

**European Banking Union: A Legal and
Institutional Analysis of the Single Supervisory
Mechanism and the Single Resolution Mechanism**

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Articles

European Banking Union: A Legal and Institutional Analysis of the Single Supervisory Mechanism and the Single Resolution Mechanism

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Abstract

This article analyses the EU legal and institutional structure of the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM) of the European Banking Union (EBU). The Banking Union represents an unprecedented transfer of sovereignty from participating Member States to an EU institution for conducting banking supervision and for delegating authority to an EU agency to have responsibility for the preparation, implementation and funding of a European bank resolution regime. The article examines the legal basis of the SSM in the Lisbon Treaty and considers whether the ECB's strong form of independence is appropriate for its role as a bank supervisor, and whether its limited powers to take macro-prudential regulatory and supervisory measures are adequate to ensure banking sector stability. The article further argues that the SRM provides an important institutional step to build a more effective European bank resolution framework, but it suffers from institutional weaknesses and legal uncertainty regarding the use of resolution tools that undermine its ability to manage a bank resolution. The article concludes that a more effective banking regulation and resolution regime in the Banking Union requires a sounder legal basis in the EU Treaty that would empower the ECB to have full powers to conduct macro-prudential supervision and to co-ordinate more with the Single Resolution Board (SRB) in the use of resolution powers, but subject to strict criteria established in law.

Introduction

The European Banking Union represents one of the most important institutional and legal transformations in the EU. The events leading to the European Commission's legislative proposals for a banking union began in June 2012 when the European Council of Ministers issued a Decision to create a euro area banking union designed to build a more effective banking supervision regime in the euro area and across the EU by empowering the European Central Bank to be the bank supervisor for euro area and other participating Member States.¹ The banking union proposal consisted of three pillars: a unified banking supervisory

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¹ Council, *Conclusions*, June 29, 2012, EUCO 76/12, p.1.

regime, a bank recovery and resolution framework (a single resolution mechanism), and a bank deposit guarantee system.² These three pillars were considered necessary to stabilise the euro zone financial system by providing for the possibility that the European Stability Mechanism could recapitalise ailing euro area banks on the condition that these banks were subject to strict ECB supervision and conditionality and provide for an orderly resolution of a bank in financial distress.³ It would also justify the ECB's use of extraordinary monetary policy measures (outright monetary transactions) to increase liquidity support for euro zone sovereigns and banks. The Council's Decision was followed by the European Commission's proposed Regulation⁴ in September 2012 conferring bank supervisory powers on the European Central Bank, and another Regulation amending the European Banking Authority's powers regarding its interaction with the ECB in respect of the supervision of credit institutions.⁵ After further amendments to the SSM Regulation by the Cyprus Council Presidency in December 2012 and further amendments agreed with the European Parliament in March 2013, the SSM Regulation was approved by Council in October 2013 and entered into force in November 2013.⁶ After a one-year transition period, the ECB took up its full supervisory tasks on November 4, 2014 for both banks it will supervise directly and banks it will indirectly have supervisory responsibility for through national competent authorities. During the one-year transition period, the ECB carried out a comprehensive assessment of all banks which are under its direct supervision by conducting an asset quality review and stress tests.⁷

Under the second pillar of the Banking Union, the Commission proposed on July 10, 2013 a draft Regulation proposing a uniform set of rules and procedures for the resolution of banks established within the euro area.⁸ The Single Resolution Mechanism Regulation (SRM) was designed to supplement the Commission's earlier proposal for a Bank Recovery and Resolution Directive (BRRD)⁹ that would apply

² Council, *Conclusions*, June 29, 2012, EUCO 76/12, p.3.

³ *Euro Area Press Release* (June 29, 2012), stating "[w]hen an effective single supervisory mechanism ('SSM') is established ... for banks in the euro area, the European Stability Mechanism ('ESM') could ... have the possibility to recapitalize banks directly": Council, *Conclusions*, June 29, 2012, EUCO 76/12, p.3, http://consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131359.pdf [Accessed February 24, 2015].

⁴ 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.

⁵ Commission, "Proposal for a Regulation amending Regulation 1093/2010 establishing a European Supervisory Authority (European Banking Authority)" COM(2012) 512 final.

⁶ Regulation 1024/2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions [2013] OJ L 287/63.

⁷ The stress tests were conducted in co-ordination with the European Banking Authority and were published by the EBA on October 26, 2014. See the report by the European Banking Authority, *Results of 2014 EU-wide stress test* (London: October 26, 2014), p.19, "Impact of asset quality reviews on weighted average Common Equity Tier 1 Capital Ratio for the starting point 2013". The stress tests for the euro area banks showed that 25 banks had capital shortfalls, of which 13 had adopted adequate recapitalisation plans, while the other 12 had yet to remedy their shortfalls.

⁸ Commission, "Proposal for a Regulation establishing uniform rules and uniform procedures for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Bank Resolution Fund and amending Regulation 1093/2010" COM(2013) 520 (SRM Proposal). The creation of an "EU Authority in resolution" and an "EU resolution fund to complement an integrated approach to the resolution of cross-border banking groups" was postponed. See Commission, "An EU Framework for Crisis Management in the Financial Sector" COM(2010) 579 final (October 20, 2010), p.18.

⁹ Commission, "Proposal for a Directive for establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Directives 77/91 and 82/891, Directives 2001/24, 2002/47, 2004/25, 2005/56, 2007/36 and 2011/35, and Regulation 1093/2010" COM(2012) 280/3, p.2. The draft Directive was later amended to recognise its relationship to the Commission proposal for the Single Resolution Mechanism. See Council, "Proposal for establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Directives 77/91 and 82/891, Directives 2001/24, 2002/47, 2004/25, 2005/56, 2007/36, and 2011/35 and Regulation 1093/2010" General approach (June 6, 2013) (the Compromise Recovery and Resolution Directive). In 2014, the European Parliament and Council adopted Directive 2014/59 "establishing a framework for the recovery

to all Member States both inside and outside the euro area.¹⁰ The SRM intends to put banks experiencing solvency problems and which are supervised by the ECB/SSM into resolution with minimal costs to taxpayers and to the broader economy. Under the 2013 proposal, the decision to take a bank into resolution in the SRM framework would be made by the European Commission acting either on a recommendation from a Single Resolution Board (SRB) or on its own initiative, and would draw on funding from a Single Resolution Fund to stabilise and restructure the bank in resolution.¹¹

On March 20, 2014, the European Parliament and Council reached agreement on the SRM that provided for a greater role for the Single Resolution Board to initiate a bank resolution on its own initiative or based on a notification by the European Central Bank that a bank is failing or likely to fail. Once the European Commission and Council approve the SRB's recommendation to take a bank into resolution, the SRB has broad powers to adopt a scheme placing the bank into resolution that specifies the use of resolution tools and the extent to which the Single Resolution Fund (SRF) will be used to provide financing for the resolution.¹² Although art.114 TFEU was the legal basis for the creation of the SRB, it was ultimately considered inadequate under art.125(1) TFEU for establishing an EU resolution fund that would mutualise the risks associated with a bank resolution across participating Member States.¹³ The Council of Ministers decided therefore to adopt an intergovernmental agreement¹⁴ (IGA), ratified by 26 of the 28 EU Member States, which would provide a separate legal basis outside the EU Treaty for the creation of a Single Resolution Fund to be funded by participating Member States.¹⁵

In contrast, the BRRD largely harmonises across the EU the legal rules and procedures applicable to bank recovery and resolution, with responsibility for resolution remaining with Member State national authorities, subject to strengthened co-ordination in cross-border cases.¹⁶ Generally, the SRM Regulation supplements the rules and procedures of the BRRD, which would continue to apply to Member States both within and outside the euro area.¹⁷ Although the national resolution authorities of euro area states will be responsible, among other things, for adopting resolution plans, carrying out assessments of resolvability and taking early intervention measures,¹⁸ their powers are subject to the SRB's overriding power to draw up resolution plans, approve resolvability assessments and adopt all resolution decisions for firms that are systemically significant or which are directly supervised by the ECB under the SSM Regulation.¹⁹ The SRM centralises decision-making with the SRB that would co-ordinate the drawing up

and resolution of credit institutions and investment firms ...” (the Bank Recovery and Resolution Directive or BRRD) [2014] OJ L173/190–348.

¹⁰ See Eurogroup, *Summit Statement* (June 29, 2012), p.1, http://consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131359.pdf [Accessed February 24, 2014].

¹¹ See “SRM Proposal” COM(2013) 520.

¹² Regulation 806/2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of the Single Resolution Mechanism and a Single Resolution Fund and amending Regulation 1093/2010 (SRM Regulation) art.18(1)(a)(c).

¹³ EU Treaty(TFEU) art.125(1), stating that “the Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State”.

¹⁴ Council, Legislative Acts and Other Instruments, “Agreement on the transfer and mutualisation of contributions to the Single Resolution fund”, EF 121, ECOFIN 342 [2014] OJ 8457/14. 26 of the 28 EU Member States signed the IGA (Sweden and the UK did not sign).

