whether the EU espouses a certain model of constitutional pluralism. Yet, by ignoring the argument altogether, the CJEU missed the opportunity to assuage the legitimate concerns behind the FCC's decision.

The CJEU could have chosen to counter the premise that the EU lacks mechanisms to render the ECB accountable. A full analysis of the EU's democratic credentials, or the believed lack thereof which seems to lie beneath the FCC's construction, is beyond the scope of the present article.[66] *Accountability* is a broad concept that encompasses *judicial*, *political*, and *administrative* accountability.[67] Suffice it to say the ECB is not only subject to judicial review by the CJEU; it is also politically accountable to the European Parliament and Council via appointment,[68] reporting,[69] amendment of its Statute, and complementary legislation.[70]

The CJEU's silence is even more unfortunate because, even if it had ignored the argument about the ECB's accountability and sidelined the FCC's major premise that democratic legitimacy only lies in Member States as being too politically sensitive, the CJEU could have simply addressed the second concern

---

[64] The *ultra vires* review based on constitutional identity was not initially designed to be so contentious. The CJEU should be given the opportunity to decide on the issue, and the FCC should, *in principle*, accept the former's decision. Plus, the transgression of powers had to be *manifest*, and the challenged act *highly significant* for the allocation of powers. Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court] Jul. 6, 2010, BVerfGE 126, 286 (*Honeywell*) (Ger.), ¶¶ 303–304. Conversely, there was an attempt to accommodate national sensitivities by including a reference to domestic "constitutional identity" in TEU art. 4(2), and by accepting that social or linguistic matters could allow for exceptions to EU freedoms. Treaty on European Union, art. 4(2), Oct. 26, 2012, 2012 O.J. (C 326) 1 [hereinafter TEU]. *See, e.g.*, Sayn-Wittgenstein v. Landeshauptmann von Wien, Case C-208/09, EU:C:2010:806, ¶ 83 (linguistic matters, or the status of individuals (for example, prohibition of nobility titles) form part of the "constitutional identity" which may justify an exception to free circulation or mutual recognition policies). Yet, ever since its *Lisbon* decision, where it held that its concept of "constitutional identity," and TEU art. 4(2) went hand-in-hand, the FCC has gradually hardened its view, and held that the German concept is narrower, stronger (it cannot yield to other principles) and can only be appraised by the FCC itself. BVerfG, 2 BvE 2/08 (*Lisbon*), ¶ 240.

[65] In his opinion on *Gauweiler* on January 14, 2015, Advocate General Cruz Villalón tried to reconcile the national and EU concepts, but his views were not included in the CJEU's decision. Opinion of Advocate General Cruz Villalón, Gauweiler & Others v. Deutscher Bundestag, Case C-62/14, EU:C:2015:7, ¶ 213.

[66] From a legal perspective, see the criticism in Daniel Halberstam & Christoph Möllers, *The German Constitutional Court says "Ja zu Deutschland!,"* 10 GERMAN L. J. 1241 (2009). From a legal-political perspective, see*, e.g.,* J. H. H. Weiler et al., *European democracy and its critique*, 18 WEST EUR. POL. 4 (1995). See also the articles in that special issue on "The Crisis of Representation in Europe." 18 WEST EUR. POL. (1995).

[67] *See* Gijsbert Ter Kuile et al., *Tailor-made accountability within the Single Supervisory Mechanism*, 52 COMMON MKT. L. REV. 155, 159 (2015).

[68] Members of its Executive Board (including President and Vice-President) are appointed "by the European Council, acting by a qualified majority, from among persons of recognised standing and professional experience in monetary or banking matters, on a recommendation from the Council after it has consulted the European Parliament and the Governing Council." *See* Statute of the ESCB and of the ECB, *supra* note 4, art. 11(2).

[69] *Id.* art. 15(3).

[70] *Id.* arts. 40–41.

and minor premise, i.e. that OMT would entail a budgetary redistribution without the opportunity for a vote by democratically elected bodies. This not a realistic assumption. In principle, if another Member State were to default, a redistribution resulting from central bank operations would take place only if the ECB had to be recapitalized with German taxpayers' money without the opportunity of German democratically elected bodies voting on the issue. There are several problems with this reasoning.

First, a central bank becoming insolvent is an extremely rare scenario.[71] Some authors even argue that central banks do not need capital to function.[72] Their *financial strength* has more to do with the credibility of their policies than with the central bank's actual risk of insolvency.[73] Nonetheless, the ECB has mechanisms in place to cover potential losses before actually resorting to recapitalization with States' funds, for example, by allocating losses to the general reserve fund, which is formed with the non-distributed profits. Another option is following a decision by the Governing Council, setting those losses off against the monetary income of the relevant financial year in proportion and up to the amounts allocated to the national central banks.[74]

Second, even in the unlikely scenario that a recapitalization were necessary, the actual financial burden to be shouldered by German taxpayers would be, under any realistic assessment, lower than the amount committed to the ESM,[75] which the FCC has considered to be compliant with the German Basic Law.[76]

Finally, even in a scenario of recapitalization with fresh government money, that decision would be adopted by the Council, which is formed by the government representatives of the EU Member States. The recapitalization decision would provide an opportunity for an *ex ante* parliamentary control, and even "constitutional identity" control by the FCC over the German representative's vote in the Council and over the actual commitment of the German government to ensure that the burden is shared fairly.[77]

d. The Standard of Review: Proportionality and Beyond

---

[71] For a few exceptions, see Peter Stella, *Do Central Banks Need Capital?* 7 (Internat'l Monetary Fund, Working Paper WP/97/83, 1997), https://www.imf.org/external/pubs/cat/longres.aspx?sk=2260.0.

[72] *See, e.g.,* Ulrich Bindseil et al., *The role of central bank capital revisited* 5 (European Central Bank, Working Paper Series No. 392, 2004), https://ideas.repec.org/p/ecb/ecbwps/20040392.html; *see also* Peter Stella, *Central Bank Financial Strength, Policy Constraints and Inflation* 5 (Internat'l Monetary Fund, Working Paper WP/08/49, 2008), https://www.imf.org/external/pubs/cat/longres.aspx?sk=21718.0.

[73] *See, e.g.,* Stella, *supra* note 71.

[74] *See* Statute of the ESCB and of the ECB, *supra* note 4, art. 33(2). It is interesting to note that in 2014, while the debt crisis in the Eurozone was still ongoing, the ECB had net profits of € 988,8 million, and it decided to distribute them in their entirety. *See* EUROPEAN CENTRAL BANK, *Annual Report*, at 155 (2014), https://www.ecb.europa.eu/pub/annual/html/index.en.html.

[75] Currently, the ECB's subscribed capital is €10.83 billion, while the subscribed capital of the ESM as of 31 December 2014 is €701.94 billion. *See* EUROPEAN CENTRAL BANK, *Capital subscription* (Jan. 1, 2015), https://www.ecb.europa.eu/ecb/orga/capital/html/index.en.html; EUROPEAN STABILITY MECHANISM, *ESM Annual Report*, at 88 (2014), http://www.esm.europa.eu/publications/reports/index.htm.

[76] *See* Bundesverfassungsgericht [BverfG] [Constitutional Court] Sept. 12, 2012, 2 BvR 1390/12 (Ger.), ¶ 245 (holding the ESM valid under the German Constitution).

[77] *See* Statute of the ESCB and of the ECB, s*upra* note 4, arts. 28(1), 41.

The divergence between the FCC's reluctance and the CJEU's willingness to trust the ECB does not mean that the CJEU gave the ECB a blank check.[78] After concluding that the OMT program was a measure of monetary policy, the CJEU made the validity of the OMT Program dependent on the proportionality of the measure with the objectives of monetary policy.[79] According to settled case-law of the Court, "the principle of proportionality requires that acts of the EU institutions [(i)] be appropriate for attaining the legitimate objectives pursued by the legislation at issue and [(ii)] do not go beyond what is necessary in order to achieve those objectives."[80] The Court found the OMT decision satisfied those criteria.

First, the Court sided with the view of the ECB that the excessive risk premium in certain government bonds responded to macroeconomic differences between Member States and the risk of the euro breaking up.[81] It also considered that such excessive risk premia affected the effectiveness of the monetary policy transmission mechanism.[82] In addition, the Court argued that the unlimited quantity of bonds to be purchased helped buttress the unity of the euro area.[83] In fact, the Court argued that the mere announcement of the program, without its implementation, had contributed to its success. This fact has not been challenged.[84]

Second, the Court found that the OMT program had not manifestly exceeded what was necessary to achieve the monetary policy objectives. The Court made a particular emphasis on six facts: 1) the OMT program would cease as soon as the

---

[78] On the other hand, the FCC failed to enunciate a clear standard of review. First, in its *ultra vires* review in *OMT* the FCC applied its concept of "manifest transgression," and drew an analogy with the CJEU's concept of "manifest and grave disregard" used in damages actions against EU institutions. BVerfG, 2 BvR 2728/13 (*OMT*), ¶ 24; *see also* BVerfGE 126, 286 (*Honeywell*) ¶ 61 (referencing Comm'n v. Fresh Marine, Case C-472/00 P, EU:C:2003:399, ¶ 26). However, the CJEU's "manifest" transgression depends on the amount of discretion granted to the institution, which, in the ECB case, should be ample. *Fresh Marine,* EU:C:2003:399, ¶ 27. This aspect, however, was not present in the FCC reasoning. Second, the FCC stated that OMT would "bypass" the policies of budgetary restraint that accompany aid programmes under the ESM and the prohibition of monetary financing, and, in so doing, it made reference to the CJEU's case law on "abuse of law." BVerfG, 2 BvR 2728/13 (*OMT*), ¶¶ 79, 85 (referencing Teritorialna direktsia na Natsionalnata agentsia za prihodie – Plovdiv v. Rodopi-M 91, Case C-259/12, EU:C:2013:414, ¶ 41). However, ever since *Halifax*, where the CJEU outlined the doctrine, to conclude that there is abuse of law it does not suffice that there is a mere risk of circumvention. The "essential aim" must be contrary to the finality of the rule, and there must be no other explanation for it. Halifax Plc & Others v. Commissioners of Customs & Excise, Case C-255/02, EU:C:2006:121, ¶¶ 74–75. The FCC failed to state convincingly why there was no other explanation for OMT than the wish to circumvent Treaty prohibitions and budgetary discipline. Some scholars suggest that the FCC's standard of review was inadequate and that a "rationality check" would have been appropriate. *See* Matthias Goldmann, *Adjudicating Economics: Central Bank Independence and the Appropriate Standard of Judicial Review*, 15 GERMAN L. J. 265, 265–280 (2014). However, we limit ourselves to suggest that the FCC failed to indicate whether the standard of review used was the "manifest transgression," the "abuse of law," or a combination of the two. The FCC failed to apply any of the two in a consistent manner, as if the invalidity of OMT were but a foregone conclusion.

[79] The Court justified the examination of the OMT program under the proportionality principle on the basis of a joint reading of TFEU, arts. 119(2) & 127(1) with TEU, art. 5(4). *See Gauweiler,* EU:C:2015:400, ¶ 66.

[80] *Gauweiler,* EU:C:2015:400, ¶ 67. To that effect, see Association Kokopelli v. Graines Baumax SAS, Case C-59/11, EU:C:2012:447, ¶ 38, and the case-law cited therein.

[81] *Gauweiler,* EU:C:2015:400, ¶ 76.

[82] *Id.* ¶¶ 73–75.

[83] *Id.* ¶ 76.

[84] *Id.* ¶ 79.

objectives had been achieved;[85] 2) its actual implementation would depend on an in-depth assessment of the requirements of monetary policy;[86] 3) actual limits existed on the potential scale of the program;[87] 4) its selective nature avoided a needless increase in the program; [88] 5) the disruptions in the monetary transmission mechanism would be identified in accordance with monetary policy objectives, thus excluding the possibility of an arbitrary selection;[89] and 6) the Court considered that the ESCB had weighed various interests in play to prevent disadvantages that would have been disproportionate.[90]

Some of the arguments presented by the CJEU deserve a close examination. First, the Court held that the OMT program was proportionate because it was "limited" to specific States and bonds.[91] In a similar vein, the Court relied on the *ex ante* limitation of the scale of the program to the 3-year bonds of Member States undergoing macroeconomic adjustments.[92] However, these limits were more apparent than real. Under OMT there were no *ex ante* limits to the actual quantity of bonds that the ECB could purchase, i.e. the ECB's commitment to use all its available financial firepower to restore the balance to the monetary transmission channel. The argument, thus, hinged on whether the ECB could be trusted in its *ex ante* pledge to not exceed necessity and to cease the OMT program as soon as its objectives had been achieved. Given the complexity of this high-stakes poker of sorts, the CJEU relied on the hindsight observation that OMT had not been used in practice.[93] Hindsight may be useful in practice, but it is not a strong theoretical argument.

On the other hand, reliance on the ECB's pledge of self-restraint as a basis to assess the measure's proportionality, absent evidence to the contrary, can be a legitimate argument, but it can be easily politicized by detractors of the CJEU or the ECB. Moreover, in order to be convincing, such an argument would need to be accompanied by other considerations.

---

85 *Id.* ¶ 82.

86 *Id.* ¶ 83.

87 Although the OMT decision did not provide for any limit as to the quantity of bonds that could be purchased in the secondary markets under the OMT program, the Court identified two practical limitations: a) the ESCB could only purchase bonds from those Member States that are under a macroeconomic adjustment program and that have access to the bond market again; and b) the ESCB would only purchase government bonds with a maturity of up to three years. *Gauweiler,* EU:C:2015:400, ¶¶ 85–88.

88 *Id.* ¶ 89.

89 *Id.* ¶ 90.

90 *Id.* ¶ 91. The Court conceded that the ESCB enjoys broad discretion when preparing and implementing open market operations such as the ones under the OMT program due to the technical decisions involved and the need to perform complex assessments based on forecasts. However, the Court also noted that such broad discretion would require a review of compliance with certain procedural guarantees. "Those guarantees include the obligation for the ESCB to examine carefully and impartially all the relevant elements of the situation in question and to give an adequate statement of the reasons for its decisions." *Id.* ¶ 69. Nevertheless, the Court clarified that the context and other applicable legal rules might allow for that statement not to go "into every relevant point of fact and law." *Id.* ¶ 70.

91 *Gauweiler,* EU:C:2015:400, ¶¶ 85–89.

92 *See id.* ¶ 86.

93 In its decision, the CJEU noted that "more than two years after the programme at issue in the main proceedings was announced, that programme has not been implemented[.]" *Id.* ¶ 84.

Proportionality means that, as a result of a collision of protected interests, a balancing exercise ensures that neither infringes beyond necessity on the other.[94] In the *Gauweiler* case, the potential principle at risk was central bank independence and, had it been addressed, democratic legitimacy, which is safeguarded by the monetary-fiscal division. Thus, the real question was whether the bond purchase announcement without *ex ante* quantitative limits compromised the independence of central bank policy. This question is inextricable from the prohibition of monetary financing.

By separating the analysis of proportionality from the analysis of the prohibition of monetary financing, the CJEU's proportionality assessment lost much of its substance. It was deprived of the main countervailing principle to central bank discretion, i.e. the requirement that such discretion is not used in a way that compromises independence, which, in turn, depends largely on whether the ECB is financially assisting Member States. The only satisfactory answer was to hold that the ECB's commitment to limited intervention prevented the States from relying on ECB funding, and thereby protected the ECB's independence.[95] The problem, however, is that this answer means relying again on the credibility of the ECB's pledge, absent proof to the contrary. Yet, the CJEU could have stated that the *ex ante* assessment—when the measure was floated—would have been accompanied by an *ex post* review of its implementation details. However, this could have jeopardized OMT or future ECB programs, which rely on the ECB's unlimited firepower. Therefore, the CJEU preferred to adopt a slightly formalistic proportionality review.

e. A framework to Delineate the Boundaries of Monetary Policy

Upon a close examination of both *Pringle* and *Gauweiler*, the CJEU's rationale to define the limits of monetary policy relies exclusively on the objectives that the relevant measure pursues:[96] if the measure will have a direct effect on a monetary policy objective, then the measure must belong to monetary policy, regardless of the indirect effect that it might have on other policies, including economic policy. This is the *direct effect rationale*. The CJEU's argumentation in *Gauweiler* might be criticized for ignoring some of the arguments raised by the FCC to defend that the OMT program had a direct effect on monetary policy.[97] Nonetheless, the rationale is clear and both the FCC and the CJEU resort to it, although reaching different conclusions.

In their decisions, both the FCC and the CJEU relied extensively on the distinction between economic policy and monetary policy. However, this is quite a slippery distinction and should be approached with caution. Decisions on

---

[94] *See e.g.* Tor-Inge Harbo, *The Function of the Proportionality Principle in EU Law*, 16 EUR. L. J. 158, 164-165 (2010).

[95] The way the ECB conceived OMT, it prevented States from relying "on the certainty that the ESCB will at a future point purchase their government bonds on secondary markets[.]" *Gauweiler,* EU:C:2015:400, ¶ 113.

[96] Although the CJEU examined both the objectives and the instruments provided to attain those objectives, the Court concluded that because similar instruments could serve different objectives, the objectives were crucial in determining whether a measure would fall under the scope of monetary or economic policy. *See id.* ¶ 64.

[97] In particular, the CJEU failed to address in detail the direct effect that restoring the monetary policy mechanism will actually have on monetary policy objectives, the potential effect of the OMT program on fiscal redistribution, and the selective nature of the OMT program. *See supra* Part I.B.1.d.

interest rates, tax, and spending are combined to determine overall levels of inflation, consumption, investment, output, and employment, in ways that are difficult to dissociate. This is so especially if one considers consumer expectations, which operationalize fiscal or monetary decisions under the so-called "Ricardian equivalence."[98]

Moreover, article 127 TFEU does not try to establish a purely objective distinction between economic and monetary policy. Although some Treaty provisions and the CJEU's *Pringle* decision may suggest that the two policies can be delineated clearly,[99] in practice there are no such neat limits. Price stability, the key goal of monetary policy, is heavily dependent on tax-and-spend decisions, and consumption, investment, and employment, typically associated with *economic policy*, depend on inflation and interest rates.[100] The key to the separation is finalistic: putting specific goals (such as price stability and liquidity) and tools (such as interest rates, asset purchases, and liquidity lines) in the hands of a non-democratically elected institution (like the central bank) works *as long as* the institution remains independent and subject to strict rules.[101] Thus, the distinction needs to uphold that finality. Courts trying to draw the distinction should remember this finality to avoid engaging in a mere exercise of semantics.