¹⁵ Council, Legislative Acts and Other Instruments, “Agreement on the transfer and mutualisation of contributions to the Single Resolution fund”, EF 121, ECOFIN 342. See also, SRM Regulation 806/2014, Ch.2, The Single Resolution Fund [2014] OJ L225/76–77 arts 69–71.

¹⁶ See Commission, “An EU Framework for Crisis Management in the Financial Sector” COM(2010) 579 final (October 20, 2010).

¹⁷ SRM Regulation art.5(1)–(2).

¹⁸ SRM Regulation art.7(3)(a)–(f).

¹⁹ SRM Regulation art.7(2)(a)(i)–(ii).

and application of resolution plans with national resolution authorities and make decisions for the restructuring of a bank in resolution including whether to use the bail-in tool to recapitalise a bank.²⁰

Regarding the third pillar of deposit insurance, the European Commission amended the Deposit Guarantee Scheme Directive in 2014 by ensuring that retail depositors will continue to benefit from a guaranteed coverage of €100,000 in the case of a bank default and with increased contributions from the banking sector to a deposit guarantee fund.²¹ In addition, the European Stability Mechanism (ESM)²² provides a fiscal backstop for Member States in the Banking Union by making available funds for the direct recapitalisation of banks as long as the following pre-conditions are met²³: that by 2015 participating Member States require their banks to meet a target minimum bail-in requirement of 8 per cent total loss-absorbent capital as a percentage of total liabilities²⁴; and by 2016 the ESM will only be able to use the recapitalisation instrument after the SSM is operational and when the BRRD is fully in effect and once national parliamentary scrutiny procedures have been adopted.²⁵

This article analyses the EU legal and institutional structure of the SSM and the SRM of the Banking Union. Academic commentary has primarily focused on the SSM and its relationship to the EU internal market.²⁶ For instance, Ferran analyses the impact of the European Banking Union on the EU single market from a legal perspective by emphasising the centripetal and centrifugal effects of the Banking Union

²⁰ SRM Regulation art.3(f).

²¹ See Directive 2014/49 on deposit guarantee schemes (recast) (DGS Directive) (repealing Directive 94/19) [2014] OJ L173/149–178, entered into force on July 3, 2014. See DGS art.22(1). The DGS Directive was adopted by the European Parliament and ECOFIN Council on April 16, 2014 according to art.289 TFEU with regard to the “ordinary legislative procedure” based on a proposal of the Commission, acting under art.12(1) of Directive 94/19. EU Member States are required to implement it into domestic law by ensuring a target level of funds of 0.8 per cent of covered deposits (i.e. about €55 billion) to be collected from banks over a 10-year period. Moreover, access to the guaranteed amount for depositors will be expedited and made easier to access along with a reduction in the payment deadline for a bank or deposit fund from 20 working days required by the DGSD in 2014 to 7 days in 2024.

²² Treaty Establishing the European Stability Mechanism, T/ESM 2012/en [2011] OJ L91/1. A first version of the treaty was signed on July 11, 2011, but was subsequently modified to incorporate decisions taken by the heads of state and government of the euro area on July 21, and December 9, 2011 to improve the ESM’s operational effectiveness. A final version of the ESM Treaty was signed on February 2, 2012 and entered into force on September 27, 2012, and the ESM Board held its inaugural meeting on October 8, 2012. See European Commission, “Fact Sheet—European Stability Mechanism” (2013). The ESM took over the tasks that were previously the responsibility of the European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM). The ESM operated alongside the EFSF until the EFSF lending operations ended early in 2014 and were transferred to the ESM. See http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/132734.pdf [Accessed February 24, 2015].

²³ The Eurogroup agreed in June 2013 on the main elements of the ESM’s bank recapitalisation instrument. See “Eurogroup agrees the main features of a direct bank recapitalisation instrument” (June 21, 2013), <http://eurozone.europa.eu/newsroom/news/2013/06/eurogroup-agrees-the-main-features-of-a-direct-bank-recapitalisation-instrument-and-welcomes-latvias-progress-towards-joining-the-euro/ro>s [Accessed February 24, 2015]. Previously, the Eurogroup agreed on March 30, 2012 to set up a firewall of more than €800 billion to safeguard the financial stability of the euro area. See Eurogroup, “Joint lending power of the ESM and EFSF reinforced” (March 30, 2012).

²⁴ Eurogroup, “ESM Direct Recapitalization Instrument-Statement by the President” (June 2014 Statement), stating that “for a transitional period until 31 December 2015 a bail-in of 8 % of all liabilities will be a precondition for using the instrument as well as the use of the resources available in ESM Member’s national resolution fund”. And “from 1 January 2016, bail-in in line with the rules of the Banking Resolution and Recovery Directive will be applied”. See <http://www.eurozone.europa.eu/newsroom/news/2014/06/statement-by-the-president-of-the-eurogroup-on-the-esm-direct-recapitalisation-instrument/> [Accessed February 24, 2015].

²⁵ Eurogroup, “The instrument is to be finalised when the BRRD has been agreed with the European Parliament. Once this has happened and national parliamentary scrutiny procedures have been finalised and the Single Supervisory Mechanism is established and effective, the ESM Board of Governors will be able to add this instrument to their toolkit” (August 2013).

²⁶ See K. Alexander, “European Banking Union: Implementation Challenges” (September 24, 2012), written and oral evidence before the House of Lords EU Economic and Financial Affairs Subcommittee, *Inquiry on European Banking Union: Key Issues and Challenges*, pp.3–25.

within the single market.²⁷ On the one hand, the Banking Union might make joining the monetary union more appealing to those Member States outside the euro zone, but which decide to join the Banking Union. On the other hand, those states which are outside the Banking Union could potentially be marginalised economically and financially within the EU, which, it is argued, will inevitably undermine the unity of the single market.²⁸ Furthermore, Ferran analyses both the Single SSM and the SRM to argue that, despite some limits in the Banking Union's design, their legal bases are adequate enough to guarantee that the Banking Union has the authority to rebuild confidence and contribute to a reversal of the trend of EU banking and financial market fragmentation.²⁹ Gortsos analyses the impact of the SSM on the existing structure of EU banking regulation and supervision and comments on the institutional design.³⁰ And Grunewald provides a comprehensive analysis of the EU burden-sharing regime for resolving cross-border banking crises in Europe to conclude that although the BRRD and SRM provide needed legal and institutional reforms of the EU bank resolution framework, the institutional complexity and apparent gaps in key areas may undermine its effectiveness.³¹

The Banking Union represents an unprecedented transfer of sovereignty from participating Member States to an EU institution for conducting banking supervision and in the case of the SRM for delegating authority to an EU agency to have responsibility for the preparation, implementation and funding of a bank resolution regime. The article extends the academic analysis of the Banking Union by critically analysing the legal basis in the EU Treaty for the creation of the SSM and its institutional effectiveness to conduct banking supervision. In doing so, the first part reviews the institutional and legal context of the Banking Union. It assesses the structure and legal framework of the Single Supervisory Mechanism and the amendments to the SSM Regulation resulting from the Cyprus Council Presidency and European Parliament negotiations. It then analyses whether the ECB's strong form of independence under the EU Treaty is appropriate for its role as a bank supervisor—and whether its limited powers to take macro-prudential regulatory and supervisory measures are adequate to ensure banking sector stability.

The second part of the article then critically analyses the SRM regime and the legal basis on which it was adopted. It suggests that the Commission's objective of aligning the exercise of banking supervision and bank resolution at the same level of governance in the EU has not been met.³² It also discusses the rationale and purpose of SRM and the Commission's initial SRM proposal and how critical objections from Germany led to crucial amendments that resulted in the adoption of an IGA that mutualises the risks associated with Member State contributions to the Single Resolution Fund. The article critically examines the legal basis of the SRM under art.114 of the Treaty and argues that the Single Resolution Board's exercise of discretionary authority in preparing and implementing, and recommending the approval of, resolution plans raises serious concerns under the *Meroni* doctrine. It also questions the legality of the vast amount of discretion afforded to the SRB to order a bank which is not in resolution to reorganise its institutional structure in order to reduce or eliminate any impediments to its effective resolution. It also analyses the financial policy weaknesses of the SRM and related legal concerns regarding the discretion

²⁷ E. Ferran, "European Banking Union and the EU Single Financial Market: More Differentiated Integration or Disintegration?" *Cambridge Legal Studies Research Papers* 29/2014 (2014), p.3, <http://www.law.cam.ac.uk/ssrn> [Accessed February 24, 2015].

²⁸ Ferran, "European Banking Union and the EU Single Financial Market" *Cambridge Legal Studies Research Papers* 29/2014 (2014), p.3, <http://www.law.cam.ac.uk/ssrn> [Accessed February 24, 2015].

²⁹ Ferran, "European Banking Union and the EU Single Financial Market", *Cambridge Legal Studies Research Papers* 29/2014 (2014), p.2, <http://www.law.cam.ac.uk/ssrn> [Accessed February 24, 2015].

³⁰ See C. Gortsos, "The Crisis-based EU Financial Regulatory Intervention: Are we on the Top of the Prudential Wave?" (2015) 16 ERA Forum *Journal of Academy of European Law*, forthcoming.

³¹ S. Grunewald, *The Resolution of Cross-Border Banking Crises in the European Union* (The Netherlands: Kluwer Law International, 2014), pp.271–273.

³² See SSM Regulation, 1024/2013, Recital 85; see also Commission, "A Blueprint for a Deep and Genuine Economic and Monetary Union, Launching a European Debate" COM(2012) 777 final/2, p.39.

afforded to the SRB to exempt some banks from being taken into resolution and to waive losses for certain bondholders and other creditors of a bank in resolution. Finally, it raises some institutional and legal issues regarding how the European Banking Authority's technical standards for bank resolution should be accepted by the European Commission for implementation in the SRM.

Although the SRM provides an important institutional step at EU level to build a more effective bank resolution framework, it suffers from institutional weaknesses and legal uncertainty regarding the use of resolution tools, such as bail-in, that undermine its ability to manage effectively a bank resolution. Also, it concludes that a more effective banking regulation and resolution regime in the Banking Union requires a sounder legal basis in the EU Treaty that would empower the ECB to have full powers to conduct macro-prudential supervision and to co-ordinate more with the SRB in the use of resolution powers, but subject to strict criteria established in law.

Legal and institutional context of the Banking Union

In June 2012, as euro zone sovereign bond markets were experiencing extreme volatility, EU policy-makers and investors feared that a collapse of the Spanish banking sector was imminent and would cause contagion throughout the euro zone and seriously threaten the viability of the single currency area itself.³³ During this time, Spanish authorities were conducting negotiations with the European Commission over the terms of a euro zone bailout of the Spanish banking system. Parallel with these negotiations, the EU President, Herman van Rompuy, issued a paper calling for a European banking union that had as its main objective the severing of the link between the banking crisis and the sovereign debt crisis.³⁴ The Van Rompuy paper proposed that the Banking Union consist of three pillars: (1) the European Central Bank, with vast new powers to supervise over 6,000 banks in the euro zone; (2) an EU-wide deposit guarantee scheme with mutualisation of risk across Member States; and (3) an EU/euro area bank resolution authority and fund that would restructure banks and investment firms having financial difficulties without direct costs to taxpayers.³⁵ The German Chancellor, Angela Merkel, welcomed the proposals as an important step in obtaining German parliamentary support for allowing the Spanish banking system to be recapitalised by the euro zone bailout fund—the European Stability Mechanism.³⁶

The Van Rompuy paper formed the basis for the European Council of Ministers' Decision in late June 2012 to create a euro area Banking Union designed to build a more effective banking supervision regime in the euro area and across the EU.³⁷ This was followed by draft legislation proposed by the European Commission on September 12, 2012 in the form of a Council Regulation³⁸ conferring bank supervisory powers on the European Central Bank, and another Regulation amending the European Banking Authority's powers regarding its interaction with the ECB in respect of the supervision of credit institutions.³⁹ The ECB's supervisory powers would be exercised through an SSM that would have an executive board—a Single Supervisory Board (SSB)—that would be primarily responsible for licensing, monitoring and enforcing prudential regulations, such as capital adequacy requirements, liquidity buffers, concentration and leverage limits, and all other prudential requirements under EU law applicable to banks based in the

³³ See European Council, President, *Towards a Genuine Economic and Monetary Union*, Report by the President of the European Council, Herman van Rompuy (Brussels: June 26, 2012), EUCO 120/12, pp.1–2.

³⁴ Van Rompuy, *Towards a Genuine Economic and Monetary Union* (June 26, 2012), EUCO 120/12, pp.3–4.

³⁵ Van Rompuy, *Towards a Genuine Economic and Monetary Union* (June 26, 2012), EUCO 120/12, pp.6–7.

³⁶ House of Lords, *Genuine Economic and Monetary Union and the implications for the UK*, 8th Report of Session 2013–14 (February 14, 2014), HL Paper 134, pp.23–25.

³⁷ Council, *Conclusions*, June 29, 2012, EUCO 76/12, p.3.

³⁸ 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.

³⁹ Commission, "Proposal for a Regulation of the European Parliament and of the Council amending Regulation 1093/2010 establishing a European Supervisory Authority (European Banking Authority)" COM(2012) 512 final.

euro area and other participating EU jurisdictions.⁴⁰ The ECB/SSB would also be empowered to approve bank recovery plans and asset transfers between affiliates within banking groups or mixed financial conglomerates.⁴¹

As mentioned above, the Van Rompuy paper also envisaged bank resolution and deposit insurance as the second and third pillars respectively of the Banking Union.⁴² To this end, the Commission proposed on July 10, 2013 a Regulation for a uniform set of rules and procedures for the resolution of banks established within the euro area and that resolution decision-making be centralised at the European level through the creation of a Single Resolution Mechanism.⁴³ Also, the Commission proposed minor amendments to the Deposit Guarantee Scheme Directive in 2013 that were approved by the European Parliament and Council in 2014, creating additional obligations on all Member States to require more ex ante funding of the deposit fund and reducing the time a depositor must wait to receive repayment when a bank fails.⁴⁴

The Banking Union and the internal market

What distinguishes the EU from other international and regional regulatory groupings in terms of banking regulation, supervision and resolution is the EU Treaty (TFEU) principle of the “internal market”.⁴⁵ The internal market principle has its origins in the Treaty of Rome of 1957 and has served as a core building block of European economic and financial integration.⁴⁶ The principle consists, in part, of the right of establishment and free movement of persons, services and capital across Member State borders under conditions of competitive equality.⁴⁷ The rights of establishment and free movement in financial services were reinforced by the Single European Act 1986⁴⁸ that recognised the principle of mutual recognition which required host state regulatory authorities in the European Economic Area (EEA) to recognise the home country authorisation and prudential oversight of financial firms that were incorporated or established in another EEA state and were operating in the host market. This paved the way for adoption of the Second Banking Directive in 1989,⁴⁹ which created the single passport regime that allowed EU-based banks to

⁴⁰ SSM draft Regulation art.4(1)–(4).

⁴¹ SSM draft Regulation art.4(1)(k).

⁴² See Van Rompuy, *Towards a Genuine Economic and Monetary Union* (June 26, 2012), EUCO 120/12, p.4.

⁴³ See SRM Proposal, p.5.

⁴⁴ See Directive 2014/49 of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (recast) (DGS Directive) (repealing Directive 94/19) [2014] OJ L173/149–178.

⁴⁵ Treaty on the Functioning of the EU (TFEU) Title IV, “Free movement of persons, services and capital”, arts 45–66. See discussion in M. Andenas and J. Snell, “Exploring the Outer Limits: Restrictions on the Free Movement of Goods and Services” in M. Andenas and W.-H. Roth (eds), *Services and Free Movement in EU Law* (Oxford: Oxford University Press, 2002), pp.69–139.

⁴⁶ See J. Dermine, “European Banking: Past, Present and Future” in V. Gaspar, P. Hartmann and O. Skeijpen (eds), *The Transformation of the European Financial System*, Second European Central Bank Conference (Frankfurt: European Central Bank, 2003), pp.31–96.

⁴⁷ TFEU Ch.1, Workers, arts 45–48; Ch.2, Right of establishment, arts 49–55; Ch.3, Services, arts 56–62; Ch.4, Capital and payments, arts 63–66.

⁴⁸ Single European Act 1986 art.18 (implementing art.100a of the EEC Treaty). The Act also provided for qualified majority voting by Council (instead of unanimity) for banking and financial services directives and regulations. See M. Andenas and C. Hadjiemmanuil, “European Banking Supervision, the Internal Market and European Monetary Union” in M. Andenas, L. Gormley, C. Hadjiemmanuil, and I. Harden (eds) *European Economic and Monetary Union: The Institutional Framework* (London: Kluwer Law International, 1997), pp.373–417.

⁴⁹ Second Council Directive 89/446 on the co-ordination of the laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780 [1989] OJ L386/1.

establish branches and to supply cross-border financial services in other EU Member States without having to obtain additional regulatory authorisation by host states.⁵⁰

Under the single passport regime, however, a cross-border banking group's subsidiary incorporated in another Member State was subject to the licensing requirements and ongoing prudential supervision of the relevant host state authority. Nevertheless, banking groups or banks individually have the right to establish a subsidiary in another Member State under the same conditions as domestic banks incorporated in those states based on the principles of non-discrimination, proportionality and necessity.⁵¹ EU policy-makers accepted the assumption that the home state passport and mutual recognition principles would increase competition in regulatory practices between Member States and would lead eventually to a more or less harmonised system of regulatory and supervisory practices across the EU that would promote the overall objective of European financial integration. The banking crisis of 2007–09, however, revealed serious flaws in this approach to EU banking regulation and supervision. The European Commission's expert committee led by Jacques de Larosière considered these issues in a Report published in February 2009 that called for reform of European financial regulation and supervision by creating three new European supervisory agencies to establish a harmonised EU rulebook for financial regulation while leaving Member State authorities with responsibility for applying and enforcing the rulebook in day-to-day supervision.⁵² Reflecting the views in the De Larosière Report, the Commission proposed a European System of Financial Supervision, consisting of a European Banking Authority, a European Securities and Markets Authority and a European Insurance and Occupational Pension Authority,⁵³ which would establish a single regulatory rulebook and supervisory framework for the financial sector. The three European Supervisory Authorities would, with support from a European Systemic Risk Board,⁵⁴ promote more effective micro-prudential

⁵⁰ See G. Walker, *European Banking Law: Policy and Programme Construction* (London: British Institute of International and Comparative Law), pp.16–18.