In OMT, the purchase of bonds was available to the ECB as a tool. However, the use of this tool could be justified in monetary terms, as a means of restoring market liquidity to ensure that the signals given by interest rates are properly transmitted through the market (the transmission mechanism)[102] and not distorted

[98] "Ricardian equivalence" postulates that whenever policymakers stimulate the economy, the market adjusts its levels of consumption and investment to anticipate the future reversion of the policy *regardless of how this stimulus is funded*, *i.e.*, via tax increases, deficits, or by printing money. If the government increases spending but also taxes to fund that spending, the increase in investment and consumption due to the spending increase will be compensated for by the reduction resulting from the tax increase, so the net effect will be zero. If the government resorts to deficit financing, the market will anticipate the future tax increase to bridge the gap, and, again, will adjust its consumption/investment levels accordingly. And, if the deficit is funded by printing more money, the market will anticipate the "inflation tax" to the same effect. This is called the "Ricardian equivalence" after David Ricardo's *Essay on the Funding System*. *See* DAVID RICARDO, ESSAY ON THE FUNDING SYSTEM, *reprinted in* THE WORKS OF DAVID RICARDO 515 (Morrison & Gibb eds., 1888). More recently, it has been reformulated in Robert J. Barro, *Are Government Bonds Net Wealth?*, 82 J. POL. ECON. 1095 (1974). One can dispute the realism of the equivalence's underlying assumptions (efficient capital markets, perfect information, or ultra-rational consumers) but that does not affect the conclusion that, when market expectations are included, economic policy includes monetary policy.

[99] Title VIII of the TFEU distinguishes, in its Chapters 1 & 2, between "economic policy" and "monetary policy". TFEU, Title VIII, arts. 119–133. In *Pringle*, The CJEU held that the ESM mechanism did not constitute an instance of "monetary policy" because its objective was "to safeguard the stability of the euro area as a whole," an objective "that is clearly distinct from the objective of maintaining price stability, which is the primary objective of the Union's monetary policy." *Pringle,* EU:C:2012:756, ¶ 56. The CJEU went on to clarify that the fact that the stability of the euro could have repercussions on price stability could not mean that the ESM should be treated as a tool of monetary policy. *See id*. ¶ 60.

[100] Therefore, the distinction between the purpose pursued by a policy and its side effects can be easily disguised. Furthermore, "Ricardian equivalence" postulates that the market will absorb any stimulus by policymakers regardless of whether it is funded via tax increases, deficits, or by printing money. *See* Ricardo, *supra* note 98, more recently reformulated in Barro, *supra* note 98.

[101] Democratically elected bodies, however, are more likely to let their decisions be hijacked by short-term political considerations, which might result in monetary financing and inflation. This is the so-called "time inconsistency." *See, e.g.,* Alesina & Summers, *supra* note 9; *see also* Alex Cukierman, *Central Bank Independence and Monetary Policymaking Institutions — Past, Present and Future*, 24 EUR. J. POL. ECON. 722, 735 (2008).

[102] EUR. CENT. BANK, *Transmission Mechanism of Monetary Policy* (2016), https://www.ecb.europa.eu/mopo/intro/transmission/html/index.en.html.

by liquidity shortages causing interest rate spikes,[103] or in non-monetary terms, as a means to finance EU governments' deficits. Thus, the key was not the tools or the goals, but whether the design of OMT indicated a loss, or risk of loss, of the ECB's independence.

In light of *Gauweiler*, courts should also remember that the exercise of ascertaining the boundaries of monetary policy is a subtle one. Beyond specific prohibitions, for example, granting loans to Member States or acquiring their debt in primary markets, the assessment should be based on the principle of proportionality. This is the best tool to balance two or more interests in conflict. In our opinion, no measure of monetary policy should undermine the principle of independence, enshrined in article 130 TFEU, under which the ECB is meant to operate. Doubts remain as to whether in cases where the CJEU lacks the benefit of hindsight the Court should insist on (1) more robust evidence of the aims of a program and its intended use and (2) an *ex post* review as part of the proportionality assessment. These checks would have to be carefully managed to balance the need for a firm constitutional footing in the exercise of central bank competences with that of an effective monetary policy.

2. Could LOLR Functions Fit within the ECB's Monetary Mandate?

The *Gauweiler* case has set an important precedent to determine how far the ECB can go into stretching the limits of its monetary policy mandate under EU primary law. In light of the standard of review set in *Gauweiler*, in this section we examine whether measures of financial stability such as LOLR, where the central bank provides financial assistance to individual institutions facing temporary liquidity problems,[104] could fit within the ECB's mandate of monetary policy.

In light of the framework laid down in the *Gauweiler* case, the fact that financial stability is a goal enshrined in secondary EU law need not prevent the application of operational instruments generally associated with monetary policy for purposes of achieving that goal. According to article 18 of the Statute, the ECB can use its operational instruments "to achieve the objectives of the ESCB and to carry out its tasks."[105] Since this provision is included in a Protocol to the TFEU, these "objectives" and "tasks" should be construed as the "objectives" and "tasks" enumerated under article 127(2) of the TFEU.[106] Financial stability, on the other hand, is a goal enshrined in secondary law under Treaty authorization pursuant to article 127(6) TFEU.[107] Because the ECB is subject to a more stringent proportionality test than other central banks with broader mandates,[108] the use of such instruments for purposes of financial stability would require balancing the

[103] Piti Disyatat, *Monetary Policy Implementation: Misconceptions and Their Consequences* 11 (Bank for International Settlements, Working Paper No. 269, 2008), http://www.bis.org/publ/work269.pdf.

[104] In the EU, the paramount example of LOLR assistance is the Emergency Liquidity Assistance (ELA) program. *See* EUR. CENT. BANK *ELA Procedures*, (2014), https://www.ecb.europa.eu/pub/pdf/other/201402_elaprocedures.en.pdf?e716d1d560392b10142724f50c6bf66a.

[105] Statute of the ESCB and of the ECB, *supra* note 4, art. 18.

[106] *See* TFEU, art. 127(2). This is confirmed by the CJEU's interpretation in *Gauweiler*, analyzed above, which focused on the link between instruments and the goal of "price stability." *See infra* Part I.B.1.

[107] *See* TFEU, art. 127(6).

[108] *See Gauweiler,* EU:C:2015:400, ¶ 68. More generally, *see infra* Part I.B.1.

protected interest of monetary policy *if* its implementation is endangered by financial instability with the harm potentially arising from the measure. Thus, transactions that may have a positive effect on financial stability, and thereby ease the transmission of monetary policy impulses, and that will not compromise the ECB's independence, could be justified in monetary terms. Massive purchases of non-government assets (such as asset-backed securities (ABS)) [109] are a paramount example.

When the assets purchased are government bonds, the fit might not be so clear: first, the operations might be seen as undermining central bank independence; and second, there may be an express prohibition protecting such central bank independence, for example, that of monetary financing under article 123 TFEU. In the specific circumstances of *Gauweiler*, however, the CJEU applied a rather mild proportionality test, leaving the ECB ample room to manoeuver.[110] If the ECB were to engage in the purchase of financial assets other than government bonds, such as ABS,[111] to restore financial stability, we could reasonably expect the CJEU to apply a proportionality test that would be at least as mild as the one it applied in *Gauweiler*. As a result, these ABS would not be affected by the monetary financing prohibition.

A problem might arise, however, when examining the goal of a purchase program under the LOLR function. In light of the *Gauweiler* case, in order for such a purchase program to be considered a measure of monetary policy rather than one of economic policy, the ECB would have to demonstrate that the objective of the program has a "direct effect" on the primary objective of the ECB as stipulated in article 119 TFEU, i.e. price stability. Otherwise, the CJEU might characterize the program as a measure of economic policy, thus falling under the exclusive competence of Member States, as where a major financial institution that is normally a counterparty to the ECB's open market operations undergoes financial difficulties. The ECB could argue that the failure of such a financial institution could cause a major disruption to the implementation of monetary policy. However, an ECB asset purchase program that would attempt to anticipate future shocks by *leaning against* asset-price or credit bubbles,[112] rather than to *restore* financial stability, might be less clear. In those cases, the connection between the program and price stability might be too tenuous. Moreover, that would translate into the measure not being *appropriate* or it *going too far* under a proportionality test. However, to make that determination and limit ECB action, the CJEU would need to examine the economic substance of the argument, something that, today, seems rather unlikely. Despite an EU measure being characterized as monetary policy, the democratic legitimacy of the measure should still be questioned. This is particularly important for any "uncharted" powers, such as LOLR functions, since they are more likely to be challenged.

---

[109] *See, e.g.*, EUROPEAN CENTRAL BANK, *Asset Purchase Programmes*, https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html.

[110] *See Gauweiler,* EU:C:2015:400, ¶¶ 66–68.

[111] *See, e.g., Asset Purchase Programmes*, *supra* note 109.

[112] Credit bubbles are easier to identify than asset price bubbles. *See* Frederic S. Mishkin, *Monetary policy flexibility, risk management, and financial disruptions*, 21 J. ASIAN ECON. 242 (2010); William R. White, *Should Monetary Policy "Lean or Clean"?* (Fed. Reserve Bank of Dallas Globalization and Monetary Pol. Inst., Working Paper No. 34, 2009), https://www.dallasfed.org/assets/documents/institute/wpapers/2009/0034.pdf.

To date, however, the CJEU has not examined the compatibility of LOLR measures with the ECB's monetary policy mandate. This could explain the ECB's reluctance to assume clear responsibilities in the implementation of LOLR programs, such as the Emergency Liquidity Assistance (ELA) program.[113] For the foregoing reasons, our assessment should be read with the necessary caution.

C. How Far into "Uncharted Waters"? Fitting LOLR Functions Within Other Core Mandates

The analysis in the previous section illustrates the complexity of fitting policy measures aimed at protecting financial stability within the ECB's mandate of monetary policy. In spite of this complexity, we believe that the ECB could justify the exercise of its operational powers for purposes of financial stability within the scope of two other core mandates.

The first is the ECB's exercise of its competence "to promote the smooth operation of payment systems" to fit financial stability purposes.[114] Unlike more traditional LOLR mechanisms, where credit is typically extended to individual institutions, measures that aim at smoothing the functioning of the payments system tend to have a more general scope.[115] Nevertheless, when the failure of one or several institutions threatens to cause a disruption in the payments system, extending credit to the relevant institutions would seem like a reasonable measure. This premise could have served to justify the ECB's past recourse to extraordinary Long-Term Refinancing Operations to ease pressures on the cross-border system of EU payments (Target2) when there was an increasing gap in the balances between entities located in Northern and Southern Europe.[116]

Article 127(5) of the TFEU provides a second possibility: "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

[113] Under the ELA program, national central Banks (NCBs) are responsible for the implementation of financial assistance transactions. The ECB simply holds the right to control the operation of those transactions by examining the information provided by the relevant NCBs. *See ELA Procedures*, *supra* note 104. For a recent and insightful discussion, compare C. Zilioli, *Introduction, in* ECB LEGAL CONFERENCE 2015: FROM MONETARY UNION TO BANKING UNION, ON THE WAY TO CAPITAL MARKETS UNION 49 (2015); C. V. Gortsos, *Last Resort Lending to Solvent Credit Institutions in the Euro Area Before and After the Establishment Of The Single Supervisory Mechanism (SSM), in* ECB LEGAL CONFERENCE 2015: FROM MONETARY UNION TO BANKING UNION, ON THE WAY TO CAPITAL MARKETS UNION 53 (2015); and R. Lastra, *Reflections on Banking Union, Lender of Last Resort and Supervisory Discretion*, *in* ECB LEGAL CONFERENCE 2015: FROM MONETARY UNION TO BANKING UNION, ON THE WAY TO CAPITAL MARKETS UNION 154 (2015).

[114] TFEU, art. 127(2).

[115] *See* Francesco Purificato & Caterina Astarita, *TARGET2 Imbalances and the ECB as Lender of Last Resort,* 3 INT. J. FIN. STUD. 482 (2015); Ulrich Bindseil & Philipp Johann König, *The Economics of Target2 Balances* (SFB 649, Discussion Paper 2011-035, 2011) (discussing both the functioning of the Target2 system of inter-bank payments and the ECB's role in keeping liquidity levels across the system).

[116] *See, e.g.*, European Central Bank Press Release, ECB announces measures to support bank lending and money market activity, (December 8, 2011), https://www.ecb.europa.eu/press/pr/date/2011/html/pr111208_1.en.html. For an account of the "Target 2 balances crisis" that had economists worried in 2011-2012; see Silvia Merler, *What is the meaning of TARGET balances?*, BRUEGEL (February 29, 2012), http://bruegel.org/2012/02/what-is-the-meaning-of-target-balances; *see also* Silvia Merler, *One chart explaining what happened to the European debt crisis*, QUARTZ (October 6, 2014), http://qz.com/275180/one-chart-explaining-what-happened-to-the-european-debt-crisis.

financial system."[117] This provision was drafted at a time when monetary policy was a competence of the ECB and prudential supervision a competence of Member States. Since the ECB is now the "competent authority" for prudential supervision in accordance with the SSM Regulation, one could argue that article 127(5) of the TFEU could serve as a solid ground for the ECB to exercise its powers.[118] However, the language of the provision seems merely to emphasize that the responsibility for financial stability is attached to prudential supervision. It is therefore advisable to regard the provision as a mere interpretative device rather than a source of new powers.

In our view, the ECB could find ample ground in its *monetary* and *payments* mandates to exercise its powers for purposes of financial stability, and even for LOLR programs such as ELA. Nevertheless, at least in the case of monetary policy, the ECB might have to justify a connection between the said programs and the ECB's primary objective of price stability. The programs would have to meet the restrictions arising from the proportionality principle.

Finally, it is important to understand that, unlike monetary policy, financial stability is not an exclusive EU competence (except in what concerns monetary policy). This is reflected in the SSM Framework,[119] and in the fact that other bodies, such as the European Stability Mechanism (ESM), have responsibilities in that regard.[120]

II. BANKING UNION, PRUDENTIAL SUPERVISION, AND ITS LIMITS

After discussing the core mandates of the ECB, where it has broad operational discretion, this Part examines the new competences on prudential supervision conferred on the ECB under the SSM Regulation, where the ECB enjoys less discretion. We begin by describing briefly the ECB's role in the SSM/SRM, and its broader picture (A). Then, we analyze the limits of the ECB's mandate resulting from the transition into the "resolution" area (B). Finally, we analyze the ECB's exercise of *quasi-regulatory* competences, and its limits (C).

A. The Banking Union Reforms

1. The Path Towards the Banking Union

Arguably, the Banking Union has been the more drastic rearrangement of competences in the field of EU banking and financial law. Its origins lie in the 2007-2008 financial crisis, which, upon crossing the Atlantic, morphed into the 2011-2013 sovereign debt crisis, when its effects were compounded by a weak

---

[117] TFEU, art. 127(5).

[118] This could justify, for example, the exercise of residual discretion in the field of 'prudential regulation' when it is closely linked to supervision, or the exercise of macro-prudential regulation. *See infra* Parts II.A.2, II.C.1.

[119] *See, e.g.,* Council Regulation 1024/2013/EU, Conferring Specific Tasks on the European Central Bank Concerning Policies Relating to the Prudential Supervision of Credit Institutions, rec. 2, 5, 6, 13, 30, art. 5(2), 2013 O.J. (L 287) 63 (demonstrating the ECB's role as guarantor of stability); *id*. rec. 15, 44, art. 5(1) (showing that the competence is shared).

[120] The ESM (the European Stability Mechanism) is the crisis resolution mechanism for countries in the euro area. The decision leading to the creation of the ESM was taken by the European Council in December 2010, and euro area Member States signed an intergovernmental treaty establishing the ESM on 2 February 2012. The ESM was inaugurated on October 8, 2012. *See* EUROPEAN STABILITY MECHANISM, *Home*, http://www.esm.europa.eu/index.htm.

institutional structure, and a euro-sized crisis was not met with a euro-sized response. Calls to build a crisis management framework[121] went unheeded, or prompted slow responses. The Presidents of the Council, Commission, Eurogroup and ECB only submitted a report with formal proposals in June 2012.[122]

After President Draghi's highly consequential warning that the ECB would do "whatever it takes to preserve the euro,"[123] the joint work tried to accompany the credibility of a promise with concrete institutional reforms, which would sever the link between banks and sovereigns, and reduce the risk of supervisors' moral hazard.[124] This would come with a single European banking supervision mechanism and a common deposit insurance and resolution framework.[125]

In the ensuing Euro Area Summit, the Commission was asked to submit a proposal for a single supervisory mechanism (SSM) based on article 127(6) of the TFEU.[126] On September 12, 2012, the Commission presented a proposal to rearrange supervisory powers between the ECB and National Competent Authorities (NCAs) that would become the SSM,[127] and a roadmap for the Banking Union, including the single rulebook, common deposit protection and a single bank resolution mechanism (SRM).[128] The SSM was established in October 2013,[129] and the SRM and the Single Resolution Fund (SRF) in July 2014.[130] The

---

[121] *See, e.g.,* European Parliament Resolution of 7 Jul. 2010, With Recommendations to the European Commission on Cross-Border Crisis Management in the Banking Sector, EUR. PARL. DOC. P7_TA(2010)0276.

[122] *See* Herman Van Rompuy, President of the European Council, *Towards a Genuine Economic Monetary Union*, EUCO 120/12 (June 26, 2012), available at http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/134069.pdf.

[123] Draghi, *supra* note 2.

[124] "An integrated financial framework to ensure financial stability in particular in the euro area and minimize the cost of bank failures to European citizens." Van Rompuy, *supra* note 122 at 3. The three other building blocks were an integrated budgetary framework, an integrated economic policy framework, and the need to ensure the necessary legitimacy and accountability of decision-making within the EU.

[125] *See id.* at 4–5.

[126] The proposal would be considered by the Council "as a matter of urgency" before the end of 2012. *See* Euro Area Summit*, Brussels, June 29, 2012 Euro Area Summit Statement* (June 29, 2012), http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131359.pdf.

[127] *See Commission 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) 511 final (Dec. 9, 2012). The Commission also proposed a regulation that re-balanced decision-making at the European Banking Authority (EBA) (*see Commission 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),* COM (2012) 512 final (Dec. 9, 2012)).

[128] *See Communication from the Commission to the European Parliament and the Council, A Roadmap Towards a Banking Union,* COM (2012) 510 final (Dec. 9, 2012).

[129] It was created by two Regulations: SSM Regulation, *supra* note 5 and Parliament and Council Regulation 1022/2013/EU, 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, 2013 O.J. (L 287) 5 [hereinafter EBA Regulation].

[130] Parliament and Council Regulation 806/2014/EU, Establishing Uniform Rules and a Uniform Procedure for the Resolution of Credit Institutions and Certain Investment Firms in the Framework of a Single Resolution Mechanism and a Single Resolution Fund, 2014 O.J. (L 225) 1 [hereinafter SRM Regulation]. This would apply to banks covered by the SSM, which would enter "resolution" procedures managed by a Single Resolution Board (SRB) in conjunction with national resolution authorities (NRAs) (*see* SRM Regulation, *supra* note 5, art. 7) and a Single Resolution Fund (SRF) (*see* SRM Regulation, art. 67 *et seq*).

two mechanisms were backed by a *single rulebook*, which applied to all banks across the EU, and comprised common prudential rules,[131] resolution procedures,[132] and deposit guarantee schemes.[133] This is not a finished work,[134] but that does not render the process any less impressive.

2. The Single Supervisory Mechanism (SSM). Competences, Coordination, and Accountability

The present article focuses on the ECB mandates. Thus, we concentrate on the SSM, enacted through a Regulation (the SSM Regulation),[135] because it places the ECB at the center of a new supervisory hub-and-spoke network. This network does not have separate legal personality,[136] and is formed by the ECB and NCAs of euro Member States as well as NCAs of closely-cooperating States.[137] In that network the ECB is clearly the most important node and it is vested with direct supervisory powers.

Article 4 contains a wide range of micro-prudential tasks that should form the basis of ongoing supervision. These tasks include: (i) authorization and withdrawal of credit institutions, branches and qualifying holdings, (ii) supervision of compliance with prudential requirements (i.e. capital,

---

[131] *See* Parliament and Council Directive 2013/36/EU, On Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms, 2013 O.J. (L 176) 338 [hereinafter CRD IV]; Parliament and Council Regulation 575/2013/EU, On Prudential Requirements for Credit Institutions and Investment Firms, 2013 O.J (L 176) 1 [hereinafter CRR], known together as the "CR Compact."

[132] *See* Parliament and Council Directive 2014/59/EU, Establishing a Framework for the Recovery and Resolution of Credit Institutions and Investment Firms, 2014 O.J. (L 173) 190 [hereinafter BRRD]. The European Stability Mechanism ("ESM") instrument adopted on 8 December 2014 gave the ESM the power to directly recapitalize euro area financial institutions under specific circumstances (*e.g.*, only if private investors have been bailed-in in accordance with the BRRD) as a last resort measure [hereinafter DRI]. The DRI aims to contribute to breaking the link between governments and banks that caused major instability for some euro area countries in recent years. *See* European Stability Mechanism Press Release, ESM Direct Bank Recapitalisation Instrument Adopted (Dec, 8, 2014), http://www.esm.europa.eu/press/releases/esm-direct-bank-recapitalisation-instrument-adopted.htm.

[133] *See, e.g.,* Parliament and Council Directive 2014/49/EU, On Deposit Guarantee Schemes, 2014 O.J (L 173) 149 [hereinafter DGS Directive].

[134] The Conclusions of the December 2012 European Council intentionally left the door open to further reforms towards a more resilient banking union. *See* Nicolás Verón & Guntram B. Wolff, Directorate General for Internal Policies, *Next Steps on the Road to European Banking Union: The Single Resolution Mechanism in Context in* BANKING UNION: THE SINGLE RESOLUTION MECHANISM, Eur. PARL. DOC. IPOL-ECON_NT(2013)492473 (Feb. 2013), at 8–9. In fact, the European Commission recently presented a *Proposal for a Regulation of the European Parliament and of the Council Amending Regulation (EU) No. 806/2014 In Order to Establish a European Deposit Insurance Scheme*, COM (2015) 586 final (Nov. 24, 2015). For an analysis of possible areas for further integration within the banking union, see Jean Pisani-Ferry et al., *What Kind of European Banking Union?*, BRUEGEL POL'Y CONTRIBUTION Jun. 2012, 1.

[135] SSM Regulation, *supra* note 5. This with the purpose of "contributing to the safety and soundness of credit institutions and the stability of the financial system within the Union and each Member State." SSM Regulation, *supra* note 5, art. 1. The exclusion of insurance undertakings (a necessity imposed by article 127 (6) of the TFEU) is the more controversial point as to its scope. *See* Hans Geeroms & Pawel Karbownik, *A Banking Union for an Unfinished EMU*, Wilfried Marten Centre For European Studies Policy Brief, 5 (2014), http://www.martenscentre.eu/publications/banking-union-unfinished-emu. That, however, would require a change of the Treaties. *See* TFEU, art. 127(6) *and* Statute of the ESCB and of the ECB, *supra* note 4, art 25(2).

[136] *See* Raffaele D'Ambrosio, *The ECB and NCA Liability within the Single Supervisory Mechanism* 78 BANCA D'ITALIA EUROSISTEMA 1, 59 (2015).

[137] *See* SSM Regulation, *supra* note 5, arts. 2(1), (9).

securitizations, large exposure limits, liquidity, leverage, reporting and governance arrangements, including reviews, stress tests, and additional compliance measures), and (iii) early intervention and supervision of recovery plans.[138]

The complexity of the new supervisory arrangement requires careful management of the *vertical* relationships between the ECB and NCAs. In this sense, the exercise of micro-prudential tasks is coordinated between the NCAs and the ECB, which has direct supervisory competence over credit institutions in euro Member States.[139] Article 6 divides the tasks between NCAs, over "less significant" credit institutions,[140] and the ECB, over institutions not considered "less significant",[141] and provides the ECB's accountability, and the assistance by NCAs in the performance of the ECB's tasks.[142] When "*necessary to ensure consistent application of high supervisory standards*," the ECB may exercise all the relevant powers for one or more credit institution(s) directly.[143]

On macro-prudential tasks, both the ECB and NCAs can apply the tools granted by prudential rules, and, while NCAs have the initiative,[144] the ECB may

---

[138] SSM Regulation, *supra* note 5, art. 4(1). Although the tasks may be distributed, the ECB has a clear preponderant role in their design. *See infra* Parts II.B–C.

[139] Non-euro area Member States may choose to be subject to the ECB's supervisory powers under a close cooperation regime. *See* SSM Regulation, *supra* note 5, art. 7; *see also* European Central Bank Regulation 468/2014/EU, Establishing the Framework for Cooperation within the Single Supervisory Mechanism Between the European Central Bank and National Competent Authorities and with National Designated Authorities (SSM Framework Regulation), arts. 106–119, 2014 O.J. (L 141) 1 [hereinafter SSM Framework Regulation].

[140] Except for authorizations and notifications of the acquisition and disposal of qualifying holdings in credit institutions (together: "the Exceptions"). *See* SSM Regulation, *supra* note 5, art. 6(5)(a).

[141] The definition of institutions not considered less significant under SSM Regulation, *supra* note 5 art. 6(4) encompasses "a credit institution or financial holding company or mixed financial holding company," that: (i) has a total value of assets above €30bn, (ii) has a ratio of total assets over the GDP of the Member State of establishment exceeding 20%, unless such total value is below €5bn, or (iii) the NCA considers an institution of significant relevance for the domestic economy and the ECB confirms the decision." *See also* SSM Framework Regulation, *supra* note 139, art. 50–58. Pursuant to SSM Regulation, *supra* note 5, art. 6(4)(4), an institution that has received financial assistance from the EFSF or the ESM shall not be considered as a "less significant" institution either. *See also* SSM Framework Regulation, *supra* note 139, arts. 61–64. Pursuant to SSM Regulation, *supra* note 5, art. 6(4)(3), the ECB may also decide, on its own initiative, to consider an institution to be of significant importance when it has established subsidiaries in more than one participating Member State and its cross-border assets or liabilities represent a significant part of its total assets or liabilities subject to certain conditions. SSM Framework Regulation, *supra* note 139, arts. 59–60. For general provisions relating to the classification of credit institutions as significant or less significant, see *id.* arts. 39–49. For specific provisions governing the structures for the supervision of significant and less significant supervised entities, see *id.* arts. 3–7. For specific details about the procedures for the supervision of significant and less significant entities, see *id.* arts. 89–100. The tasks of the ECB will also extend to the three most significant institutions in each participating Member State unless justified by particular circumstances. *See* SSM Regulation, *supra* note 5, art. 6(4)(5); *see also* SSM Framework Regulation, *supra* note 139, arts. 65–66.

[142] SSM Regulation, *supra* note 5, arts. 6(1)–(3). *See also* SSM Framework Regulation, *supra* note 139, arts. 19–24.

[143] SSM Regulation, *supra* note 5, art. 6(5)(b) (emphasis added). This includes cases of indirect support from the EFSF or ESM. *See also* SSM Framework Regulation, *supra* note 139, art. 67–69. The ECB shall also oversee the functioning of the SSM and may request information from NCAs on the performance of the tasks carried out by them. *See* SSM Regulation, *supra* note 5, art. 6(5)(c), (e).

[144] *See* SSM Regulation, *supra* note 5, art. 5(1). Macro-prudential tools include, among others, the imposition of own funds requirements (*see id.* art. 4(1)(d)), of capital buffers, countercyclical buffer rates, and any other measures aimed at addressing systemic or macro-prudential risks as

impose more stringent measures directly if the NCAs' measures were not strict enough.[145] In the latter case, however, the ECB shall cooperate closely with the NCAs, notify them of its intention,[146] and shall consider their objections before proceeding with a decision.[147]

The new supervisory arrangement also requires carefully managing the *horizontal* relationship between ECB and other EU institutions and bodies. In this sense, the SSM regulation provides for several coordination mechanisms between the ECB on one hand, and the European Banking authority (EBA) and European Commission on the other, to avoid regulatory overlaps. These mechanisms include the participation of the ECB in EBA's Board of Supervisors,[148] and the invitation of a representative of the European Commission to participate in the ECB's Supervisory Board's meetings.[149] These mechanisms will be extremely relevant in situations where ECB and EBA competences overlap, such as during supervisory reviews and stress tests.[150]

Regarding the ECB's regulatory competences, article 4(3) SSM outlines the ECB's regulatory powers using equivocal language, stating that those are conferred "for the purpose of ensuring high standards of supervision" to the ECB.[151] The latter shall adopt "guidelines and recommendations," and may also adopt regulations[152] "*only to the extent necessary to organise or specify the arrangements for the carrying out of the tasks conferred on it by this Regulation*."[153] We will examine the implications of this equivocal language later.[154] Nevertheless, at this point it is important to note that in exercising the tasks conferred on it under the SSM Regulation, the ECB shall be subject to EU law, including legislative and non-legislative acts by the Commission, technical standards developed by the EBA and adopted by the Commission, and the provisions on the European supervisory handbook developed by EBA in accordance with that Regulation. There is specific emphasis on the need for the

---

provided for, and subject to the procedures set out in the Capital Compact. *See, e.g.*, CRD IV, *supra* note 131, arts. 128–142.

[145] *See* SSM Regulation, *supra* note 5, art. 5(2). Pursuant to art. 5(3), national authorities may require the ECB to act in accordance with art. 5(2) "to address the specific situation of the financial system and the economy in its Member State." *Id.* art. 5(2)–(3).

[146] For details about the cooperation between the ECB and the relevant national authorities, see SSM Framework Regulation, *supra* note 139, arts. 101–105.

[147] *See* SSM Regulation, *supra* note 5, art. 5(4). It shall also "take into account the specific situation of the financial system, economic situation and the economic cycle in individual Member States or parts thereof." *Id.* art. 5(5).

[148] SSM Regulation, *supra* note 5, art. 3.

[149] *Id.* art. 26(11). Although art. 26(11) does not provide for the possibility of the Supervisory Board inviting a representative of the EBA to attend the Board's meetings as an observer, "[i]n order to ensure full coordination with the activities of EBA and with the prudential policies of the Union," rec. 70 does provide that "the Supervisory Board should be able to invite EBA and the Commission as observers." *Id.* rec. 70.

[150] *See, e.g., id.* art. 4(1)(f).

[151] SSM Regulation, *supra* note 5, art. 4(3).

[152] Statute of the ESCB and of the ECB, *supra* note 4, arts. 25(2), 34(1) confer the power upon the ECB to make regulations to the extent necessary to implement tasks of prudential supervision of credit institutions and other financial institutions under the jurisdiction of the ECB, in accordance with any Regulation of the Council under art. 127(6) of the TFEU. This is the case with the SSM Regulation.

[153] SSM Regulation, *supra* note 5, arts. 4(3)(2), 6(5)(a) (emphasis added). Some the ECB's regulations cannot be substantive banking rules, *i.e.*, they cannot directly impose obligations vis-à-vis credit institutions. *See* D'Ambrosio, *supra* note 136, at 101–105. In case of breach, the ECB may impose pecuniary penalties. *See* SSM Regulation, *supra* note 5, art. 18; SSM Framework Regulation, *supra* note 139, arts. 120–137. Moreover, *see* CRD IV, *supra* note 131, arts. 64–72.

[154] *See infra* Part II.C.

ECB to respect the tasks of the EBA.[155] The ECB, however, shall also contribute to the development of draft technical standards (DTS) or implementing technical standards by the EBA, or it shall draw its attention to a potential need to submit DTS to the Commission.[156]

Finally, with regard to governance and accountability, SSM provisions state that supervision will be carried out independently,[157] and separately from monetary tasks,[158] under the aegis of a Supervisory Board.[159] Supervisory Board draft decisions, however, will be submitted to the Governing Council of the ECB, which will adopt them unless it objects in writing.[160] In terms of political accountability, the ECB shall be accountable to the European Parliament and the European Council for its implementation of the SSM Regulation,[161] as well as to the relevant national parliaments under certain circumstances.[162] Moreover, the European Court of Auditors[163] will take into account the ECB's supervisory tasks when evaluating its operational efficiency.[164] ECB acts can be reviewed by an Administrative Board of Review,[165] as well as the CJEU,[166] and the ECB is subject to the liability regime under article 340 TFEU.[167]

---

[155] SSM Regulation, *supra* note 5, rec. 32 states that "[t]he ECB should not replace the exercise of those tasks by EBA, and should therefore exercise powers to adopt regulations in accordance with Article 132 of the [TFEU]." *See also id.* art. 3(3); Parliament and Council Regulation 1022/2013/EC, 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, rec. 4, 2013 O.J. (L 287) 5.

[156] *See* SSM Regulation, *supra* note 5, art. 4(3)(4).

[157] *See id.* art. 19.

[158] *See id.* art. 25.

[159] This is composed of a Chair, Vice-Chair, four ECB representatives, and one representative of the NCA of each participating Member State. *Id.* art. 26(1). Arts. 26(2)–(5) provide specific details about the appointment and removal of members of the Supervisory Board. It will decide by simple majority, unless otherwise stated in the SSM Regulation. *See id.* art. 26(6). The Supervisory Board shall establish a steering committee from among its members to support the Board's activities; however, it shall have no decision-making powers. *See id.* art. 26(10).

[160] *Id.* art. 26(8). Arts. 7(7), 8 provide for specific procedures for participating Member States that are non-euro States. For the composition of the ECB's Governing Council, see TFEU, art. 283(1) and Statute of the ESCB and of the ECB, *supra* note 4, art. 10(1).

[161] *See* SSM Regulation, *supra* note 5, art. 20.

[162] *See id.* art. 21.

[163] On the role of the European Court of Auditors in the control of financial supervisors, see EUROPEAN COURT OF AUDITORS, *European Banking Supervision Taking Shape—EBA and its Changing Context* (2014), http://www.eca.europa.eu/Lists/ECADocuments/SR14_05/SR14_05_EN.pdf.

[164] *See* SSM Regulation, *supra* note 5, art. 20(7).

[165] *See id.* art. 24.

[166] *See* Statute of the ESCB and of the ECB, *supra* note 4, art. 35(1); *see also* TFEU, art. 271(d).

[167] Statute of the ESCB and of the ECB, *supra* note 4, art. 35(3). SSM Regulation, *supra* note 5, rec. 60 continues to subject the ECB to the liability regime laid under TFEU, art. 340 for its supervisory authority conferred under the SSM Regulation. D'Ambrosio, however, concludes that the absence of any limitation of the ECB's liability is unjustified in light of the 2012 Basel Core Principles for Effective Banking Supervision and is also inconsistent with a single and unitary SSM. *See* D'Ambrosio, *supra* note 136, at 11–70. Moreover, he argues that the absence of any limitation on the ECB's liability could lead it to over-rely on NCAs, as they enjoy a greater degree of legal protection, and that this could *de facto* distort the allocation of supervisory powers and responsibilities within the SSM, as well as the allocation of accountability obligations towards the EU or national parliaments. The procedures also contain important individual safeguards, such as the right to be heard of persons subject to the proceedings. SSM Framework Regulation, *supra* note 139, arts. 25–38. These will be analyzed in a separate article.