⁵¹ *CaixaBank France v Ministère de l'Économie, des Finances et de l'Industrie* (C-442/02) [2004] E.C.R. I-8961; [2005] 1 C.M.L.R. 2. In *Caixa Bank*, the ECJ interpreted the proportionality and necessity principles to apply to a Member State's regulation of a subsidiary of a cross-border banking group by holding that “[a]ll measures which prohibit, impede or render less attractive the exercise of that freedom must be regarded as such restrictions” (at [11]). A regulatory measure “hinders credit institutions which are subsidiaries of foreign companies in raising capital from the public, by depriving them of the possibility of competing more effectively”, “with the credit institutions traditionally established in the Member State of establishment” (at [12]); and a regulatory measure “may be justified where it serves overriding requirements relating to the public interest, is suitable for securing the attainment of the objective it pursues and does not go beyond what is necessary in order to attain it” (at [17]). See also *Sevic Systems AG v Amtsgericht Neuwied* (C-411/03) [2005] E.C.R. I-10805; [2006] 1 C.M.L.R. 45 (that the distinction on the ground of different nationalities was discriminatory and contrary to the right of establishment). See also the Gambling cases: *Criminal Proceedings against Engelmann* (C-64/08) [2011] 1 C.M.L.R. 22; *Stoss v Wetteraukreis* (C-316/07) [2011] 1 C.M.L.R. 20; [2011] All E.R. (EC) 644 (invalidating non-discriminatory restrictions on gambling if the measure lacks proportionality and not necessary to achieve a regulatory objective).

⁵² High-Level Group on Financial Supervision in the EU (chaired by Jacques de Larosière), Report (Brussels: EU Commission, February 25, 2009), pp.39–41, 57, http://ec.europa.eu/finance/general-policy/docs/de_larosiere_report_en.pdf [Accessed February 24, 2015]. The *De Larosière Report* recognised the difference between “regulation”, defined “as a set of rules and standards that govern financial institutions”, and “supervision”, defined as “the process designed to oversee financial institutions in order to ensure that rules and standards are properly applied”: pp.4–5.

⁵³ Regulation 1093/2010 establishing a European Supervisory Authority (European Banking Authority) [2010] OJ L331/12; Regulation 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pension Authority) [2010] OJ L331/48; Regulation 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) [2010] OJ L331/84.

⁵⁴ Regulation 1092/2010 on EU macro-prudential oversight of the financial system and establishing a European Systemic Risk Board [2010] OJ L331/1.

and macro-prudential regulation and supervision of European financial markets and a more efficient functioning of the internal market.⁵⁵

Shortly thereafter, the Commission was confronted with the euro zone sovereign debt crisis, which began in May 2010 with Greece receiving the first of three bailouts from the European Commission and the International Monetary Fund and entering into negotiations with its creditors to restructure its sovereign debt. As the euro zone sovereign debt crisis intensified when Spain requested a bailout from the European Stability Mechanism in May 2012, the Commission and the euro zone's largest economy, Germany, decided that further institutional consolidation of banking supervision at the European level was necessary in order to help sever the link between banking sector crises and sovereign debt crises. It was decided that the European Central Bank was the most credible EU institution to be given the powers of prudential bank supervision because of its relative success in maintaining price stability in the euro area, its experience in guiding the euro zone banks and sovereigns through the banking crisis of 2008–09 and the sovereign debt crisis of 2010–12, and its strong legal basis in the EU Treaties guaranteeing its independence from external political pressure.⁵⁶ Moreover, the Banking Union would aim to increase harmonised practices in banking supervision, resolution and deposit guarantee funding, thereby supporting further integration in the provision of banking and related financial services in the internal market and reversing the fragmentation of banking markets that had been occurring since the global financial crisis began in 2008.⁵⁷

Historical context for the ECB's supervisory function

The question as to what extent the European Central Bank should be engaged in banking supervision had been one of the most contentious issues for the Delors Committee in the late 1980s⁵⁸ and during the drafting of the Maastricht Treaty and the Statute of the European System of Central Banks and of the European Central Bank in 1991.⁵⁹ National governments generally sought to retain control over banking supervision, while central bankers considered supervision to be a potential task for the ECB. The resulting institutional framework created by the Maastricht Treaty severely restricted the capacity of EU institutions (i.e. the ECB) from providing preventative pre-crisis prudential supervision, while also limiting stability enhancing post-crisis resolution powers.⁶⁰ Sovereign powers for monetary policy were fully transferred from Member States of the euro area to the newly created euro system presided over by the European Central Bank.⁶¹

⁵⁵ Regulation 1092/2010 on EU macro-prudential oversight of the financial system and establishing a European Systemic Risk Board [2010] OJ L331/1.

⁵⁶ See discussion in European Council, President, *Towards a Genuine Economic and Monetary Union* (December 5, 2012), pp.6–9 (Four Presidents' Report). See http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/134069.pdf [Accessed February 24, 2015].

⁵⁷ See Commission Staff Working Document, *European Financial Integration Report 2009* SEC(2009) 1702 final, demonstrating the fragmentation of EU banking and financial markets after the onset of the financial crisis of 2007–08.

⁵⁸ *Delors Report* (1989): the penultimate draft specified in para.32 that the “system [ESCB] would participate in the coordination of banking supervision policies of the national supervisory authorities”. In the final report “national” was deleted, implying that the supervisory authorities would be European.

⁵⁹ See Maastricht Treaty Text and Committee of Governors' Draft of the Statute of the European Central Bank.

⁶⁰ The then art.105(6) of the Maastricht Treaty (December 1991) provides:

“The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.”

⁶¹ See discussion in L. Pauly, “Financial Crisis Management in Europe and Beyond” (2008) 27 *Contributions to Political Economy* 77. The article discusses the three-stage process through which the European Monetary Union was created: stage 1 began in July 1989 with increased co-ordination among Member States regarding their monetary and financial policies. Stage 2 covered the establishment of the European Monetary Institute on January 1, 1994, while stage 3 began when the ECB and the European System of Central Banks became operational and assumed responsibility

Banking supervision, however, remained nationally based with the relevant Member State authority. Substantial opposition by the UK and some other Member States led to the omission of “prudential supervision of credit institutions and other financial institutions” from the list of basic tasks that were given to the European System of Central Banks by the Maastricht Treaty.⁶²

Despite the Treaty’s express exclusion of prudential supervision of credit and financial institutions from the ECB’s conferred powers, it nevertheless conferred upon it, in the area of banking supervision and financial stability oversight, two functions: (1) an advisory function, and (2) a facilitating function. The advisory function involves the requirement that the EU institutions and Member State authorities consult the ECB on proposed legislation that impinge on the ECB’s “fields of competence”.⁶³ As there is no definition of the ECB’s “fields of competence” in the Treaties, they are generally understood as being the tasks that are entrusted to the European System of Central Banks (ESCB).⁶⁴ The facilitating function is a secondary or “non-basic” task that is limited to euro area Member States and allows the ECB to contribute to the smooth conduct of policies that relate to the prudential supervision of credit institutions.⁶⁵

In addition, as mentioned above, a third function set forth under art.127(6) TFEU confers limited supervisory powers on the ECB but only on the condition that Member States vote unanimously through a special legislative procedure to entrust the ECB, after consultation with both the European Parliament and the ECB, with “specific tasks ... concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings”.⁶⁶ This so-called enabling clause of art.127(6) TFEU allows the Council to avoid the cumbersome procedure of Treaty revision by relying on an existing Treaty provision to authorise the ECB to become a prudential supervisor of individual credit and financial institutions.⁶⁷

Single Supervisory Mechanism

Two decades after the Maastricht Treaty separated monetary policy from banking supervision institutionally at EU level, the Eurogroup announced on June 29, 2012 that it was proposing to activate art.127(6) TFEU as a means to create an SSM to govern and supervise euro area banks and banking groups.⁶⁸ Later, on September 12, 2012, the Commission proposed two SSM Regulations, one establishing an SSM that confers on the European Central Bank substantial new powers and responsibilities as a bank supervisor

for monetary policy and the single currency on January 1, 1999 and included the euro replacing national currencies on January 1, 2002. See R. Lastra, *Legal Foundations of International Monetary Stability* (Oxford: Oxford University Press, 2006), pp.305–307.