B. ECB's Competences Over Failing Banks: Coordination and Overlaps in the Twilight Zone

The resolution framework is a more recent piece of the Banking Union. These changes come as a result of: first, the controversy over loss mutualization;[168] second, the difficulty to combine a more centralized system for euro area countries (the SRM) with a looser coordination mechanism for all EU Member States under the Bank Recovery and Resolution Directive (BRRD);[169] third, the absence of an express Treaty basis like article 127(6) TFEU for the SSM; and fourth, unlike in the context of the SSM, the presence of clear objections to putting the ECB in charge of bank resolution, a policy decision that could create an unnecessary overload and conflicts of interests. [170]

The resolution framework resulted in an architecture that pivoted away from article 127(6) TFEU and the ECB. The SRM is based on article 114 TFEU, which addresses the Single Market, and a Regulation (the SRM Regulation)[171] that is applicable to euro Member States. This regulation is coordinated with a Directive (the BRRD), [172] which is applicable in all EU Member States. The SRM Regulation also relies on an intergovernmental agreement that sets up the single resolution fund (SRF). [173] Resolution competences almost mirror supervisory competences: in principle, if the latter are exercised at the EU level, so will the former. [174] These competences are exercised by the Single Resolution Board (SRB), which is a Union "agency," [175] a middle-term between a Union

---

[168] *See, e.g.*, Niamh Moloney, *European Banking Union: Assessing its risks and resilience*, 51 COMMON MKT. L REV. 1609, 1625 (2014).

[169] *See generally*, BRRD, *supra* note 132.

[170] BRRD. art. 3(3) provides that: "Resolution authorities may be national central banks, competent ministries or other public administrative authorities or authorities entrusted with public administrative powers. Member States may exceptionally provide for the resolution authority to be the competent authorities for supervision for the purposes of Regulation (EU) 575/2013 and Directive 2013/36/EU. Adequate structural arrangements shall be in place to ensure operational independence and avoid conflicts of interest between the functions of supervision pursuant to Regulation (EU) 575/2013 and Directive 2013/36/EU or the other functions of the relevant authority and the functions of resolution authorities pursuant to this Directive, without prejudice to the exchange of information and cooperation obligations as required by paragraph 4. In particular, Member States shall ensure that, within the competent authorities, national central banks, competent ministries or other authorities there is operational independence between the resolution function and the supervisory or other functions of the relevant authority." *Id.* art. 3(3). It would be a bit contradictory to consider the accumulation of supervisory and resolution functions "exceptional" and subject to safeguards within the BRRD system, and then turn the exception into the rule in the SRM.

[171] SRM Regulation, *supra* note 5.

[172] Examples of coordination can be found in the identical language between SRM Regulation, *supra* note 5, art. 19(1); BRRD, *supra* note 132, art. (32)(1) (triggers for the resolution procedure); SRM Regulation, *supra* note 5, arts. 27(1)–(2) and BRRD, *supra* note 132, arts. 43(2)– (3)(bail-in).

[173] SRM Regulation, *supra* note 5, art. 1 provides that: "The SRM shall be supported by a single resolution fund ("the Fund"). The use of the Fund shall be contingent upon the entry into force of an agreement among the participating Member States ("the Agreement") on transferring the funds raised at national level towards the Fund as well as on a progressive merger of the different funds raised at national level to be allocated to national compartments of the Fund." The Intergovernmental Agreement (IGA) was signed in May 2014 by all Member States, except for Sweden and the UK. *See Council Agreement on the transfer and mutualisation of contributions to the Single Resolution fund*, SEC (2014) 8547 (May. 14, 2014). It needs to be ratified by the Member States.

[174] Resolution competences are exercised at an EU level in cases where the ECB exercises supervisory competences under the SSM Regulation over the same banking group.

[175] SRM Regulation, *supra* note 5, art. 42(1). It is like the three European Supervisory Authorities (ESAs), also based on TFEU, art. 114.

"institution," such as the ECB,[176] and the looser "colleges" of resolution authorities, such as those included in the BRRD.[177] The SRB has legal personality and decision-making capacity.[178] Its composition shows a balance between expediency and political compromise,[179] which is also present in the decision-making process. The SRB makes the more critical decisions (including resolution plans and tools).[180] National Resolution Authorities (NRAs) retain specific tasks[181] and participate in the executive session if they are relevant for the group or entity.[182]

The ECB does not retain as central a role under the SRM as it does under the SSM. Despite the difference, the coordination of the SRM and the SSM creates a seamless continuum between non-compliance with regulatory requirements, early intervention, and resolution, which may blur the boundaries between the different stages. This area of convergence-blurred boundaries will be referred to as "the twilight zone." This makes sense considering how quickly the breach of prudential rules can result in the deterioration of a bank's financial position, resulting in resolution.

First, the ECB can take early intervention measures when a supervised institution does not meet regulatory requirements, when a breach may occur within the next 12 months, or when there is no assurance of sound management or coverage of risks.[183] Next, the ECB participates in relevant resolution decisions.[184] A key example is the decision to adopt a resolution scheme. Although the SRM can decide whether the relevant criteria are met[185] and is

---

[176] *See* TEU, art. 13.

[177] *See* BRRD, *supra* note 132, art. 8. A resolution college is not decision-making body, "but a platform facilitating decision-making by national authorities" *Id*. rec. 98.

[178] SRM Regulation, *supra* note 5, art. 42(1) *in fine*; *id.* arts. 50, 53–54.

[179] It is formed by a Chair and four full-time members, as well as a representative of each National Resolution Authority (NRA) (all with a vote), and two observers from the Commission and the ECB (with no vote). *Id*. arts. 43(1)–(3).

[180] *Id*. arts. 8–11(resolution plans), 20 (procedure and valuations), 12 (requirements for own funds and liabilities), 21 (debt write-down or conversion of capital instruments), 22–27 (resolution schemes, making use of tools such as a sale of business, bridge institution, asset separation and bail-in). In general, the decision is made by the executive session (with the chair and four full-time members). *See id*. arts. 18(1), 21(1). For the composition, see *id*. art. 53(1). However, the decision will be adopted by the plenary session, if a member of this session so requests. *See id*. art. 50(2).

[181] *Id*. art. 7(3).

[182] *See id*. arts. 53(3)–(4).

[183] These include requiring the institution to raise funds above mandatory capital requirements; requiring reinforcements of arrangements or processes; strategic plans to restore compliance; specific provisioning policies; restrictions of activities or a reduction of risks; limits in variable remuneration; use of profits to strengthen own funds, including restricting distributions; or removing managers in breach of requirements. *See* SSM Regulation, *supra* note 5, art. 16. Besides the measures specified therein, pursuant to SRM Regulation, *supra* note 5, arts. 13, 2(1) and BRRD, *supra* note 132, rec. 21, the ECB may also adopt the early intervention measures specified under BRRD, *supra* note 132, art. 21(1), 28, 29. Moreover, pursuant to BRRD, *supra* note 132, arts. 18(1)–(2), the ECB is vested with the power to evaluate whether a credit institution is failing or is likely to fail, regardless of its significance. *See* D'Ambrosio, *supra* note 136, at 85; Moloney, *supra* note 168, at 1640; CRD IV, *supra* note 131, art. 104.

[184] The ECB is consulted in the drafting of resolution plans (SRM Regulation, *supra* note 5, art. 8(2), 13), the assessment of resolvability of groups and institutions (*id.* art. 10), or the determination of minimum requirement for own funds and eligible liabilities (*id.* art. 12).

[185] That the entity is likely to fail, there is no prospect of a private solution, and resolution is in the public interest. *See id.* art.18(1). These are supplemented by *id.* art. 18(4) which specifies the criteria to assess whether an entity is failing or is likely to fail, and *id.* art. 18(5) for the elements to determine the "public interest" criterion.

formally responsible for adopting the decision,[186] the assessment of the two *technical* conditions—likelihood to fail and absence of private sector alternative—correspond *primarily* to the ECB.[187] This creates an overlap between ECB and SRM competences. To resolve the potential conflict of interest, the rules allow the Board to sidestep the ECB and to make its own assessment.

This potential conflict raises a legitimate question: who should be considered responsible for making the decision and could thus be challenged in courts? The letter of the law is clear: the decision to adopt a resolution scheme belongs to the SRB.[188] In cases where the ECB does not make an assessment, the SRB retains some degree of discretion, and it would therefore make sense to challenge the latter's decision. However, in cases where the ECB does make an assessment and determines that the resolution conditions are fulfilled, the SRB retains a thin margin of discretion. If the SRB refuses to adopt a resolution on grounds of lack of public interest, the decision would most likely be challenged by the Commission, and overturned by the Council.[189] Further, the SRB may lack the means to challenge the ECB's view on the grounds of its own assessment about the likelihood of a private sector solution or regulatory intervention.[190] Thus, financial institutions should be entitled to challenge the SRB's decision on the need to adopt a resolution scheme and the ECB's assessment on that same issue separately, or, alternatively, to challenge the SRB's decision and, via this challenge, examine the substance of the ECB's assessment.[191]

Another decision where the ECB and the SRB overlap is the decision to convert or write down capital instruments. The decision nominally belongs to the SRB.[192] However, the assessment that the entity is failing or likely to fail and that of viability, which gives rise to the decision, are made by the ECB, making the ECB the primary participant.[193] The SRB can also step in and make its own assessment, but the prerogative in this case looks quite exceptional.[194] Additionally, Article 21 of the SRM Regulation states that the SRB will only decide on the write-down if, among other things, (a) the conditions for resolution under article 18 are met, and (b) the entity will not be viable in the absence of a

---

[186] Subject to objections by the Commission or Council. The decision is transmitted "immediately" to the Commission, which in 24 hours can endorse it or object to its discretionary aspects. If the objections concern the "public interest," its proposal must be adopted by the Council. *Id.* art. 18(7).

[187] *Id.* art. 18(1).

[188] *Id.* arts. 18, 21.

[189] *Id.* art. 18(7)

[190] *Id.* art. 18(1)(4) states: "An assessment of the condition referred to in point (b) of the first subparagraph shall be made by the Board, in its executive session, or, where applicable, by the national resolution authorities, in close cooperation with the ECB. The ECB may also inform the Board or the national resolution authorities concerned that it considers the condition laid down in that point to be met."

[191] Still, given that the assessment itself can turn into a self-fulfilling prophecy, judicial review of the act does not look like a promising avenue to enhance the accountability of the Board or the ECB.

[192] *See* SRM Regulation, *supra* note 5, art. 21(1).

[193] *Id*. art. 21(2).

[194] Pursuant to SRM Regulation, *supra* note 5, art. 21(2), the Board may make the decision "only after informing the ECB of its intention and only if the ECB, within three calendar days of receipt of such information, does not make such an assessment."

write-down or conversion must be made.[195] Article 18, for its part, requires that the entity must not be viable *even* if a write-down takes place.[196]

The plain reading of article 18(1) suggests that, *before* adopting a resolution scheme, it will be necessary to make an assessment about whether the entity could be made viable by less drastic measures, including private sector solutions, supervisory solutions, *and debt write-downs*. If the institution cannot be made viable, *even* using the means under article 18, the write-down is adopted as part of the resolution scheme pursuant to article 21(1)(a). In other words, although a write-down is part of the resolution scheme, it may also be used outside resolution as a last resort measure to make the entity viable.[197]

The problem is that if the write-down or conversion is adopted *as part of* a resolution scheme, the decision belongs to the SRB. But if it is a solution to avoid resolution, who should adopt it? In principle, given the fact that the entity is not in resolution, the competence could belong to the ECB. This would also make sense in order to ensure that the supervisory and resolution frameworks are seamlessly interconnected. However, write-down or conversion mechanisms are not included within the supervisory powers of the ECB under prudential rules,[198] the SSM Regulation,[199] or early intervention powers under the BRRD.[200] Thus, absent any other specific reference, the ECB might wish to choose caution and ensure that the SRB adopts the decision, even nominally.

---

[195] SRM Regulation, *supra* note 5, art. 21.

[196] SRM Regulation, *supra* note 5, art. 18(1)(b) states that, to adopt a resolution scheme, an assessment must be made that "there is no reasonable prospect that any alternative private sector measures, including measures by an IPS, or supervisory action, including early intervention measures or the write-down or conversion of relevant capital instruments in accordance with Article 21, taken in respect of the entity, would prevent its failure within a reasonable timeframe."

[197] Since SRM Regulation, *supra* note 5, art. 21(1)(b) states that it needs to be ascertained that "the entity will no longer be viable unless the relevant capital instruments are written down or converted into equity," this entails directly that write-down or conversion can be used to make the entity viable. However, this is still subject to article 21(1)'s first paragraph, which states that the SRB shall adopt the write-down or conversion "acting under the procedure laid down in Article 18." SRM Regulation, *supra* note 5, art. 21(1).

[198] *See* Parliament and Council Directive 2013/36/EU, On Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms, art. 104, 2013 O.J. (L 176) 338. Prudential rules seem to presume that the write-down or conversion can only be decided by the resolution authority. Parliament and Council Regulation 575/2013/EU, On Prudential Requirements for Credit Institutions and Investment Firms, art. 28(2), 2013 O.J. (L 176) 1, which deals with the definition of capital instruments, states that: "The conditions laid down in point (i) of paragraph 1 shall be deemed to be met notwithstanding a write down on a permanent basis of the principal amount of Additional Tier 1 or Tier 2 instruments. The condition laid down in point (f) of paragraph 1 shall be deemed to be met notwithstanding the reduction of the principal amount of the capital instrument *within a resolution procedure or as a consequence of a write down of capital instruments required by the resolution authority* responsible for the institution. The condition laid down in point (g) of paragraph 1 shall be deemed to be met notwithstanding the provisions governing the capital instrument indicating expressly or implicitly that the principal amount of the instrument would or might be reduced *within a resolution procedure or as a consequence of a write down of capital instruments required by the resolution authority* responsible for the institution." (Emphasis added.)

[199] *See* SSM Regulation, *supra* note 5, art. 16.

[200] *See* BRRD, *supra* note 132, arts. 27-29.

C. *The ECB's Power to Issue Prudential Rules and its Constitutional Limits*

1. Can the ECB Exercise Regulatory Powers on Prudential Matters?

With the general framework in mind, the critical question is whether, in addition to the day-to-day supervision of financial entities, the ECB can also issue regulatory rules for the performance of its tasks.

The SSM/SRM rules are not coordinated with the rules that preceded them, i.e. the Single Prudential Rulebook (SPR) rules, including the Capital Requirements Directive (CRD IV),[201] and the Capital Requirements Regulation (CRR).[202] Despite their length and level of detail, CRD/CRR leave many options open and indicate that "Member States" and/or "competent authorities," depending on the measure, are entitled to fill the gaps or exercise the options. These open aspects include the restriction of qualifying holdings outside the financial sector,[203] classification of loans as defaulted,[204] systemic risk buffers,[205] restrictions on distributions,[206] additional disclosures,[207] or liquidity ratios,[208] among others.

The ECB is now moving to exercise some of these competences.[209] These include risk weighting and prohibition of qualifying holdings outside the financial sector,[210] classification of defaulted loans,[211]hedging sets,[212] netting,[213] waivers of own funds requirements in case of system-wide failure,[214] limits to large exposures,[215] exemptions,[216] and the liquidity framework.[217] The matters concern options and discretions where the exercise is conferred to "competent authorities" rather than Member States, and only over *significantly important* institutions.[218]

---

[201] Parliament and Council Directive 2013/36/EU, On Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms, 2013 O.J. (L 176) 338 [hereinafter CRD].

[202] Parliament and Council Regulation 575/2013/EU, On Prudential Requirements for Credit Institutions and Investment Firms, 2013 O.J. (L 176) 1 [hereinafter CRR].

[203] *See* CRR, *supra* note 202, art. 89(3).

[204] *Id*. art. 178(1).

[205] *See* CRD, *supra* note 201, art. 133.

[206] *Id*. art. 141.

[207] *Id*. arts. 143(1)(b). 144.

[208] *See* CRR, *supra* note 202, arts. 415, 420.

[209] *See* EUROPEAN CENTRAL BANK, *Public Consultation on a Draft Regulation of the European Central Bank on the Exercise of Options and Discretions Available in Union Law,* (Nov. 2015), https://www.bankingsupervision.europa.eu/legalframework/publiccons/html/reporting_options.en.html; *Public Consultation on a Draft ECB Guide on Options and Discretions Available in Union law,* EUR. CENT. BANK (Nov. 2015), https://www.bankingsupervision.europa.eu/legalframework/publiccons/html/reporting_options.en.html.

[210] *See* CRR, *supra* note 202, art. 89(3).

[211] *Id*. art. 178(1).

[212] *Id*. art. 282(6).

[213] *Id*. art. 327(2).

[214] *Id*. art. 380.

[215] *Id*. art. 395(1).

[216] *Id.* art 400.

[217] *Id*. arts. 415, 420; Commission Delegated Regulation 2015/61/EU, To Supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with Regard to Liquidity Coverage Requirement for Credit Institutions, 2014 O.J. (L 11) 1; Commission Delegated Regulation 2015/62/EU, Amending Regulation (EU) No 575/2013 of the European Parliament and of the Council with Regard to the Leverage Ratio, 2014 O.J. (L 11) 37.

[218] *See Public Consultation on a Draft Regulation*, *supra* note 209, art. 1.

The ECB has therefore been careful in adopting prudential *regulation*. Nevertheless, this caution does not elude an important question: is the ECB a "competent authority" to exercise such options and discretion, and to turn itself into a *regulatory* authority with normative powers in the field of prudential rules? In theory, there are two possible interpretations.[219]

The first interpretation emphasizes SSM Regulation article 9(1), which states that the ECB may be considered as the competent authority of the Member State "*[f]or the exclusive purpose of carrying out the tasks conferred on it by Articles 4(1), 4(2) and 5(2)*."[220] The provision also states that "*[f]or the same exclusive purpose, the ECB shall have all the powers and obligations set out in this Regulation*."[221] And, more importantly, "*[i]t shall also have all the powers and obligations, which competent and designated authorities shall have under the relevant Union law, <u>unless otherwise provided for by this Regulation</u>.*"[222] Then, article 4(3) of the SSM Regulation provides that the ECB may adopt regulations "*only to the extent necessary to organise or specify the arrangements for the carrying out of the tasks conferred on it by this Regulation.*"[223]

Following this logic, article 4(3) of the SSM Regulation would be the provision that "provides otherwise" and restricts the ECB's capability to act as "competent authority" for purposes of developing prudential rules. Article 127(6) TFEU, which is inspired by a philosophy of a narrow conferral of "specific tasks" (i.e. not discretionary competences), could support this *restrictive* approach to ECB powers.[224] From a substantive perspective, some authors have argued that the restriction of discretion otherwise granted to NCAs would make sense to avoid the distortion that would result from a different exercise of discretion between the ECB for "significant" credit institutions and NCAs for the rest.[225]

However, this line of reasoning is problematic. The sequence of provisions does not support the view that article 4(3) is intended to limit article 9(1), both in the SSM Regulation. Rather, article 4 enumerates the tasks conferred on the ECB by the SSM Regulation, while article 9(1) specifies how those "tasks" translate into "powers." Indeed, the language of article 9(1) is very close to that of article 4(3) in stating that the ECB will act as the competent authority "for the exclusive purpose" of carrying out supervisory tasks.[226] Yet, it adds that the ECB shall *also* have all the powers and obligations of competent authorities *under relevant Union law*.[227] Thus, what the provision seems to say is that entrusting the ECB with specific supervisory "tasks" under the SSM Regulation is not incompatible with it wielding the powers vested in it as "competent authority" under *separate* EU legislation when exercising those tasks. Had the SSM

[219] We have examined these two possible interpretations in greater detail in an earlier version of this paper. *See* Marco Lamandini, David Ramos & Javier Solana, *Depicting the Limits to the SSM's Supervisory Powers: The Role of Constitutional Mandates and of Fundamental Rights' Protection*, 79 BANCA D'ITALIA EUROSISTEMA (2015).
[220] SSM Regulation, *supra* note 5, art. 9(1) (emphasis added).
[221] *Id.* (emphasis added).
[222] *Id.* (emphasis added).
[223] *Id*. art 4(3) (emphasis added).
[224] *See* TFEU art. 127(6).
[225] *See* D'Ambrosio, *supra* note 136, at 105–107.
[226] SSM Regulation, *supra* note 5, arts. 4(3), 9(1).
[227] *Id*. art. 9(1).

Regulation intended to go as far as to curtail these powers, it should have used a more explicit language.

This interpretation is also echoed in constitutional provisions. Article 132 TFEU and article 34 of the Statute of the ESCB and ECB provide that, in order to carry out the tasks entrusted to the ESCB, the ECB may "make regulations" to implement those tasks.[228] Article 127(6) TFEU itself, while construed on a basis of strict conferral of tasks, also states that the tasks conferred will be "*concerning* *policies* *relating to ... prudential supervision*."[229] This supports the idea that the ECB can be conferred tasks that have as their purpose the design of policies *relating* to prudential supervision, which can include prudential rules.[230]

This interpretation is also consistent with recital 34 of the SSM Regulation, which provides a sort of roadmap of what the new landscape of EU law, national laws, further rules by regulatory authorities, and guidelines, should look like.[231] First, it states that the ECB is subject to EU law, which includes Regulations, Directives, and EBA rules. Second, the regulation states that the ECB must also apply national *legislation* transposing Directives, as well as national *legislation* exercising the options granted expressly to Member States. And third, such options "*should be construed as excluding options available only to competent or designated authorities.*"[232] Thus, the ECB must apply national standards *insofar* as those standards are contained in national legislation. This is consistent with extending to the ECB the discretion granted to competent authorities. This interpretation is more reasonable, albeit not the only possible one.

The fact that granting discretion to competent authorities is justified by the difficulty of agreeing on a single approach to an issue—for example, liquidity or additional disclosures—does not necessarily mean that the divergences will be neatly divided across national boundaries. Banking models and their prudential issues may differ between Germany, Italy, or Spain, but not all issues need to be the same within Italy, Germany or Spain; the use of discretion may depend on the structure of the industry or the individual institutions' business model. Since the

[228] TFEU art. 132 and Statute of the ESCB and ECB, *supra* note 4, art. 34.

[229] TFEU art. 127(6) (emphasis added). *See also* Statute of the ESCB and ECB, *supra* note 4, art. 25(2).

[230] In fact, the reference to "policies" stirred controversy, as some argued that the article did not permit the allocation of tasks regarding day-to-day supervisory responsibilities. In particular, there was some opposition in Germany. For a description of this, *see* Kuile, Wissink, and Bovenschen, *supra* note 67, at 162. Other scholars consider TFEU, art. 127(6) a "solid" basis for allocating tasks involving direct supervision. *See* Moloney, *supra* note 168, at 1659. Yet, based on this assumption, there seems to be even stronger support for the idea that the ECB can be conferred tasks involving the design of prudential policies.

[231] SSM Regulation, *supra* note 5, rec. 34. The text of rec. 34 of SSM Regulation provides that: "For the carrying out of its tasks and the exercise of its supervisory powers, the ECB should apply the material rules relating to the prudential supervision of credit institutions. Those rules are composed of the relevant Union law, in particular directly applicable Regulations or Directives, such as those on capital requirements for credit institutions and on financial conglomerates. Where the material rules relating to the prudential supervision of credit institutions are laid down in Directives, the ECB should apply the national legislation transposing those Directives. Where the relevant Union law is composed of Regulations and in areas where, on the date of entry into force of this Regulation, those Regulations explicitly grant options for Member States, the ECB should also apply the national legislation exercising such options. Such options should be construed as excluding options available only to competent or designated authorities. This is without prejudice to the principle of the primacy of Union law. It follows that the ECB should, when adopting guidelines or recommendations or when taking decisions, base itself on, and act in accordance with, the relevant binding Union law." *Id*. rec. 34.

[232] *Id*. rec. 34 (emphasis added).

options seem to be granted based on the supervisors' proximity and superior ability to gauge risk, which may entail the ability to impose stricter requirements, or gold-plating those under EU rules,[233] this rationale should also apply when the supervisor is the ECB. Otherwise, denying the ECB the options formerly granted to NCAs would be tantamount to considering it unable to gauge such risk.

In fact, an assumption by the ECB of discretion formerly granted to NCAs is in line with the changes in the policies underpinning prudential rules. With the financial crisis exposing the failures of the micro-prudential approach of Basel's initial stages,[234] the present approach is clearly re-focused towards "systemic" risk and financial stability in a macro-prudential sense.[235] When new economic approaches result in new legal principles, the law's interpretation should change too—especially in the hard cases, where the open texture of the provisions is not merely a matter of semantics but reflects deeper disagreements over legislative intent.[236] If the principles underpinning the law have pivoted towards a more macro-prudential focus, this should be a relevant consideration to support the allocation of competence to the authority that is better placed to gauge the risk of individual institutions and the systemic risk. Presently, that seems to be the ECB.

In fact, the regulatory powers granted to the ECB as "competent authority" under CRR or CRD would be consonant with its macro-prudential powers under article 5 of the SSM Regulation. The provision contemplates the powers of NCAs to impose additional buffers,[237] including countercyclical buffers, but this is no obstacle for the ECB's power to disregard these and impose higher requirements.[238] In fact, the exercise of many of the options granted under CRD and CRR could be justified as an exercise of macro-prudential tasks under this provision. An important number of those prerogatives relate to the same type of measures. This makes no secret of the fact that, whereas the ECB has to cooperate closely with NCAs, the ECB has the final word due to its superior position to protect macro-prudential stability.

Critics could still object that, even if putting the ECB in charge is more in line with legislative intent, as the whole SSM edifice and the new underlying macro-prudential logic suggest, the distribution of tasks under CRD/CRR follows a *territorial* logic. This logic tries to protect national sovereignty and has to be respected. One could retort that the SSM is well-aware of this when it emphasizes that the ECB has to apply "national legislation" transposing Directives or exercising the options envisaged in regulations.[239]

---

[233] *See* CRD, *supra* note 201, arts. 133–137. This would be possible using countercyclical or systemic risk buffers.

[234] *See* Markus Brunnermeier et al., *The Fundamental Principles of Financial Regulation*, 11 GENEVA REP. ON THE WORLD ECON., xvii–xx (2009).

[235] A basic example, perhaps, but a useful one, has to do with the wording of the rules. Regulation 575/2013 (CRR) uses the word 'systemic' 32 times, and Directive 2013/36/EU (CRD) 108 times. *See* CRR, *supra* note 202 *and* CRD, *supra* note 201. The forerunner of the two texts, Directive 2006/48/EC, uses the word once, to refer to the systemic importance of some institutions when making a supervisory review. Parliament Directive 2006/48/EC Relating to the Taking Up and Pursuit of the Business of Credit Institutions 2006 O.J. (L 177) 1. The word "macro-prudential" is used 40 times in CRR, and 14 times in CRD, compared to 2006/48/EC Directive's none.

[236] *See* RONALD DWORKIN, LAW'S EMPIRE 10–11 (1986).

[237] *See* SSM Regulation, *supra* note 5, art. 5(1).

[238] *Id*. art. 5(2).

[239] *Id*. art. 4(3), rec. 34.

This, admittedly, gives rise to a complex decision tree, where options granted solely to "Member States" should be exercised only via legislation, options granted to "competent authorities" should be exercised by the ECB, save for the macro-prudential competences still granted to NCAs under article 5 SSM Regulation, and options granted indistinctly to either of them can be exercised by the ECB unless a Member State claims it by enacting specific legislation.

It is a unique mechanism of distributed decision-making, mirroring a complex political compromise. It is still too soon to conclude whether it will work out. We expect that, from an institutional perspective, this will lead to compromise, rather than unilateral action, in order to prevent opening the Pandora's box of accountability.[240] Still, far from answering all questions, the conclusion that the ECB can exercise regulatory competences raises new ones. We turn to them now.

2. Scrutiny Over the Exercise of Regulatory Powers (I): Institutional Balance and Control of Discretionary Competences

Once the ECB can adopt regulations on prudential matters, the next question is what type of control can be exercised over those powers. This is a difficult task, given the unique features of ECB competences under the SSM and the Single Prudential Rulebook (SPR). Whereas the ECB is an EU institution and the Treaties vest it with monetary powers, the ECB's role under SSM/SPR is closer to that of an EU agency. Its powers are granted by, and subject to, EU secondary legislation and the Commission delegated legislation.[241] The limits to ECB regulatory powers can thus be analyzed using at least three different blueprints: the limits to agencies' powers, the limits to EU institutions' powers (notably, the Commission), and a finalistic interpretation of the specific ECB provisions. We will analyze the implications of using one or another blueprint in that order.

Starting with EU agencies, the first relevant case to discuss the exercise of delegated powers by agencies was *Meroni*, where the CJEU remarked that:

> there can be seen in the balance of powers which is characteristic of the institutional structure of the Community a fundamental guarantee granted by the Treaty in particular to the undertakings and associations of undertakings to which it applies. To delegate a discretionary power, by entrusting it to bodies other than those which the Treaty has established to effect and supervise the exercise of such power each within the limits of its own authority, would render that guarantee ineffective.[242]

Meroni remains relevant today due to its combined reference to (a) the "balance of powers," as the rationale to effect control (*teleological* element); (b) the limits of a "delegation" or "discretionary powers" (*objective* element); and (c) to certain "bodies" (*subjective* element). Today's problems arguably lie, in part, in the difficulty of pinning down the teleological element, due to the fact that it can refer either to the need for balance between different EU institutions, or to the need to prevent abuses of power and ensuing harm to individuals resulting from

[240] *See infra* Part II.C.3 *in fine.*

[241] Actually, according to SSM regulation, *supra* note 5, art. 4(3), the ECB is also subject to the EBA's rules.

[242] Meroni Co. Industrie Metallurgique v. High Authority, Case 9/56, EU:C:1958:7, ¶ 152.

the unfettered exercise of such power.[243] While *Meroni* can be read to call for both, the CJEU's posterior standard of "institutional balance" in *Chernobyl* focuses exclusively on the distribution of powers between EU institutions,[244] leaving aside the concerns of judicial protection.[245]

Uncertainty over the teleological element is closely connected to the *objective* element. *Meroni* limited the conferral of "discretionary" powers. Later, in *Romano*, the Court also limited the conferral on agencies of the power to adopt acts "with the force of law."[246] The difficulty to determine whether the objective standard in *Romano* was a derivation of *Meroni* or something different relates to the inability to conclude whether the Court's concern was the Member States-EU balance,[247] the institutional balance between EU institutions, or the lack of judicial protection and review.[248]

The greater uncertainty, however, concerns the *subjective* element. Part of the problem in *Meroni* was that the powers had been delegated to an *outside* agency, set up under private law, and thus unaccountable under the then-existing systems of EU law.[249] But in *Romano*, the Court declared invalid a delegation of powers to an Administrative Commission created by secondary legislation, and thus, legally accountable under EU law,[250] leaving open the issue of how to calibrate

---

[243] *See* Jean-Paul Jacqué, *The Principle of Institutional Balance*, 41 COMMON MKT. L. REV. 383, 383–391 (2004).

[244] "Those prerogatives are one of the elements of the institutional balance created by the Treaties. The Treaties set up a system for distributing powers among the different Community institutions, assigning to each institution its own role in the institutional structure of the Community and the accomplishment of the tasks entrusted to the Community. Observance of the institutional balance means that each of the institutions must exercise its powers with due regard for the powers of the other institutions. It also requires that it should be possible to penalize any breach of that rule which may occur." European Parliament v. Council, Case C-70/88, EU:C:1990:217, ¶¶ 21–22.

[245] In *Vreugdenhil v. Comm'n* the Court held that "it is sufficient to state that the aim of the system of the division of powers between the various Community institutions is to ensure that the balance between the institutions provided for in the Treaty is maintained, and not to protect individuals. Consequently, a failure to observe the balance between the institutions cannot be sufficient on its own to engage the Community's liability towards the traders concerned. The position would be different if a Community measure were to be adopted which not only disregarded the division of powers between the institutions but also, in its substantive provisions, disregarded a superior rule of law protecting individuals." Vreugdenhil BV v. Comm'n, Case C-282/90, EU:C:1992:124, ¶¶ 20–22.

[246] Though "legislative," according to the Court, the acts concerned were extremely specific in nature, as they only determined the choice of the relevant dates for determining the exchange rate used for the conversion of pensions paid in different currencies. *See* Romano v. Institute National d'Assurance Maladie Invalidité, Case 98/80, EU:C:1981:104, ¶¶ 15–20.

[247] The Court held that "[w]hilst a decision of the Administrative Commission may provide an aid to social security institutions responsible for applying Community law in this field, it is not of such a nature as to require those institutions to use certain methods or adopt certain interpretations when they come to apply the Community rules." *See Romano,* EU:C:1981:104, ¶ 20.

[248] The Opinion of AG Warner was the only one to delve explicitly into the issue, by stating that: "The idea that there may be set up for the Community an administrative body empowered to make binding decisions, but whose decisions are, in themselves, incapable of review by this Court seems to me incompatible with the scheme of the Treaty. Nor does it seem to me that the concept of an administrative body whose decisions are incapable of judicial review is reconcilable with constitutional principles that are accepted in all the Member States and, I think, in every other civilized country." Opinion of Advocate General Warner, Romano v Institute National d'Assurance Maladie Invalidité, Case 98/80, EU:C:1980:267, ¶ 1265.

[249] *See* Merijn Chamon, *EU Agencies Between* Meroni *and* Romano *or the Devil and the Deep Blue Sea*, 48 COMMON MKT. L. REV. 1055, 1059 (2011).

[250] *Romano,* EU:C:1981:104, ¶ 20. Mr. Romano received a pension from the Belgian state, which, since he was also receiving a pension from the Italian state, considered the need to discount it. In calculating the discount, it used the rules issued by the Administrative Commission of the European

the importance of the delegated body's legal nature, in assessing the validity of its powers.

The Court had the opportunity to address these uncertainties in the ESMA case. There, the European Securities Markets Authority (ESMA), an agency created by secondary legislation, had passed a regulation restricting short-selling of financial instruments. The legislation was later challenged by the United Kingdom based on *Meroni* and *Romano*.[251] The Court validated the decision and, in so doing, it adapted its previous case law to the new realities of the EU's institutional structure. It held that the exercise of regulatory powers by ESMA was not "at odds with the principle established in *Romano*".[252] EU law now permitted bodies and agencies to adopt acts of general application. There was no evidence that the delegation required conditions other than those under *Meroni*, i.e. nothing more than "clearly defined executive powers" were delegated.[253] Hence, in the ESMA case, the CJEU reduced the *Romano* test to that of *Meroni.* The CJEU also held that the short-selling regulation was not contrary to the *Meroni* test because ESMA did not enjoy broad, discretionary powers to adopt rules: its regulatory powers were rule-bound powers of implementation.[254]

The CJEU, however, did not clarify matters further. The conclusion was partly based on the fact that the regulation was issued in "exceptional circumstances," under a "threat" to the orderly functioning of markets and financial stability.[255] Furthermore, the CJEU held that the provisions regulating the exercise by the Commission of the power to supplement, amend or implement legislation (Articles 290 and 291 TFEU) do not exhaust all forms of delegation and implementation powers.[256] In other words: they cannot be read to mean that the exercise of such powers by other bodies will be invalid. [257] However, the Court did not explain what principles would govern the exercise and limits of such powers when they are not exercised by the Commission.[258]

The above is relevant for the ECB. Although it may be an institution in agency clothes, it is an institution nonetheless. This conclusion makes it necessary to draw inferences from a second blueprint, such as the CJEU's case law on the control of the exercise of powers by the Commission.