⁶² The basic tasks are listed in art.127(2) TFEU (ex art.105(2) EC).

⁶³ Articles 127 (4) and 282(5) TFEU; ESCB Statute art.4. See also European Central Bank, “Guide to Consultation of the European Central Bank by National Authorities Regarding Draft Legislative Provisions” (2005). The UK is exempt from the obligation to consult under these articles.

⁶⁴ A non-exclusive list of tasks was adopted by Council on which national authorities must consult the ECB. See ECB Consultation Decision 98/415 arts 2(1) and 2.

⁶⁵ Article 127(5) TFEU; ESCB Statute art.3(3). See K. Alexander, R. Dhumale and J. Eatwell, *Global Governance of Financial Systems* (Oxford: Oxford University Press, 2005), pp.120–123 (discussing the ECB’s financial stability functions under the EU Treaty and the European Statute for Central Banks).

⁶⁶ Article 127(6) TFEU and ESCB Statute art.25(2). Article 127(6) of the Treaty and art.25(2) of the ESCB Statute provide that Member States can decide through a special legislative procedure to entrust the ECB with “specific tasks ... concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings”. This clause is interpreted as requiring a unanimous vote of EU Finance Ministers (Ecofin).

⁶⁷ See R. Smits, *The European Central Bank: Institutional Aspects* (The Hague: Kluwer Law International, 1997), p.357.

⁶⁸ Eurogroup, *Summit Statement* (June 29, 2012), p.1, https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131359.pdf [Accessed February 15, 2015].

for over 6,000 banks in participating Member States, and the other regulation amending the regulation on the European Banking Authority⁶⁹ to take account of the ECB's new supervisory powers. After much debate and considerable revision by the European Parliament and Council, both SSM Regulations were approved in October 2013 and came into force in November 2013.⁷⁰ Following a one-year transition period, the ECB assumed its full supervisory powers under the SSM regulation on November 4, 2014.⁷¹

The SSM provides the main pillar of the Banking Union and consists of the ECB and the national competent authorities of participating Member States. Its overriding objectives are to ensure safety and soundness of the European banking system and to ensure the unity and integrity of the EU internal market.⁷² All euro area Member States are automatically members, while non-euro area members can decide to participate in the SSM through a procedure involving the national competent authority entering into a "close cooperation" with the ECB.⁷³ For the other non-participating Member States, the ECB is authorised to adopt a memorandum of understanding with the relevant national competent authority that explains how the ECB will co-operate with the NCA in performing their respective supervisory tasks.⁷⁴ The ECB will also conclude memoranda of understanding with each EU home Member State competent authority of a systemically important financial institution.⁷⁵

The ECB is responsible for direct supervision of "significant" banks, which represent almost 85 per cent of banking assets in the euro area.⁷⁶ The ECB will also be indirectly responsible for the supervision by national competent authorities of smaller, less systemically important banks.⁷⁷ The SSM, acting through the ECB, only has jurisdiction to apply and enforce EU prudential banking law and regulatory requirements against "credit institutions" under EU law.⁷⁸ For instance, financial institutions that do not accept retail deposits are not defined as "credit institutions" under EU law and therefore are not subject to SSM jurisdiction. Similarly, a "credit institution" subject to SSM jurisdiction for carrying on activities governed by EU prudential banking law is not subject to SSM jurisdiction for activities not subject to EU prudential banking law, such as brokering and dealing securities or the marketing and sale of retail financial products. For such non-prudential activities, the bank would be subject to other EU banking and financial law

⁶⁹ Regulation 1022/2013 amending Regulation 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards the conferral of specific tasks on the European Central Bank pursuant to Regulation 1024/2013 [2013] OJ L287/5.

⁷⁰ Regulation 1024/2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions [2013] OJ L287/63.

⁷¹ SSM Regulation art.33(2).

⁷² SSM Regulation art.1.

⁷³ SSM Regulation art.7(1) and (2)(a)–(c), providing the legal requirements for ECB co-operation with national competent authorities that enter "close cooperation" with the SSM, including rules that apply directly to banks established in participating countries.

⁷⁴ SSM Regulation art.8.

⁷⁵ SSM Regulation art.6(7)(b).

⁷⁶ The criteria used to define a bank as significant are: total value of assets, whether it is one of the top three largest banks in its home Member State; its importance to the economy of its home state or the EU as a whole; and whether it has requested or received direct public financial assistance from the European Stability Mechanism (ESM) or the European Financial Stability Facility (ESFS). SSM Regulation, art.6(4)(i)–(iii).

⁷⁷ SSM Regulation art.4(1).

⁷⁸ "Credit institution" is defined as a firm which accepts deposits from the public that are insured by the EU Deposit Guarantee Scheme Directive. See Capital Requirements Directive IV (CRD IV Package) (including the Capital Requirements Directive and Capital Requirements Regulation), entered into force January 1, 2014. The CRD IV transposes into European law the prudential capital requirements for credit institutions and investment firms which are based on the internationally agreed Basel Capital Accord (Basel III Agreement).

requirements, such as conduct of business rules, that are the sole responsibility of national competent authorities to monitor and enforce.⁷⁹

The ECB will act through an executive board—the SSB⁸⁰—that is responsible for supervising the euro zone’s largest cross-border banks and the top three banks by size in each participating Member State. The SSB is also responsible for overseeing the supervisory actions of participating national competent authorities who directly supervise small and medium-sized credit institutions in the SSM regime.⁸¹ The ECB/SSB has ultimate discretion to decide whether to intervene and take direct oversight of small and medium-sized institutions that are ordinarily subject to direct supervisory control by national competent authorities.⁸²

The SSB’s organisational structure and operational functions will be separate from the ECB’s monetary policy operations and related functions.⁸³ Germany insisted on separation of the ECB’s supervisory functions from its monetary policy functions in order to protect ECB monetary policy from being influenced by the pursuit of banking supervision mandates.⁸⁴ The separation between monetary policy and supervisory tasks within the ECB is reinforced by a requirement to ensure the organisational separation of both the staff involved and their reporting lines.⁸⁵ The procedure for appointing the chair and vice-chair of the Supervisory Board also reflects this separation: rather than having the ECB Governing Council elect a member of the Executive Board as was proposed in the draft Regulation, the chair and vice-chair are now appointed by the Ecofin and cannot be a member of the ECB Governing Council.⁸⁶ Moreover, the Supervisory Board will have to submit draft supervisory decisions to the ECB Governing Council; the decisions will be deemed adopted unless objected to by the Governing Council.⁸⁷ Should it do so, a non-euro zone participating Member State has the option to challenge the Council’s objection to a SSB draft decision. If the Council decides to confirm its objection, thereby rejecting the Member State’s challenge, the participating Member State may notify the ECB that it will not be bound by the Council decision, in which case the ECB shall then consider whether to suspend or terminate the Member State’s close co-operation in the SSM. A non-euro zone participating Member State may also challenge a SSB decision that is not objected to by the Council, and if the Council rejects the Member State challenge, the Member State has the option to comply with the decision or if not to terminate its close co-operation with the SSM, in which case it would be barred from rejoining for three years.⁸⁸

⁷⁹ The SSM does not apply to most conduct of business rules that govern a credit institution’s capital market activity—such as prospectus requirements, insider dealing and market abuse rules, or miss-selling of retail financial products. These are subject to other areas of EU and national law and are regulated by that country’s national competent authority (not the ECB).

⁸⁰ SSM regulation art.26 (“planning and execution of the tasks conferred on the ECB shall be fully undertaken by an internal body composed of its Chair and Vice Chair”).

⁸¹ SSM Regulation art.6(7)(a)–(c). See also art.25(8) (SSB shall adopt “draft decisions” “to be transmitted . . . to the national competent authorities of the Member States concerned”).

⁸² SSM Regulation art.6(5)(b): “when necessary to ensure consistent application of high supervisory standards, the ECB may at any time, or on its own initiative after consulting with national competent authorities or upon request by a national competent authority, decide to exercise directly itself all the relevant powers for one or more credit institutions.”

⁸³ SSM Regulation art.25 (“Separation from “monetary policy function”). Article 25(2) states that “[t]he ECB shall carry out the tasks conferred on it by this Regulation without prejudice to and separately from its tasks relating to monetary policy and any other tasks”.

⁸⁴ P. Mulbert, Presentation at European Company and Financial Law Conference, Bundestag, Berlin (November 7, 2014) (on file with author).

⁸⁵ SSM Regulation art.25(2).

⁸⁶ SSM Regulation art.26(3).

⁸⁷ SSM Regulation art.26(8).

⁸⁸ SSM Regulation art.7(7). The European Parliament March compromise expanded this procedure in allowing non-euro participating Member States to also disagree with the SSB’s draft decision itself (rather than the Governing Council’s objection to it), which may result in the Member State terminating its SSM participation for three years.