The comparison between ECB regulatory powers and the case law on the Commission's post-Lisbon exercise of powers, however, must be handled with

Communities on Social Security for Migrant Workers, which were clearly prejudicial to Mr. Romano's the interests, in light of the devaluation of the lira.

[251] United Kingdom v. Parliament & Council, Case C-270/12, EU:C:2014:18.

[252] *Id.* ¶ 65.

[253] *Id.* ¶ 67.

[254] *Id*. ¶¶ 44-45. In paragraphs 44–54, the CJEU explained why the powers conferred on ESMA were not "discretionary." *See id.* ¶¶ 44–54. Moreover, the CJEU stated that "the bodies in question in *Meroni v. High Authority* were entities governed by private law, whereas ESMA is a European Union entity, created by the EU legislature." *See id.* ¶ 43.

[255] *Id.* ¶ 46.

[256] *See* TFEU arts. 290–291.

[257] United Kingdom v. Parliament & Council, EU:C:2014:18, ¶¶ 78–83. The CJEU held that this was inconsistent with the assumption in the articles that regulate the review of acts by the CJEU that such delegated acts by other bodies are possible.

[258] *Id.* ¶¶ 84–86. The decision leaves one with the impression of having witnessed a sleight-of-hand or magic trick. Just when one thinks the Court is going to make its assessment, the Court considers it finished, leaving the reader confounded and without answers to the question that really matters.

caution. Today, the TFEU grants the Commission powers to "implement" laws when "uniform conditions" are needed (article 291), as well as the power to "supplement" or "amend" non-essential parts of the legislation (article 290).[259] Thus, unlike the case of agencies, it is not constitutionally unlawful to grant the Commission broader "supplementing" or "amending" powers. The possibility to grant such broader powers to the Commission can also nudge the CJEU's case law towards a more lenient stance: if now the Commission can be granted broader and narrower powers, the scrutiny over their exercise by the Commission is no longer a question of whether the Commission can do or has discretion to do something, but of whether the choice of legal basis by the EU legislature was appropriate, a matter on which the Court can be expected to be more flexible. Recently, the Court followed this approach in *Biocides* and *Visa requirements*.[260] The Court was also unwilling to differentiate on the basis of criteria other than those expressly contemplated in the Treaties. The suggestion by the Advocates General in the two cases, that the distinction should be based on the degree of discretion granted to the Commission in each instance, was rejected by the Court.[261] This, in turn, renders the comparison between the scrutiny over the Commission powers exercised in that case law and the scrutiny over ECB powers more unsuitable, and requires caution.

Conversely, precedent on the control of pure "implementing" powers remains relevant to conclude whether such powers can entail a degree of discretion, especially if the Court's stance is the same before and after Lisbon.[262] Case law shows that, to exercise control, the Court has relied mostly on (i) the limits introduced by the Council when conferring implementing powers, and (ii) on the *objective* content of the specific rules, and less on *intrinsic* and *subjective* limits to the powers that can be conferred on the Commission under the label of "implementation."[263] The conclusion is the same before and after Lisbon:

---

[259] TFEU arts. 290–291.

[260] In *Biocides* the Commission argued that, despite the use of Article 291 (implementing powers), the powers at issue were delegated powers to supplement and amend. The Court held, contrary to the Commission's arguments, that the EU legislature enjoys discretion when selecting the legal basis for the conferral of powers, and that the Court will only control for manifest errors of assessment. *See* Comm'n v. Parliament & Council (Biocides), Case C-427/12, EU:C:2014:17, ¶ 40. *See also* Comm'n v. Parliament & Council (Visa Requirements)**,** Case C-88/14, EU:C:2015:499, ¶ 28.

[261] *See* Opinion of Advocate General Cruz Villalón, Comm'n v. Parliament & Council (Biocides), Case C-427/12, EU:C:2013:871, ¶¶ 62, 76, 87; Opinion of Advocate General Mengozzi, Comm'n v. Parliament & Council (Visa Requirements)**,** Case C-88/14, EU:C:2015:304, ¶¶ 23–28. The CJEU has stuck to the letter of the Treaties, and insisted that the lawful conferral of delegated powers "depends solely on whether the acts the Commission is to adopt on the basis of the conferral are of general application and whether they supplement or amend non-essential elements of the legislative act." *Visa Requirements***,** EU:C:2015:499, ¶ 32.

[262] We are aware of two opposing arguments suggesting that the exercise by the Commission of regulatory powers involves special circumstances, which negate the importance of the CJEU's case law on the control of such powers as guidance. One says that, after Lisbon, since the Commission has been granted broader powers to "supplement" or "amend," the Court is expected to grant some latitude to the Commission in the exercise of "implementing" powers, as the Council and Parliament may not anticipate all the implications when making the choice of legal basis (thus, by granting latitude to the Commission, the Court is actually granting latitude to the Council and Parliament, which form the EU legislature). The other says that, before Lisbon, the Court had to grant the Commission latitude, since it had great normative responsibilities, and mere "implementing" powers to fulfil them. However, one cannot have it both ways. If case law on "implementing" powers before and after Lisbon remains consistent, it can be used as a guidance.

[263] The Court has held that, in the implementation of rules to manage the import quota, the Commission should be granted wide powers, whose limits would be assessed by reference to the

"implementing" powers grant broad latitude to the Commission, which "*is authorised to adopt all the measures which are necessary or appropriate for the implementation of the basic legislation, provided that they are not contrary to it*."[264]

To address the specific case of the ECB we will combine the two blueprints of the case law on the exercise of powers by EU agencies and the Commission, but we need to temper them with a third blueprint, resulting from the specific provisions applying to the ECB. Beginning with the *objective* element of the nature and extent of the ECB's powers, we can conclude that its SSM powers (which are subject to the SSM Framework, the EBA's technical standards adopted as regulations by the Commission, and the EBA's rules)[265] cannot be characterized as "discretionary" under the *Meroni* standard, as re-interpreted by the CJEU in its ESMA case.[266] If they are permissible under the *Meroni* standard for agencies, the powers would thus comfortably meet the standard for the exercise of "implementing" powers by the Commission.

Would this argument hold when the ECB exercises residual regulatory powers as "competent authority" under CRD/CRR?[267] If we apply the *Meroni* standard, we should begin by analyzing whether the powers of transposition entail the exercise of "discretionary" competences. This is impossible to answer in the abstract. CJEU case law shows that "discretion" does not have a fixed meaning under EU law: it depends on the wording of each specific legal text.[268] Where EU

---

general aims of the legislation in question. *See* Netherlands v. Comm'n, Case C-478/93, EU:C:1995:324, ¶¶ 30–31; *see also* Portugal v. Comm'n, Case C-159/96, EU:C:1998:550, ¶ 41. In *Parliament & Denmark v. Comm'n*, where the Court annulled a Commission's decision to amend the Annex of a Directive on the restriction of use of certain hazardous substances in electronic equipment in order to exempt certain materials from the restriction based on criteria other than those contemplated in the Directive, the key to the decision was the fact that the Commission's measure was contrary to the aim of the EU legislation. *See* Parliament & Denmark v. Comm'n, Joined Cases C-14/06 & 295/06, EU:C:2008:176, ¶ 52. In *Philippines Border Management Project*, the Court annulled a Commission Decision granting aid to the Philippines to combat terrorism, given that the aim was not part of those signaled by the relevant Council regulation, and the Commission had tried, and failed, to introduce an amendment to that regulation that included the aim. *See* Parliament v. Comm'n (Philippines Border Management Project), Case C-403/05, EU:C:2007:624, ¶ 59. In *EURES*, the Court held that the Commission's establishment of the EURES network of agencies to fill job vacancies was valid, and rejected the Parliament's argument that the Commission exceeded its implementing powers by requiring in its implementing rules "that EURES promote participation in targeted mobility activities and the development of measures to encourage and facilitate mobility of young workers." Parliament v. Comm'n (EURES), Case C-65/13, EU:C:2014:2289, ¶ 65. Again the issue was whether such details were contrary to the aims of the regulation that conferred the powers. *See Id*. ¶¶ 65–67.

[264] *Netherlands v. Comm'n*, EU:C:1995:324, ¶¶ 30–31 (emphasis added); *Portugal v. Comm'n*, EU:C:1998:550, ¶ 41; *Philippines Border Management Project*, EU:C:2007:624, ¶ 51; *Parliament & Denmark v. Comm'n*, EU:C:2008:176, ¶ 52; *EURES*, EU:C:2014:2289, ¶¶ 43–44.

[265] SSM Regulation, *supra* note 5, art. 4(3). A distinction must be made, however, between the RTS *developed* by the EBA, and *adopted* by the Commission (which are legislative/implementing acts of the Commission) and "the provisions of that Regulation [(Regulation 1093/2010)] on the European supervisory handbook developed by EBA." *Id*.

[266] There are only two caveats: first, that the *Romano* standard is *reabsorbed* into *Meroni*, meaning there is no separate *Romano* restriction for the mere fact that the acts are of *general application*; second, that the emphasis of the CJEU in its decision on the *short-selling* regulation on the "exceptional circumstances" is not taken to mean that absent such circumstances, the exercise of regulatory powers would be invalid (this would also mean that the EBA's regular exercise of rule-making power would be invalid).

[267] *See supra* Part II.C.1.

[268] The cases where the CJEU reviews the exercise of discretion upon transposition normally involve the determination of liability of the State or the European Commission, which is a more drastic consequence than the mere determination of an incorrect transposition. However, the cases remain a

legislation uses broad and finalistic language, the CJEU has been ready to grant latitude in the transposition process.[269]

Therefore, if we look at the specific rules, the leeway granted under CRD/CRR varies. On the liquidity ratio and the leverage ratio, for example, it is relatively narrow and restricted to the concrete options granted by the Commission Delegated Regulations.[270] On systemic risk buffers and countercyclical risk buffers, "competent authorities" are granted greater latitude.[271] Yet, this latitude is constrained by detailed provisions that envisage a procedure for the adoption of decisions that ensures that all relevant interests are considered.[272] Thus, in light of the ESMA case, we would be inclined to find that CRD/CRR residual competences are also non-discretionary in the sense of *Meroni*. The CJEU, however, has yet to explore this interpretation.

For the sake of completeness of our discussion, let us assume that the actual exercise of some of those competences could involve an important degree of discretion. Should one really apply the *Meroni* standard and thus subjectively conflate *agencies* and the ECB? Since the ECB is an EU institution, would it not be more appropriate to use the standard applicable to the Commission's "implementing" acts? In fact, if the regulatory landscape changes, and the EU legislature considers it appropriate to vest the ECB with implementing powers in the field of financial regulation similar to those the Commission has in other fields, would the ECB face any constitutional constrains in the exercise of such implementing powers? The most important limits on the Commission's powers of supplementation, amendment, and implementation find their basis in the TFEU—

valid precedent. This is because the CJEU first determines the extent of the discretion granted and, then, whether the provision was correctly transposed. Furthermore, if the issue is the liability of the Member State or of the Commission, the Court *also* requires that the rules were intended to confer rights upon individuals, that there is a causal link between the damage and the incorrect transposition, and that there was a "sufficiently serious" breach, consisting of a "manifest and grave disregard" of the limits of discretion in the transposition. The "manifest and grave" disregard depends on the "degree of clarity and precision of the rule infringed and the measure of discretion left by that rule to the national authorities." *See* Robins v. Secretary of State for Work & Pensions, Case C-278/05, EU:C:2007:56, ¶ 70. *See also Id.* ¶¶ 36–41 where the Court relies on the "latitude" granted as an element to determine correct transposition. *See also* Brasserie du Pêcheur and Factortame v. Secretary of State for Transport, Joined Cases C-46/93 & C-48/93, EU:C:1996:79, ¶ 51. A precise wording, leaving no discretion of choice means that the mere breach can result in liability. *See* Hedley Lomas v. Ministry of Agriculture, Fisheries & Food, Case C-5/94 EU:C:1996:205, ¶ 28; Dillenkofer & Others v. Germany, Joined Cases C-178–179, 188–190/94, EU:C:1996:375, ¶ 25. The standard is similar to the one used in cases where the issue is the liability of the Commission. *See* Comm'n v. Fresh Marine, Case C-472/00, EU:C:2003:399, ¶¶ 26–27.

[269] *See, e.g.*, Paul v. Germany, Case C-222/02 EU:C:2004:606, ¶¶ 49–51 (concerning Member States' transposition of the Deposit Insurance Directive). *See also* EFTA Surveillance Authority v. Iceland, Case E-16/11, ¶ 229 (declaring that Iceland had not breached its commitments under the Deposit Insurance Directive, despite many deposit holders not receiving their money). *See* Afton Chemical Limited v. Secretary of State for Transport, Case C-343/09, EU:C:2010:419, ¶ 28 (concerning the field of emission of pollutants and the discretion of the Council and Parliament).

[270] *See* Commission Delegated Regulation 61/2015/EU, To Supplement Parliament and Council Regulation 575/2013/EU with Regard to Liquidity Coverage Requirement for Credit Institutions, art. 4, 2015 O.J. (L 11) 1; Commission Delegated Regulation 62/2015/EU, Amending Parliament and Council Regulation 575/2013/EU with Regard to the Leverage Ratio, art. 1(1), 2015 O.J. (L 11) 37.

[271] *See* CRD, *supra* note 201, arts. 133(2), 136(2).

[272] See CRD, *supra* note 201, art. 133 for systemic risk buffers. For countercyclical risk buffers, art. 135 provides that the European Systemic Risk Board (ESRB) may issue recommendations pursuant to article 16 of Regulation 1092/2010 to competent authorities. *See* CRD, *supra* note 201, art. 135(1).

for example, the restriction of amendments to "non-essential" parts of legislation,[273] the fact that the Commission can be conferred implementing *powers*, and the requirement that the act conferring those powers shall itself include the mechanisms of control.[274]

Going back to the ECB rules, the constitutional extent of ECB powers is determined by the contrast between the exercise of monetary competences, where it enjoys a high degree of discretion,[275] and prudential tasks, which are subject to conferral by the Council pursuant to article 127(6) TFEU. This provision sets clear, objective limits: those tasks must be "*relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.*"[276] Also, the exercise of regulatory implementing tasks could fall within the prudential supervision ambit. From this perspective, it is significant that the provision refers to "policies" and therefore implies that the ECB's tasks are supposed to include the enactment of rules of general application. Furthermore, the fact that the tasks are conferred "concerning policies relating" to prudential supervision suggests, in turn, that there has to be a relevant connection with prudential supervision, but also some leeway to interpret that connection.[277]

Finally, and most importantly, article 127(6) TFEU relies on *the Council* for the specific definition of the tasks, and the Council's decision must be subject to "a special legislative procedure" that requires unanimity.[278] This adds an additional requirement regarding the form of the decision, which suggests that once the Council has complied with the unanimity requirement, it should be granted some leeway by the Court. In other words, as long as the Council act adopted unanimously confers upon the ECB powers that can be divided into *tasks*, it is unlikely that the CJEU will substitute its view for that of the Council on the sole basis that the *tasks* do not "concern policies relating to prudential supervision," unless the Council has clearly missed the mark. As long as the ECB actions conform to the aims of the Council act, it seems likely that the CJEU will grant it ample flexibility.

3. Scrutiny Over the Exercise of Regulatory Powers (II): Choice of Treaty Basis, Accountability, and the Way Forward

Once we accept that the ECB's exercise of regulatory competences is possible pursuant to the standards that control "implementing" powers, there are still a few additional questions. The first concerns the choice of Treaty basis for those powers. Currently, the power of "competent authorities" to exercise regulatory options is granted by CRD/CRR, which are grounded in article 114 TFEU

[273] *See* TFEU, art. 290(1).

[274] TFEU, art. 291(3) states that the EU acts "shall lay down in advance the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers." Thus, the reliance on the *objective* basis of the substance of the provisions for exercising control, rather than on the *subjective* element of the implicit limits to the Commission's powers, finds its basis in the Treaties.

[275] *See Gauweiler*, EU:C:2015:400, ¶ 68 (holding that the ECB enjoys "broad discretion" when implementing its monetary policy operations).

[276] TFEU, art. 127(6) (emphasis added).

[277] TFEU, art. 127(6). In a provision characterized by its otherwise narrow language, words like "circumscribed to," "restricted to," or even "referring to" to prudential supervision would be more natural choices.

[278] *Id.*

(internal market).[279] A preliminary question would be whether this is a sound legal basis for measures whose main content is regulatory. We believe it is.

Initially, the CJEU permitted regulatory measures as long as the lack of harmonization created distortions to competition.[280] Such an *open* stance was qualified later in the *First Tobacco Advertising* case, where the Court annulled a Directive prohibiting all promotion activities for Tobacco,[281] and discussed the requirement that the obstacles that legislation wishes to eliminate cannot be "abstract."[282] However, the problem in the *Tobacco Advertising* case was that the prohibition was too sweeping (it prohibited all advertising activities), and too tenuously related to the purpose of eliminating distortions (it was clearly prohibitive in nature) to withstand scrutiny. In practice, the Court has been ready to grant more leeway to the institutions in other cases. For example, in *Vodafone*, the Court upheld the EU legislature's discretion to choose the "internal market" provision as the basis to impose caps on roaming charges.[283] It regarded the measure as "appropriate" despite the other considerations at stake, such as consumer protection,[284] and "proportionate" under a pure rationality test.[285] This view was reiterated in the landmark ESMA case, where the Court did not follow the AG's opinion that the choice of Treaty basis had been invalid.[286]

The second question is whether the "internal market" provision can be used as a legal basis to confer *regulatory* competences on the ECB in the field of prudential supervision, considering that there is a more specific provision, in article 127(6) TFEU, with clear limits.[287] What about the risk that the "internal

---

[279] TFEU, art. 114(1): "The European Parliament and the Council shall, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee, 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."

[280] The initial basis can be found in *Detergents* and *Titanium Dioxide*. *See* Comm'n v. Italy (Detergents), Case C-91/79, EU:C:1980:85, ¶ 8; Comm'n v. Council (Titanium Dioxide), Case C-300/89, EU:C:1991:244, ¶ 23.

[281] Germany v. Parliament & Council, Case C-376/98, EU:C:2000:544, ¶ 118.

[282] *Id.* ¶ 84. The Court was, to some extent, willing to show that it could be entrusted with the task of policing the exercise of an open, and finalistic, competence. But the basis for this was in the requirement, already present in *Detergents* and *Titanium Dioxide*, that the distortions of competition must be "appreciable." *See, e.g.*, *Titanium Dioxide*, EU:C:1991:244, ¶ 23. The Court reiterated this reasoning in subsequent cases, where it emphasized that the measures must "genuinely" improve the functioning of the internal market, the differences in rules must have a "direct" effect, or cause "significant" distortions to competition, or cause some "likely" obstacles to emerge. *See e.g.*, British American Tobacco (Investments), Case C-491/01, EU:C:2002:741, ¶ 60; United Kingdom v. Parliament & Council, Case C-217/04, EU:C:2006:279, ¶ 62; Germany v. Parliament & Council, Case C-380/03, EU:C:2006:772, ¶ 41; Ireland v. Parliament & Council, Case C-301/06, EU:C:2009:68, ¶¶ 68–72.

[283] *See* Vodafone & Others v. Secretary of State for Business, Enterprise and Regulatory Reform, Case C-58/08, EU:C:2010:321.

[284] *Id*. ¶¶ 69–70.

[285] *Id.* ¶ 52. In this way, the Court protected the legislature's discretion and did not require that the measure was the only possible or the best, but only that it was "appropriate." The Court reasoned that the decision involved "political, economic and social choices," and the legislature was called "to undertake complex assessments and evaluations." *Id*.

[286] *See* United Kingdom v. Parliament, Case C-270/12, EU:C:2014:18, ¶ 105. However, in this case the controversy focused on the legislature's ability to delegate on an agency to adopt acts that could take decisions directed at specific natural or legal persons. The Court nonetheless reiterated its reference to the legislature's discretion.

[287] Although in some cases CJEU case law has not given much attention to the choice of legal basis in the Preamble. *See* Comm'n v. Council (Beef Labelling), Case C-269/97, EU:C:2000:183, ¶¶

market" competence is used to circumvent article 127(6) TFEU's limits, i.e. the requirement of Council unanimity, or the reference to the conferral of "specific tasks concerning policies relating to prudential supervision"?[288] The problem is that the Court's substantive approach to the adequacy of the legal basis in cases where there could be more than one, is not fully consistent. Sometimes the Court has considered the context of the measure to be relevant,[289] and sometimes not.[290] Sometimes the Court has found the choice of legal basis to be valid despite the legislation amending other legislation enacted under a different basis.[291] Sometimes the Court has developed an argument to find *the* legal basis, whereas other times it has conceded that the measure could have been justified on two different grounds.[292] Sometimes, the CJEU's reasoning has simply been un clear.[293] In general, it seems that the Court is ready to grant the EU legislature some flexibility, at least when the dispute is with Member States.

Then, in cases where an act could have multiple Treaty bases, the CJEU has required that all Treaty grounds be included *unless* they call for incompatible procedures, in which case one basis has to be chosen.[294] This would be the case if one provision called for a Council majority, as under article 114 TFEU, and another one called for Council unanimity, as under article 127 (6) TFEU.[295] However, we submit that the present case would be different. The ECB's regulatory competences would be exercised based on both an "internal market" justification and on a conferral of powers to the ECB, but on a *sequential* rather than a *joint* basis. That is, article 127(6) TFEU requires a specific procedure, with

---

43–46. In other cases, it has required the choice of Treaty basis to be explicit. *See* Comm'n v. Council (CITES), Case C-370/07, EU:C:2009:590, ¶¶ 45–49.

[288] TFEU, art. 127(6).

[289] *See e.g.*, Comm'n v. Parliament & Council (Second Waste Regulation), Case C-411/06, EU:C:2009:518, ¶¶ 64–67.

[290] *See Beef Labelling*, EU:C:2000:183, ¶¶ 43–46.

[291] Parliament v. Council, Case C-130/10, EU:C:2012:472, ¶¶ 72–73, where Council Regulation 881/2002/EC, Imposing Certain Specific Restrictive Measures Directed Against Certain Persons and Entities Associated with Usama Bin Laden, the Al-Qaida Network, and the Taliban, 2002 O.J. (L 139) 9, which contained the list of persons, entities and groups affected by the freezing of funds, and had been adopted based on EEC arts. 60, 301 & 308, was amended by Council Regulation 1286/2009/EU, Imposing Certain Specific Restrictive Measures Directed Against Certain Persons and Entities Associated with Usama Bin Laden, the Al-Qaida Network, and the Taliban, 2009 O.J. (L 346) 42, based on TFEU, art. 215 (Common Foreign and Security Policy).

[292] See, e.g., the "trilogy" of cases: United Kingdom v. Council, Case C-431/11, EU:C:2013:589; United Kingdom v. Council, Case C-656/11, EU:C:2014:97; United Kingdom v. Council, Case C-81/13, EU:C:2014:2449, where the measures on coordination of social security systems with States outside the EU (countries of the European Economic Area (EEA), Switzerland, and Turkey, respectively) were adopted pursuant to TFEU, art. 48 (social security), and not TFEU, art. 79 (immigration policy). In United Kingdom v. Council, EU:C:2014:2449, ¶¶ 63–64, the Court admitted that the measures should have been adopted pursuant to the joint bases of TFEU arts. 48 & 217 (association agreement), but that this could not lead to the annulment of the measures, as the choice of a joint legal basis was of no consequence to the underlying dispute.

[293] *See* Kadi & Al Barakaat v. Council, Case C-402/05, EU:C:2008:461, ¶¶ 223–229.

[294] *See Titanium Dioxide*, EU:C:1991:244, ¶¶ 24–25.

[295] See Comm'n v. Council, Case C-91/05, EU:C:2008:288, ¶ 46, where the different legal bases affected different "Pillars" (one was Common Foreign and Security Policy). This does not mean, as the Court has made clear, that procedural requirements can constitute the basis to evaluate the adequacy of a specific competence (for example, to argue that TFEU, art. 114 cannot be used to confer powers on the ECB because it merely requires Council majority, or that TFEU, art. 127(6) cannot be used to confer regulatory powers because it does not require a vote by the Parliament). The Court has clarified that "it is not procedures that define the legal basis of a measure but the legal basis of a measure that determines the procedures to be followed in adopting that measure." *Parliament v. Council*, EU:C:2012:472, ¶ 80.

Council unanimity, to confer specific tasks on the ECB. Such a specific procedure was needed to make the ECB a "competent authority." Once this is done, however, the conferral of regulatory powers will be correct as long as the specific legislation is properly grounded. To the extent that the prudential rules of CRD/CRR, and their conferral of powers to "competent authorities" are adequately grounded on article 114 TFEU, the fact that the ECB is one of those authorities should not pose additional challenges. The opposite would mean requiring incompatible procedures, which the Court has rejected.

The third question is, again, whether it is adequate to use an EU institution, like the ECB in a capacity similar to EU agencies created by secondary legislation. Critics could argue that, at best, this approach would result in the ECB attracting an excessive level of scrutiny, and, at worst, in the ECB depending on the courts' self-restraint and respect for central bank discretion in a field where such self-restraint and/or respect would not be justified.

This issue could open the door to private litigation, where financial institutions use tensions in the exercise of competences to defend themselves against ECB intrusion.[296] We explore the possibility of judicial protection in a different article, but the evidence does not look promising.[297] Only parties addressed by the act—parties to which the act is of "direct and individual" concern, or parties to which the act is of "direct" concern (if it is a regulatory act that does not need "implementing measures")—can directly challenge the validity of EU acts.[298] Furthermore, the CJEU has interpreted these requirements in a restrictive way,[299] which excludes the parties within the scope of application of implementing acts.[300] If, on the other hand, the CJEU were to relax its standard (and accept the standing of parties affected by regulatory acts in actions for annulment),[301] financial institutions should not rejoice too much: the CJEU has clarified that, in its *system* of judicial protection, failure to bring an action for annulment by a party who has standing will result in the loss of the possibility to raise a question of validity via a preliminary reference in proceedings before

[296] In the event of a conflict over the vertical distribution of competences within the SSM, any action initiated by the affected credit institution would not exclude the initiation of other court proceedings. For example, if the ECB were to adopt an act under a competence thought to fall under the scope of an NCA's powers, the latter could request the relevant Member State to institute proceedings against the ECB before the CJEU pursuant to TFEU, art. 263 to seek annulment of the relevant act. If an NCA were to adopt an act under a competence thought to fall under the scope of the ECB's powers, the latter could institute proceedings against the former before the relevant national court to seek the annulment of the relevant act.

[297] *See* Lamandini, Ramos & Solana, *supra* note 6.

[298] *See* TFEU, art. 263(4).

[299] The Court requires that the plaintiffs be affected "by reason of certain attributes which are peculiar to them or by reason of circumstances in which they are differentiated from all other persons." *See* Plaumann v. Comm'n, Case C-25/62, EU:C:1963:17, ¶ 107.

[300] Pursuant to its *Inuit* judgment, the Court extended this restrictive interpretation to "regulatory" acts, although the Treaty only requires "direct" (i.e., not "individual") concern. Inuit Tapiriit Kanatami & Others v. Parliament and Council, Case C-583/11 P, EU:C:2013:625, ¶ 25. This has been the standard applicable in cases of implementing measures constituting "economic regulations." *See* Telefonica v. Comm'n, Case C-274/12 P, EU:C:2013:852, ¶ 19; T&L Sugars v. Comm'n, Case C-456/13 P, EU:C:2015:284, ¶ 5.

[301] In *Dyson Ltd v. Comm'n,* the Commission neither submitted an objection of inadmissibility for lack of standing, nor did the General Court raise of its own motion Dyson's lack of standing, in Dyson's effort to seek the annulment of a Commission regulation on labeling and standard product information for vacuum cleaners. This could still prove to be a slip by the EU institutions. Dyson Ltd. v. Comm'n, Case T-544/13, EU:T:2015:836, ¶¶ 28–35.

national courts.[302] As a result, financial institutions should challenge *pre-emptively* all regulations issued by the ECB with an annulment action, lest the Court later find that they had standing but did not bring the action, which would mean their losing all avenues for challenge (i.e. both the annulment action and the preliminary reference).

If the *institutional balance* principle aims to preserve the powers of the institutions and the Member States, as well as to protect individual rights, the analysis presented above is not good news. How could we find a better fit for the ECB's new powers in the EU system of checks-and-balances?

One way would be for the Court to take a stricter stance when it comes to review of these acts. Another would be for the European Parliament and national parliaments to exercise their investigatory powers to delve into the ECB's grounds for its decisions concerning prudential regulation and supervision.[303] This discussion, however, lies beyond the scope of the present article. A third avenue would be for the ECB to exercise its regulatory competences in a context of political compromise and restrained, cooperative, solutions, rather than heavy-handed, unilateral action, followed by a conflict before the courts. In general, the ECB should try to reach a reasonable division of the exercise of normative powers with Member States,[304] and, to this end, it could also use guidelines and recommendations.[305]

III. CONFLICTS BETWEEN MANDATES

The previous two Parts have explored the limits to the exercise by the ECB of monetary and prudential competences. We have concluded that the nature of the two competences is quite distinct, that their exercise is governed by different considerations, and that they offer different angles on the meaning and limits of *discretion*. This Part discusses the potential limits resulting from the interference (and possible collision) between the two competences. First, we will analyze how the Treaties and rules address the interplay between these competences (A). Then we explore the implications that such an approach may have for the performance of monetary and prudential tasks (B).

---

[302] *See* TWD Textilwerke Deggendorf GmbH v. Bundesrepublik Deutschland, Case C-188/92, EU:C:1994:90, ¶ 15.

[303] *See* SSM Regulation, *supra* note 5, arts. 20–21 (providing for the ECB's duties of reporting and accountability to the European Parliament and national parliament and establishing the possibility of hearings, of questioning the Chair of the Supervisory Board before the competent committee in the European Parliament (arts. 20(5)–(6)), and of national parliaments submitting questions, and asking Supervisory Board members to exchange views (art. 21)).

[304] This is, arguably, what the ECB proposes to do in its consultation on the Draft Regulation and Guide on the exercise of Options and Discretions. The ECB plans to exercise options and discretion on risk weighting and prohibition of qualifying holdings outside the financial sector (CRR, art. 89(3)), classification of defaulted loans (CRR, art. 178(1)), hedging sets (CRR, art. 282(6)), netting (CRR, art. 327(2)), waiver of own funds requirements in case of system-wide failure (CRR, art. 380), limits to large exposures (CRR, art. 395(1)), exemptions (CRR, art. 400), and liquidity framework (CRR, arts. 415 & 420 and Commission Delegated Regulations 2015/61 and 2015/62, *supra* note 217) over significantly important institutions. *See* EUROPEAN CENTRAL BANK, *supra* note 209.

[305] This, in turn, makes it relevant to explore how fundamental rights protection would react to such a course of action. We explore this issue in Lamandini, Ramos & Solana, *supra* note 6.

A. *Monetary Policy and Prudential Supervision: Hierarchy and Independence (or Lack Thereof)*

The relationship between monetary policy and prudential supervision is in a state of flux. Initially, there seemed to be a consensus that the two should be kept operationally separate.[306] However, in the aftermath of the recent crises, some commentators have criticized that separation on the grounds of the intricate relationship between price and financial stability, and the possible drawbacks affecting the effectiveness of Chinese walls.[307]

Article 25(2) of the SSM Regulation provides that the supervisory tasks conferred upon the ECB under the said Regulation shall not interfere with any other tasks of the ECB.[308] However, it also specifies that such supervisory powers "shall neither interfere with, *nor be determined by*, its tasks relating to monetary policy."[309] At first glance, article 25 of the SSM Regulation would seem to suggest that the ECB's tasks of prudential supervision rank equally with the powers included in Article 127(2) TFEU. However, we believe that the EU framework presents a hierarchical disposition of the ECB's monetary policy and prudential supervision competences that discards the possibility of an independent relationship between them.

First, according to Article 127(1) of the TFEU, the "*primary objective of the [ESCB] shall be to maintain price stability*."[310] Prudential supervision, however, aims at "ensuring […] the stability of the financial system of the Union as well as of individual participating Member States and the unity and integrity of the internal market."[311] The Treaties do not recognize financial stability as a "primary objective" of the ESCB.[312] If price stability is a "guiding principle" that should inform all economic and monetary policy activities,[313] then monetary policy and exchange-rate policy do rank higher in priority than other tasks of the ECB that aim at secondary objectives, including prudential supervision.

---

[306] For an overview of the main beneficial and detrimental implications of the consolidation of the two, see, e.g., Charles Goodhart & Dirk Schoenmaker, *Should the Functions of Monetary Policy and Banking Supervision Be Separated?*, 47 OXFORD ECON. PAPERS 539 (1995); Charles A. E. Goodhart, *The Organizational Structure of Banking Supervision*, 31 ECON. NOTES 1, 1–32 (2002). For an analysis of institutional design in the context of the euro area, see Martin Hellwig, *Financial Stability, Monetary Policy, Banking Supervision, and Central Banking*, MAX PLANK INST. COLLECTIVE GOODS PREPRINT Jul. 2014.

[307] *See, e.g.,* Thorsten Beck & Daniel Gros, *Monetary Policy and Banking Supervision: Coordination Instead of Separation* 4 CESIFO FORUM 33, 33-39 (2012); Rosa M. Lastra & Charles A. E. Goodhart, Directorate General for Internal Policies, Policy Department A: Economic and Scientific Policy, *Interaction Between Monetary Policy And Bank Regulation in* INTERACTION BETWEEN MONETARY POLICY AND BANK REGULATION (Sept. 23 2015), Eur. Parl. Doc. IPOL_IDA(2015)563458 at 49.

[308] SSM Regulation, *supra* note 5, art. 25(2).

[309] *Id*. (emphasis added).

[310] TFEU, art. 127(1) (emphasis added). It is also a "guiding principle." *See* TFEU, art. 119(3).

[311] SSM Regulation, *supra* note 5, rec. 30. *See also id.* art. 1.

[312] When the ECB was created, at the beginning of the 1990s, the economic theory and empirical evidence that prevailed supported an independent central bank oriented towards price stability. *See* Lastra & Goodhart, *supra* note 307, at 7. After the 2008 financial crisis, legislators in the U.S. and the U.K. have revised central bank laws to reinforce the dual mandate of their respective central Banks to protect financial stability as well as price stability. A similar revision is yet to be implemented in EU legislation. *Id.*

[313] *See* TFEU, art. 119(3).

Second, although article 25 of the SSM Regulation tries to ensure that the supervisory staff focus purely on the implementation of SSM tasks and enjoy sufficient independence,[314] the existence of a single Executive Board, which is responsible for the internal organization and staff of the ECB, shows that the walls between functions are far from impregnable.[315] Furthermore, the mandate of "non-interference" eliminates neither the need to address frictions between policy objectives, nor the prevalence of monetary policy in resolving those frictions. Although SSM provisions vest the Supervisory Board with significant powers for the exercise of prudential supervision,[316] the ultimate decision lies with the Governing Council, albeit through "negative decision-making,"[317] which is bound by prioritization of objectives specified in the Treaties.[318] Article 26(8) of the SSM Regulation seems to support this conclusion when it states that "[i]f the Governing Council objects to a draft decision [presented by the supervisory Board], it shall state the reasons for doing so in writing, *in particular stating monetary policy concerns.*"[319]

B. Implications for the Exercise of Monetary and Prudential Policy

In light of the analysis presented above, absent a reform in the Treaties, monetary policy would prevail over prudential supervision in the unlikely, but not impossible, event of a conflict between the two.[320] However, in order to

---

[314] SSM Regulation, *supra* note 5, art. 25(1) ("When carrying out the tasks conferred on it by this Regulation, the ECB shall pursue only the objectives set by this Regulation."). Moreover, the second paragraph under Article 25(2) requires that "[t]he staff involved in carrying out the tasks conferred on the ECB by this Regulation shall be organizationally separated from, and subject to, separate reporting lines from the staff involved in carrying out other tasks conferred on the ECB." *Id*. art. 25(2).