To address accountability concerns, the ECB is directly accountable to the European Parliament and Council for carrying out its supervisory role.⁸⁹ Under the SSM regulation, the chair of the SSB is required to present an annual report in public to the European Parliament.⁹⁰ Moreover, art.21 was included as part of the Parliament-Council compromise to create a reporting obligation for the SSB towards national parliaments⁹¹ that are similar in content to the SSB's reporting obligation under art.20 to the European Parliament and Council.

Prior to taking up its supervisory powers, the ECB conducted a comprehensive assessment consisting of an asset quality review (AQR) and stress tests in 2013–14 for bank balance sheets that required banks that do not pass the stress tests to raise additional capital in addition to their minimum capital requirements.⁹² After completing the AQR and the stress tests, the ECB began to exercise its supervisory powers in the SSM framework in November 2014.⁹³

The legal basis

Before analysing the SSM Regulation further, it is necessary to consider its legal basis under the European Union Treaty. Prior to the proposal of the draft SSM Regulation in September 2012, EU policy-makers debated whether the ECB should act as a bank supervisor and play a role in bank resolution. On the one hand, there was an urgent need to sever the link between fragile banking institutions and sovereign debtors by enhancing banking supervision to repair the banking sector. The discipline and credibility of the

⁸⁹ SSM Regulation art.20. See also art.26(3), providing for the “Interinstitutional Agreement between the European Parliament and the European Central Bank on the practical modalities of the exercise of democratic accountability and oversight over the exercise of the tasks conferred on the ECB within the framework of the Single Supervisory Mechanism”, 2013/694 [2013] OJ L320/1. See also *Memorandum of Understanding between the Council of the EU and the ECB on the co-operation on procedures related to the Single Supervisory Mechanism (SSM)* (December 11, 2013), <https://www.ecb.europa.eu/ecb/legal/ssm/framework/html/index.en.html> [Accessed February 24, 2015]; Interinstitutional Agreement (IIA) between the European Parliament and the ECB.

⁹⁰ The Interinstitutional Agreement Part 1 (Reports) provides that the ECB has a duty to submit every year to the Parliament a report (defined as “Annual Report”). This report is concerned with the execution of the task conferred to the ECB under Regulation 1024/2013. The chair of the Supervisory Board must present the report to Parliament at a public hearing. See https://www.ecb.europa.eu/ecb/legal/pdf/celex_32013q113001_en_txt.pdf [Accessed March 18, 2015].

⁹¹ SSM Regulation art.21.

⁹² On October 26, 2014, the ECB published the outcomes of a year-long financial health check (the Comprehensive Assessment) of 130 banks in the euro area. The assessment detailed the results of the asset quality review (AQR) and a forward-looking stress test of the banks. The comprehensive assessment was carried out under the current EU Capital Requirement framework (CRR/CRD IV) and brought to attention the following results: (1) capital shortfall of €25 billion detected at 25 participant banks; (2) banks’ asset value needs to be adjusted by €48 billion, €37 billion of which did not generate capital shortfall; (3) shortfall of €25 billion and asset value adjustment of €37 billion implies overall impact of €62 billion on banks; (4) additional €136 billion found in non-performing exposure; and (5) adverse stress scenario would deplete bank’s capital by €136 billion reducing median CET1 ratio by 4 percentage points from 12.4 per cent to 8.3 per cent. European Central Bank (ECB), *Aggregate Report on the Comprehensive Assessment* (October 26, 2014), <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/aggreatereportonthecomprehensiveassessment201410.en.pdf> [Accessed February 24, 2015].

⁹³ SSM Regulation art.33(2). The original draft Regulation proposed that the ECB’s supervisory powers be phased in from January 1, 2013 until January 2014, with the creation of the Single Supervisory Board on January 1, 2013 with responsibility for overseeing the largest euro area cross-border banks and those banks seeking bailouts from the ESM, and then on July 1, 2013 with the ECB/SSB beginning to supervise the remaining 6,000 small and medium-sized credit institutions in the euro area and on January 1, 2014 with the ESM authorised to inject capital into banks requiring recapitalisation and who have agreed a restructuring plan. However, the Council and Parliament agreed that the timetable was too ambitious and that ECB/SSB operations should begin 12 months after entry into force of the Regulation, which was November 4, 2013: SSM Regulation art.27(2). The one-year lag was designed to give the ECB time to conduct the AQR and stress tests in conjunction with the European Banking Authority.

European Central Bank was considered a necessary remedy for the ineffective and weak supervisory practices of many euro zone states that had contributed to causing the European banking and sovereign debt crisis. Indeed, a redesigned banking supervision regime built on the shoulders of the European Central Bank was considered necessary to stem the market panic that was sweeping euro zone sovereign debt markets in early 2012.⁹⁴ After the EU institutions agreed to provide emergency funding support for Spain from the European Stability Mechanism in May 2012, the European Council issued its Decision in June proposing a European Banking Union for euro area and other participating Member States that would centralise banking supervision with the ECB and concentrate resolution powers and deposit guarantee rules at EU level.⁹⁵ In respect of banking supervision, this expedited plan of action required activation of the enabling clause of art.127(6) TFEU that provides:

“The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.”

On the other hand, policy-makers questioned whether existing Treaty provisions provided an adequate legal basis for the creation of a banking union. In particular, there was concern that the ECB’s potential treaty powers were limited strictly to micro-prudential supervision of banking and financial institutions based on a unanimous vote of EU Member States, and therefore the ECB could not play a role in broader supervision of financial markets, nor could it play a direct role in a reformed bank resolution regime.⁹⁶ According to this view, the EU Treaty required amendment before the ECB and other EU bodies could be entrusted with broad new financial supervisory and resolution powers to stabilise the euro zone banking sector. Revising the Treaty, however, would require unanimous approval by Member States and would take much more time than what was available to stabilise the euro zone sovereign debt markets. Because of the growing stresses in the sovereign bond markets for Spain and Italy in May and June 2012, EU policy-makers decided to utilise existing Treaty provisions to establish the Banking Union while providing a fiscal backstop through the European Stability Mechanism for ailing euro zone sovereigns and banks.⁹⁷

Regarding the ECB’s competence to act as a bank supervisor, art.13(2) TFEU provides that EU institutions operate under the doctrine of conferred powers, which states that public institutions are constrained by law, in this case by the Treaties, because they are creatures of law.⁹⁸ EU institutions only have powers granted to them by the Treaties.⁹⁹ The rationale behind this is that the exercise of state power

⁹⁴ As Spain began to lose access to sovereign debt markets in May 2012, urgent action was considered necessary by EU policy-makers to restore confidence in financial markets so that fragile euro area countries could regain access to debt markets on sustainable terms. See House of Lords, *Genuine Economic and Monetary Union and the implications for the UK*, 8th Report of Session 2013–14 (February 14, 2014), HL Paper 134, pp.8–9.

⁹⁵ See Van Rompuy, *Towards a Genuine Economic and Monetary Union* (June 26, 2012), EUCO 120/12, p.4.

⁹⁶ Indeed, it seemed unlikely until just before euro zone sovereign debt crisis re-erupted in May 2012 that the Council (Ecofin) would activate the enabling clause of art.127(6) TFEU. EU Ministers of Finance had rejected formal activation of the clause on a number of previous occasions. See Sir Howard Davies, “Comments on Cross-Border Banking Regulatory Challenges” in G. Caprio, D. D. Evanoff and G. G. Kaufman (eds), *Cross-Border Banking: Regulatory Challenges* (Singapore: World Scientific, 2006), p.42.

⁹⁷ See fnn.23–25 and accompanying text for discussion of ESM bank recapitalisation instrument.

⁹⁸ *Parliament v Council (Safe Countries of Origin)* (C-133/06) [2008] ECR I-3189; [2008] 2 C.M.L.R. 54, holding, inter alia, that “each institution is to act within the powers conferred upon it by the Treaty” (at [44]), and that “it has already been held that the rules regarding the manner in which the Community institutions arrive at their decisions are laid down in the Treaty and are not at the disposal of the Member States or of the Institutions themselves” (at [54]).

⁹⁹ *Parliament v Council* (C-133/06) [2008] E.C.R. I-3189 at [55]. TFEU art.13(2) provides that “[e]ach institution shall act within the limits of the powers conferred on it in the Treaties, and in conformity with the procedures, conditions, and objectives set out in them”.

in a liberal society or market economy should be exceptional and require justification and constraint.¹⁰⁰ In other words, European institutions have legal competence to exercise powers that are specifically conferred.

Under the Treaty, the ECB expressly does not have conferred powers to exercise supervision over credit and other financial institutions unless it is authorised to do so based on unanimous consent of all Member States. Therefore the SSM Regulation was adopted unanimously by activating the enabling clause of art.127(6) TFEU as a basis for conferring supervisory powers on the ECB for credit and other financial institutions. According to the language of art.127(6), however, the ECB can only have supervisory powers conferred on it “concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings”. This means it can only have supervisory powers conferred on it for individual credit and financial institutions, not wider powers involving bank resolution, nor oversight of financial conglomerates or investment firms not defined under EU law as “credit or other financial institutions”. Article 127(6) essentially applies to micro-prudential supervision of “credit institutions and other financial institutions” and not to supervision of other financial firms or areas of the financial markets that are off the balance sheets of credit and financial institutions, such as the shadow banking market.¹⁰¹ The restrictive language of art.127(6) is presumably why the SSM Regulation was designed specifically to apply only to individual “credit institutions” as defined under EU law and possibly to the larger banking groups of which they are apart.

The limited competence of the ECB to act as a bank supervisor under art.127(6) therefore would preclude it from engaging in any supervisory activities directed at the broader financial system, including, for instance, the wholesale debt securities markets or bank resolution and restructuring. This means that the ECB would not have the competence to oversee the shadow banking market, which was a source of systemic risk that caused the global banking crisis of 2007–09. Moreover, it would not have the competence to put a credit institution (which it had the competence to supervise) into resolution, nor could it exercise resolution powers, such as transferring the assets of a distressed bank to a private purchaser, or transfer a distressed bank’s assets to a bridge bank, nor even take legal measures to co-ordinate with resolution authorities. The narrow supervisory competence allocated to the ECB under art.127(6) suggests that the ECB would be acting *ultra vires* if it took broader macro-prudential supervisory measures that go beyond the micro-prudential supervision of individual credit institutions and financial institutions. The narrowly conferred powers on the ECB under art.127(6) TFEU significantly limit its ability to perform effective banking supervision and support the view that the ECB should not be granted banking supervisory powers unless the Treaty is amended to provide it—at a minimum—with enlarged powers to monitor the broader financial system (i.e. macro-prudential supervisory powers) and to take interventionist measures (i.e. prompt corrective action) as part of a bank resolution or restructuring.

The SSM Draft Regulation

Council amendments

On December 3, 2012, the Council of the EU, under the Cyprus Presidency, presented its “Presidency compromise” amending the Commission’s proposed SSM Regulation of September 2012. One of the major changes introduced in the compromise was the reallocation of supervisory tasks between the ECB

¹⁰⁰ See discussion in D. Chalmers, G. Davies and G. Monti, *European Union Law: Text and Materials* (Cambridge: Cambridge University Press, 2014), p.60.

¹⁰¹ The Financial Stability Board has defined “shadow banking as a system of credit intermediation that involves entities and activities outside the regular banking system”. Financial Stability Board, “Shadow Banking: Scoping the Issues” (April 12, 2011), p.2.

and the national competent authorities (NCAs). While the Commission proposal assigned supervisory tasks to the ECB with regard to all credit institutions established in participating Member States, the amended regulation specifically gives the NCAs direct supervision over “less significant” institutions (based on size, economic importance and cross-border activities¹⁰²) as well as those for which no public financial assistance has been requested nor received directly or indirectly from the euro zone bailout funds.¹⁰³ NCA supervisory tasks are still subject to the ECB’s instructions, guidance, and exceptional intervention.¹⁰⁴ The supervision of the remaining “more significant” credit institutions is then left by default to the ECB.¹⁰⁵ Further amendments to the SSM tasks eliminated the ECB’s duty to co-ordinate a common position amongst NCAs for voting purposes in the European Banking Authority.¹⁰⁶ The presidency compromise also explicitly excluded resolution powers from the bundle of supervisory tasks pertaining to recovery plans, early intervention and structural changes.

European Parliament and Council compromise March 2013

The European Parliament tried to address some of the weaknesses in the accountability of the ECB under the SSM. The text of the March 19, 2013 tripartite agreement (March compromise) incorporated virtually all the amendments from the Presidency compromise and reinforced some of its core principles. The SSM tasks are further prohibited from interfering with or being determined by the ECB’s other mandates, whether in relation to the European Systemic Risk Board or to the solvency monitoring of monetary policy counterparties.¹⁰⁷ Beyond the separation of the staff involved on both sides of these firewalls, the Regulation now requires the ECB to ensure an operational separation for the Governing Council itself as regards monetary and supervisory functions, e.g. through separated meetings and agendas.¹⁰⁸ The role of the European Parliament was also strengthened: the ECB must now report to the Parliament and the Council as to how it has complied with the separation of monetary and supervisory policy¹⁰⁹ as well as co-operate “sincerely” with parliamentary investigations.¹¹⁰

In addition, the Parliament insisted, in the trilogue negotiations with Council and Commission, that the SSM dispute settlement procedures clearly provide for a private party’s right to challenge a SSB supervisory decision on due process grounds.¹¹¹ Article 22 now ensures that, before taking supervisory decisions, the ECB must provide the persons subject to the proceedings the opportunity of being heard

¹⁰² SSM Regulation art.6(4)(i)–(iii).

¹⁰³ SSM Regulation art.6(4). At the time, the two euro zone bailout funds were the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM).

¹⁰⁴ SSM Regulation art.6(5)(a)–(e). The Council-Parliament compromise of March 2013 somewhat constrained the ECB discretion to take over the NCA’s tasks (the article now reads: “When necessary to ensure consistent application of high supervisory standards ... after consulting with the national authorities ...”: art.6(5)(b)).

¹⁰⁵ SSM Regulation art.6(4). The Council-Parliament March 2013 compromise, however, also placed the three most significant credit institutions of each participating Member State under the supervision of the ECB, regardless of usual criteria for significance.

¹⁰⁶ The Commission’s initial proposal of September 12, 2012 authorised the ECB “to coordinate a common position” among participating Member State representatives regarding their voting and influencing issues on the European Banking Authority Supervisory Board. The UK and Sweden objected to this use of ECB authority to influence EBA standard setting because SSM representatives on the EBA Board would constitute a majority that could be required by the ECB to take a common position against non-participating Member States. See *House of Lords Europe Committee Report* (December 2012), criticising the Commission’s proposed Regulation of September 2012 on these grounds.

¹⁰⁷ SSM Regulation arts 25 and 26.

¹⁰⁸ SSM Regulation art.25(3).

¹⁰⁹ SSM Regulation, March compromise art.18(2) first subparagraph.

¹¹⁰ SSM Regulation, March compromise art.17(9).

¹¹¹ SSM Regulation art.22 (“Due process for adopting supervisory decision”).

on the matters to which the ECB has taken objection—urgent action notwithstanding. Article 24¹¹² allows any person addressed by an ECB/SSB or NCA decision taken in accordance with the SSM regulation to request an internal review by an independent “Administrative Board of Review” appointed by the Governing Council. The Board can confirm, abrogate or amend the decision in question. The right to bring proceedings before the ECJ remains unprejudiced.¹¹³

Reconciling the ECB’s independence with effective banking supervision

The EU Treaty establishes in art.130 a strong form of independence for the ECB in deciding what measures it should use to conduct monetary policy and to achieve its primary objective of price stability.¹¹⁴ Indeed, the ECB’s independence is widely considered to be why it has been viewed as a strong and credible institution in managing the value of the euro and maintaining price stability. It is unsurprising therefore why some would advocate that this credibility be extended to the ECB in the form of banking supervision powers.¹¹⁵

Nevertheless, it should be pointed out that monetary policy and banking supervision are very different. Monetary policy usually involves the use of a few macro instruments—i.e. controlling interest rates and the quantity of money—to achieve price stability, a measurable objective often defined as keeping inflation within a range or below a target rate, and involving a more or less predictable trade-off between inflation and unemployment.¹¹⁶ Strong legal guarantees of central bank independence have been considered necessary in fulfilling the price stability mandate.¹¹⁷

Banking supervision, on the other hand, has a wider number of—often conflicting—objectives: financial stability, investor and depositor protection, consumer protection and financial crime. Moreover, it is much more difficult to measure whether these objectives have been met and what the economic trade-offs are in achieving them. Also, bank supervisors have the power to restrict and restructure property and contractual right—belonging to individual firms, depositors, shareholders and creditors—and in doing so to utilise a far greater number of regulatory instruments than is available in monetary policy.

This is one reason why banking supervision has been subjected to greater accountability mechanisms than monetary policy by requiring, for example, that firms and individuals be consulted before they are subjected to controls and that the content of regulations are clearly ascertainable in advance and proportionate to achieve a legitimate regulatory aim and can be challenged by those subject to them before a fair and impartial tribunal. Accountability controls are also necessary because bank supervisors also ordinarily have an array of investigation and sanctioning powers which can be used against banks and financial firms, individuals and other parties for failing to comply with micro-prudential regulatory requirements, and parties subject to supervisory sanctions have the right of redress before fair and impartial

¹¹² SSM Regulation art.24 (Administrative Board of Review). The Administrative Board of Review will hear appeals against supervisory decisions based on questions of procedural and substantive law in conformity with the SSM regulation only—and thus not will consider broader issues of EU law outside the SSM Regulation.

¹¹³ SSM Regulation art.24(11) (reaffirming the right of an entity subject to the SSM Regulation to appeal any decision of the ECB to the Court of Justice of the EU in accordance with the EU Treaty).