[315] According to D'Ambrosio, arts. 3(2)–(3) of the ECB Decision 2014/39/ECB On the Implementation of Separation Between the Monetary Policy and Supervisory Functions, 2014 O.J. (L 300) 57 would seem to take the view that the role of the Executive Board is compatible with the separation of functions. However, he also finds evidence that would suggest a contrary position in other relevant provisions. For example, he points at arts. 6(1)–(2) of the said decision, where "only the Executive Board is vested with the power to authorize the exchange of confidential information between the two functions." Furthermore, he points at art. 13m(2) of the ECB's Rules of Procedure, according to which the Supervisory Board maintains, in agreement with the Executive Board, the only limited power to "establish and dissolve substructures of a temporary nature, such as working groups or task forces." *See* D'Ambrosio, *supra* note 136, at 130.

[316] *See* SSM Regulation, *supra* note 5, art. 26. *See also* D'Ambrosio, *supra* note 136, at 125. These include the planning and execution of supervisory tasks, and the submission of draft supervisory decisions to the Governing Council of the ECB.

[317] *See* SSM Regulation, *supra* note 5, art. 26(8). In support of this interpretation, see *id.* art. 58. and Lastra & Goodhart, *supra* note 307, at 16–17. On the contrary, Wymeersch has argued that in spite of the Governing Council having the last word, the ten-day period in which the Governing Council may oppose the draft decision presented by the Supervisory Board is too short and would thus render any opposition ineffective. *See* Eddy Wymeersch, *The Single Supervisory Mechanism or "SSM," Part One of the Banking Union* (University of Gent, Law Working Paper No.240/2014, 2014).

[318] This has led some commentators to cast doubt on the effectiveness of the operational independence provisions contained in Article 25 of the SSM Regulation. *See, e.g.,* Geeroms & Karbownik, *supra* note 135, at 5.

[319] SSM Regulation, *supra* note 5, art. 26(8) (emphasis added).

[320] The question of how to reconcile monetary policy objectives and prudential supervision has a long constitutional tradition in several Member States. For an analysis of Article 47 of the Italian Constitution, see F. Merusi, *Commento all'art. 47 della Costituzione in Commentario alla Costituzione*, RAPPORTI ECONOMICI, BOLOGNA 155, 165 (1980). For a defence of the application of the principle of legality to banking regulation, see RENZO COSTI, L'ORDINAMENTO BANCARIO 250 (1986). In order to equate price stability and financial stability as "primary objectives" of the ESCB, Article 127 of the TFEU would need to be reformed. In support of this opinion, see Geeroms & Karbownik, *supra* note 135, at 9. More generally, on the desirability of introducing financial stability as an express concern in the legal mandates of central banks, see Hellwig, *supra* note 306, at 18–19.

understand the full interplay between the two policies, we need to take into consideration at least two additional factors: first, the actual instances in which a friction between the two policies may arise; and second, the standard of review to which each of the policies is subject.

First of all, one needs to honestly ask whether the portrayed "conflict" between the two policies is real. From an economic perspective, price stability is not necessarily at odds with financial stability. On the contrary, some scholars argue that price stability usually facilitates financial planning and thus financial transactions, which it is often a precondition of financial stability.[321] Similarly, the academic models generally used by central banks for policy planning purposes tend to perform better in the absence of financial frictions and fragilities.[322] This makes central banks the first ones interested in maintaining financial stability. So does an actual conflict exist?

The conflict could still arise. Although the two policy areas might have a relationship of complementarity when seen in a static, or long-term way, this does not fully capture the way the two of them interact dynamically in the short/medium-term. Central banks operate with varying degrees of certainty as to the purported effect of a specific policy decision. This is due to the limitations of current General Stochastic Equilibrium (DGSE) models employed by central banks to tackle inflation. Academics are still discussing how to incorporate a financial system, with its frictions and fragilities, into that general equilibrium model.[323] Until they reach a consensus, the models may continue to understate financial risk. Policymakers could react to this uncertainty from two different perspectives: the *monetary policymakers* view and the *financial stability experts* view.

Monetary policymakers may have little incentive to drop models that work well during good times in favor of models whose functioning is not well-tested. They would rather continue using DGSE models, and this would also shape their perception of risk and the optimal prudential policy. Financial stability experts would retort that those models only *seem* to work well and consequently allow for financial fragilities to emerge, which are arguably subject to longer horizons than those used by monetary policy committees. They would rather tackle risk now than face it in the future, and this, in turn, shapes their perception of the optimal monetary policy.

Interest rate policy provides an example of how the two views might collide. Keeping interest rates low and accompanying them with unconventional monetary policy measures may be seen as the right choice by monetary policymakers, who consider the risk of deflation resulting from an interest rate spike more probable than the risk of inflation resulting from the current policy. On the other hand, those mainly concerned with financial stability could reply that persistently low interest rates alter the market's risk perceptions, the structure of the balance sheet, and of

---

[321] *See, e.g.,* Marek Dabrowski, Directorate General for Internal Policies, Policy Department A: Economic and Scientific Policy, *Interaction Between Monetary Policy And Bank Regulation in* INTERACTION BETWEEN MONETARY POLICY AND BANK REGULATION (Sept. 23, 2015), Eur. Parl. Doc. IPOL_IDA(2015)563458 at 13.

[322] *See, e.g.,* Frank Smets & Raf Wouters, *An Estimated Stochastic Dynamic General Equilibrium Model of the Euro Area,* 34–35 (Eur. Cent. Bank, Working Paper No. 171, 2002). *See also* Mishkin, *supra* note 112, at 22–23.

[323] *See, e.g.,* Mishkin, *supra* note 112.

the revenues of the banks, and influence the so-called *risk-taking channel*, which possibly operates with a longer lag than other channels.[324] Therefore, central banks, which were rightly appointed to avoid governments' time-inconsistency problem—the willingness to sacrifice tomorrow's inflation levels for higher output levels today[325]— may also have some time-inconsistency problems of their own, as they may tend to focus more on the present and sacrifice the future under a discretionary mandate than if their mandate were more rule-bound.

It is also important to acknowledge that the monetary transmission channel is formed by reactions to the acts of monetary policymakers, and that an important part of these acts is adopted by banks subject to the Basel Framework prudential requirements.[326] Originally, reserve requirements were used as a sort of *brake* in the growth of money and credit, but the *braking* function is now performed by Basel capital and liquidity requirements.[327] While reserve requirements were within the framework for the implementation of monetary policy, the implementation of capital and liquidity requirements enjoys some, even formal, degree of independence, and their effects on monetary policy are not as clear.[328]

Capital requirements, to begin with, contribute to a more stable financial system in the long-run, but they may have distorting effects in the short-run.[329] Since capital requirements are risk-weighted, compliance with capital levels depends on interest policy. Yet, breaching the minimum requirements has such drastic consequences that they have a significant *threshold effect*: firms will react with greater sensitivity to interest rates (with disproportionate retrenchment), and they will react more fiercely to rate increases than decreases.[330] This could tempt the ECB to tinker with capital requirements or risk-weights to calibrate the impact of an interest rate rise, which, in the long-run, could prove problematic for effective prudential supervision.

Liquidity requirements, on the other hand, require banks to keep a certain amount of liquid assets and a stable match between assets and liabilities.[331] Among other effects,[332] this creates a *cliff effect* between assets *inside* and *outside the list*, increasing demand for the former. In particular, this may lead to an increased demand for central bank reserves and greater volatility on the dates that matter for the calculation of liquidity ratios, or to a switch from short-term

---

[324] *See, e.g.,* Claudio Borio & Haibin Zhu, *Capital Regulation, Risk-Taking And Monetary Policy: A Missing Link In The Transmission Mechanism?* (Bank for International Settlements (BIS), Working Papers 1 & 8, 2008).

[325] *See, e.g.,* Kydland & Prescott, *supra* note 24, at 474–75.

[326] Included in the Capital Requirements Directive (CRD), *supra* note 201 and Capital Requirements Regulation (CRR), *supra* note 202.

[327] *See* Borio & Zhu, *supra* note 324, at 36–37.

[328] *See id.*

[329] *See id.*

[330] *See id.*

[331] *See* BASEL COMMITTEE ON BANKING SUPERVISION, *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools,* BANK FOR INTERNAT'L SETTLEMENTS (BIS), at 65 (Jan. 2013), http://www.bis.org/publ/bcbs238.pdf.

[332] For the description of these effects we rely primarily on the Speech by Lorenzo Bini Smaghi, Member of the Executive Board of the ECB at the International Banking Conference. *See* Speech by Lorenzo Bini Smaghi, Member of the Executive Board of the ECB at the International Banking Conference in Milan, Basel III and monetary policy, *Matching Stability and Performance: The Impact of New Regulations on Financial Intermediary Management* (Sept. 29, 2010), https://www.ecb.europa.eu/press/key/date/2010/html/sp100929.en.html.

refinancing operations to long-term refinancing operations.[333] It could also lead to steeper yield curves, and to banks delivering to the ECB their less liquid and riskier assets, i.e. the assets that are included in the ECB's list of *eligible collateral* for its Open Market Operations (OMOs) or Emergency Liquidity Assistance (ELA) system,[334] but not in the list of assets eligible for the liquidity ratio. This could affect the transmission channels of monetary policy, which work better if tender rates are less volatile, yield curves are less steep, and short-term operations remain relevant.[335, 336] It could also increase risk in the ECB's portfolio. Thus, the ECB might be tempted to adjust prudential requirements to smooth the transmission mechanism of monetary policy.

The problems described above would arise in a scenario where price stability today was be prioritized over unknown financial frictions in the future (i.e. a *dove* situation resulting from the prevalence of the *monetary policymakers'* view). The examples could be reversed in a scenario where concerns with future inflation and future asset price bubbles were prioritized over monetary policy, and monetary policy was used as a supporting tool for stronger prudential cushions (i.e. the *financial stability experts'* view prevails, leading to an *enhanced hawks* situation).[337]

The other factor that can define the relationship between monetary policy and prudential supervision is the different standard of review to which the exercise of each policy is subject. The ECB enjoys great discretion in its exercise of monetary policy, controlled solely by the proportionality principle.[338] On the other hand, prudential supervision is more rule-bound and subject to less discretion.[339] This difference introduces additional considerations in our analysis.

At first glance, it might seem surprising that financial stability, which requires greater foresight and is subject to less accurate predictions, is actually subject to a lesser level of discretion. However, from a *time-inconsistency* perspective, stricter rules make sense. Policymakers that are accountable to voters may neglect predictions in favor of today's gain. This is an important justification for central bank independence. Nevertheless, when models used to make those predictions fail to take due account of financial instability factors, independence and discretion may not be enough, as monetary policymakers may be subject to a time-

---

[333] The expected outflows of banks are calculated on a 30-days basis. Short-term refinancing operations by the ECB would have to be included within the participating banks' expected outflows, thereby requiring them to hold more assets. Long-term refinancing operations, with a 3-month basis, would not have to be included for 2 months.

[334] *See ELA Procedures*, *supra* note 104.

[335] The ECB communicates its policy stance via short-term policy rates.

[336] Furthermore, the increase in demand for central bank reserves could lead to an increase in the size of open market operations, which could also crowd-out market activity. *See* Bini Smaghi, *supra* note 332.

[337] The use of "*doves*" v. "*enhanced hawks*" does not reveal a preference for the former. In a scenario where financial stability becomes a factor, the *doves* do not have reasons to be more dove-ish than usual, whereas *hawks* could argue not only that the risk of inflation is close, but also that there is a build-up of financial stability that can alter future policy, and justifies being more hawkish than usual—hence the term "*enhanced hawks*."

[338] The standard of review of the ECB's exercise of monetary policy is set in *Gauweiler*. As discussed *infra* Part I, the contours of the proportionality principle in the context of monetary policy are not well defined. Rather than proportionality in the abstract (in terms of the size of the operations) the principle should be applied more specifically, i.e., measured in terms of the implications of implementing an effective monetary policy for other principles protected by the law.

[339] *See infra* Part II.

inconsistency bias resulting from their inability to assess the effects of those factors. In such a scenario, it makes sense to go one step beyond and accompany independence with stricter rules.[340]

This means that, whereas the *doves* scenario would be limited by prudential rules (i.e. the ECB could not sidestep statutory prudential rules with the aim of facilitating credit creation), the *hawks* scenario would not; in principle, raising interest rates to constrain credit creation in aid of prudential goals, even to a level that could put the economy close to deflationary levels, is not legally precluded.[341] While the constitutional hierarchy of policies is clear (monetary goals will prevail over prudential goals), in practice, the absence of legal constraints in a *hawks* scenario could reverse that hierarchy, i.e. monetary policy used in aid of prudential goals. This is what makes it difficult to anticipate what the future will bring.

This creates yet another conundrum: central bank independence and the protection of discretion were supposed to be the best safeguards against time inconsistency; but for prudential purposes, given imperfect information, that does not suffice, and stricter rules become the safeguard of optimal supervision. The question is whether this logic is consistent with the values underpinning the Treaties, which have democracy,[342] and the rule of law, with the respect for individual rights,[343] as their centerpieces.

CONCLUSION

As a result of the recent financial crises, EU policy makers have identified the need to foster coordination in the supervision of banking and financial markets in the EU. The desire to promote a Banking Union is, perhaps, a paramount example. The ECB has been called upon to play a central role in this project. Whether this and other structural reforms will be adequate, only a future crisis will tell. Meanwhile, the institutional logic that differentiates the ECB from other EU institutions calls for a thorough examination of the boundaries of the new supervisory and regulatory powers conferred on it.

EU institutions are created following a delicate balance between democratic legitimacy, technical expertise, and pre-established rules. This translates into political, technical and judicial accountability. Limited mandates and *institutional balance* are necessary concepts to ensure that such accountability is real, and acts as a limit to the exercise of each task.

---

[340] Actually, the subject to rules was the original view of proponents of the "time-inconsistency" thesis, and the 2% raise in consumer prices, used as a rule by the ECB is a by-product of those views. *See The Definition of Price Stability*, EUR. CENT. BANK EUROSYSTEM, https://www.ecb.europa.eu/mopo/strategy/pricestab/html/index.en.html. This would only take the logic one step further, tying up central banks' powers not only to specific objectives, but to the means employed to reach those objectives (i.e. capital and liquidity thresholds).

[341] Public opinion would be enraged, but is it unclear what the CJEU could do. The proportionality principle, which applies to the exercise of monetary discretion, operates only when harm is caused to an interest protected by law; expansionary monetary policies may imperil central bank independence and breach the bank's monetary mandate (not easy, but possible, *see infra* Parts I.A.1, I.A.2). In the case of a contractionary policy, the lack of independence would be more difficult to justify. After all, the prohibition of monetary financing is enshrined explicitly in the Treaty, whereas a focus on financial stability could be justified in terms of monetary policy.

[342] *See* TEU, pmble.; TEU, art. 2; TEU, tit. II.

[343] TFEU, art. 2 includes the reference "rule of law and respect for human rights" as a single policy.

The ECB used to be the paradigm of rule-bound, limited mandates. Contrary to the Council, the European Commission, or the European Parliament, the ECB was limited to one instrument (interest rates), and one rule (price stability). This, in turn, justified its isolation from political pressures. However, despite its limited mandate, when the economy of the euro zone seemed on the brink of collapse and the need to enhance the soundness of the financial system became obvious, all eyes turned to the ECB as the more credible institution.

By implementing policies that sought to safeguard the stability of the Eurozone, the ECB entered "uncharted waters." As we discussed in Part I the *Gauweiler* decision has clarified that the ECB's use of unconventional monetary policy did not pose a risk of stepping over an imaginary boundary between *fiscal* and *monetary*. Nevertheless, it sounded as a useful alert on the importance of the rationale that justifies ECB's independence. This has brought about a new institutional balance in the EU, and it has also altered the combination of rules, discretion, and legitimacy that had traditionally characterized the ECB. New powers should come with new responsibilities and limits.

In Part II, we saw that the new mandate of prudential supervision, unlike monetary policy, is conferred under the stricter limits of article 127(6) TFEU. In our view, however, these limits are not so strict as to prevent the ECB, as a "competent authority" under the CRD/CRR pack, from exercising regulatory options contemplated therein. Although the exercise of these regulatory competences by the ECB makes legal sense, we need to identify a reasonable standard under which such exercise should be reviewed. So far, it is unclear whether the ECB, when exercising its "implementing" powers, will be subject to a standard similar to that applied to agencies created by secondary legislation and to the European Commission, or to a third, different standard altogether. As case law develops, we will gain a better understanding, not only of the nature of the ECB's regulatory powers, but also of the Court's own understanding of the principle of *institutional balance*.

Finally, in Part III we illustrate why, in our view at least, the *independence* and *equality* of the ECB's supervisory role are not consistent with the TFEU and secondary legislation. These show that such a role is coordinated operationally with monetary policy and constitutionally subordinate to it. However, this cannot predetermine the future relationship between monetary policy and prudential supervision. The relationship also depends on the way financial frictions and prudential rules shape the channels through which monetary stimulus is communicated and on the level of scrutiny to which each of the two policies is subject. Nevertheless, amending the Treaties to reflect the complexity of this relationship would help reduce the legal uncertainty that surrounds the ECB's policy decisions every time a crisis looms.

The exploration of the boundaries of the new powers recently conferred on the ECB should stir an open debate and reflection about the possible ways in which the ECB might be held accountable for its enlarged role. There are different combinations of political, technical and judicial accountability that may be tried and, in this sense, there may be promising avenues to explore. Nevertheless, any general conclusions would require the examination of the ECB's powers from the perspective of fundamental rights. We do that in the second part of this paper.[344]

[344] *See* Lamandini, Ramos, & Solana, *supra* note 6.