¹¹⁴ The ECB’s strong form of independence is set forth in arts 130 and 282(3) TFEU; art.7 ESCB Statute (to carry out its tasks to achieve its overriding objective of price stability).

¹¹⁵ SSM Regulation art.19(1), reinforcing the principle for the ECB/SSB in carrying out its supervisory functions provided that “the ECB and national competent authorities shall act independently”.

¹¹⁶ A. Phillips, “The Relation between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1861–1957” (1958) 25 *Economica* 283 (establishing the inverse relationship between the rate of change in money wages and the unemployment rate).

¹¹⁷ See C. Borio and G. Toniolo, “One Hundred and Thirty Years of Central Bank Cooperation” in C. Borio, G. Toniolo and P. Clement, *Past and Future of Central Bank Cooperation* (Cambridge: Cambridge University Press, 2008), pp.57–58 (discussing central bank independence and how it facilitates the pursuit of central bank objectives).

tribunals which can rule against the supervisor and modify or set aside supervisory controls or sanctions if not warranted by law.

Unlike monetary policy, banking supervision requires different institutional mechanisms to ensure a more equal balance between the independence and accountability of the bank supervisor. The ECB's strong form of independence—as established by the Treaty—is arguably inappropriate as a policy matter for a modern bank supervisor, and without adequate accountability mechanisms would be likely to contravene the legal principles of the rule of law as set forth in a number of rulings by the European Court of Human Rights.¹¹⁸

The SSM Regulation therefore does not address the ECB's institutional limitations as a bank supervisor. In an era where global financial policy-makers have accepted the importance of macro-prudential regulation as extending from licensing to resolution, it is striking that the proposal for an ECB/SSM only provides ex ante prudential supervisory powers for the ECB, while largely leaving macro-prudential supervisory monitoring and crisis management and bank resolution powers to national competent authorities. Indeed, most regulators now agree that effective regulation requires a seamless process from crisis prevention through crisis management and for oversight of systemically important financial conglomerates, but under the regulation the ECB Supervisory Board would not be authorised to engage in, among other things, prompt corrective action, crisis management co-ordination with national central banks or the ECB, nor would it be permitted to take any measures (other than making recommendations) involving the resolution of an institution it supervises. Furthermore, the proposals do not address the institutional limitations that could potentially restrict the ECB's legal authority under the Treaty to take certain macro-prudential measures in exceptional circumstances under art.5 of the SSM Regulation.

The ECB's price stability objective and banking supervision

The ECB's role as a bank supervisor might bring it into conflict with its main treaty objective of price stability.¹¹⁹ According to this view, the ECB might be tempted to lower interest rates or to loosen conditions for bank access to liquidity in order to stabilise the banking sector, but this might lead to easier terms of credit, thereby conflicting with its price stability objective.¹²⁰ This is why supervisory mandates for central banks tend to be controversial. In general, the price stability mandate of central banks is obstructed by short-term goals, e.g. avoiding high interest rates and unemployment owing to electoral and political pressures—hence the need for central banks to be independent so that they are immune from these pressures. Accordingly, a central bank receiving explicit or implicit employment or economic growth mandates will face the same conflict. A supervisory mandate thus potentially results in lenient monetary policies to prevent bank illiquidity and insolvency; central banks also enjoy easier “bureaucratic entrenchment” than a supervision-only agency would, making them less accountable for the moral hazard they create. Empirical evidence confirms that supervision mandates result in fewer bank failures but higher inflation—though it has yet to be established whether such regimes are better or worse in terms of overall welfare.¹²¹

¹¹⁸ See discussion in K. Alexander, “Bank Resolution Regimes: Balancing Prudential Regulation and Shareholder Rights” (2009) 9 *Journal of Corporate Law Studies* 61–93 (citing decisions of the European Court of Human Rights requiring that regulatory and supervisory decisions must comply with due process standards and legal certainty).

¹¹⁹ Article 127 TFEU (stating “the primary objective of the European System of Central Banks ... shall be to maintain price stability”).

¹²⁰ This is why Principle 2 of the Basel Core Principles for Effective Banking Supervision recommends that the functions of the bank supervisor and monetary policy-maker be independent from one another. See Principle 2 of Basel Committee's *Core Principles for Effective Banking Supervision* (September 2012) (Basel: Bank for International Settlements).

¹²¹ See discussion in G. Hertig, “Central Bank Governance” (2012) *Swiss Review of Business and Financial Market Law* 486-493 at 488.

The optimal governance architecture needed for such a double mandate is unclear: law-makers struggle to combine an efficient relationship between the pursuit of monetary and supervisory objectives and ensuring adequate accountability. Other governance issues are both external (especially towards national resolution authorities) and internal, such as the transparency of central bank policies: while excessive transparency may potentially damage the credibility of central banks, e.g. when responding to temporary market disturbance, empirical evidence shows that higher transparency in forecasts is associated with lower average inflation, and to some extent both less inflation persistence as well as reduced inflation volatility.¹²²

The SSM Regulation attempts to address the potential conflict in dual central bank mandates by requiring that bank supervision decisions and monetary policy be strictly separated by creating an SSB which would have separate staff to work solely on banking supervision matters and not to have links with staff involved with monetary policy. Moreover, the December 2012 Cyprus Presidency amendment to the SSM Regulation to require the chair and vice-chair of the SSB to be appointed by Ecofin, rather than by the ECB Governing Council as originally proposed, was an important step to creating some institutional safeguards to ensure the SSB's independence from the ECB Governing Council, while providing more accountability to Member State finance ministries, which may have to decide in a crisis whether to recapitalise an ailing bank. Nevertheless, the SSB's oversight of the SSM is ultimately accountable to the review of the ECB's Governing Council, whose strong form of independence guaranteed by the Treaty and whose overriding mandate of price stability arguably takes precedence over the ECB's newest mandate of banking supervision. However the Governing Council's final review of monetary and banking supervision decision-making is subject to the "separation" requirement in art.25, which mandates that Council decision-making is based on separate agendas that rely on separate staff and reporting channels.¹²³ This supports the SSB's independence in supervisory matters while guaranteeing the independence of the ECB's Governing Council in overseeing all of the ECB's functions and decision-making.¹²⁴

The ECB and macro-prudential supervision

Although the definition of macro-prudential regulation and supervision is intensely debated,¹²⁵ it consists mainly of four main areas: (1) adjusting the application of regulatory rules to institutions according to developments in the broader economy (i.e. countercyclical capital requirements)¹²⁶; (2) imposing regulatory controls on contractual relationships between market participants (i.e. margin requirements, loan-to-value or loan-to-income ratios for mortgage loans); (3) monetary policy controls, such as interest rates, exchange rate controls, regulating money supply, and capital controls; and (4) prudential requirements for financial

¹²²Hertig, "Central Bank Governance" (2012) *Swiss Review of Business and Financial Market Law* 486-493 at 488.

¹²³ See SSM Regulation art.25, requiring that the Governing Council's oversight of banking supervision be subject to a separate agenda, including separation of staff and reporting channels, from its agenda for overseeing and approving ECB monetary policy and oversight of payment system infrastructure.

¹²⁴To reinforce the independence of the SSB, President Draghi set forth conditions that were added as an amendment to the SSM which he argued were necessary to make the plan work and protect the ECB's reputation for maintaining and achieving its monetary policy objective of price stability. He observed that supervision and monetary policy must be "rigorously separated", and that national supervisors should play a significant role in any euro zone supervisory plan. M. Draghi, Speech before the Committee on Economic and Monetary Affairs, "Monetary Dialogue with Mario Draghi, President of the ECB" (Brussels, December 17, 2012), p.6.

¹²⁵ See European Systemic Risk Board, "Flagship Report on Macro-prudential Policy in the Banking Sector" (ECB, 2014), pp.4-5 (discussing the difficulty of defining macro-prudential regulation and supervision).

¹²⁶ Experts have observed that countercyclical buffers could be difficult to implement. See M. Brunnermeier, A. Crockett, C. Goodhart, A. Persaud and H. Shin, *The Fundamental Principles of Financial Regulation*, Geneva Reports on the World Economy 11 (Geneva: International Centre for Banking and Monetary Studies, 2009), Ch.4 (discussing design of countercyclical regulation).

infrastructure or firms providing infrastructure services (i.e. capital requirements for derivative clearing houses).¹²⁷ A growing literature has analysed the use of macro-prudential tools as part of macro-prudential regulation.¹²⁸

The wider scope of coverage and application of macro-prudential regulation will necessarily involve a wider array of prudential supervisory tools that include both ex ante supervisory powers, such as licensing, authorisation and compliance with regulatory standards, and ex post crisis management measures, such as bank recovery and resolution plans, including the use of contractual and regulatory bail-in tools to recapitalise distressed banks, enhanced deposit insurance schemes and more effective central bank funding support.¹²⁹ Indeed, the objectives of macro-prudential regulation—to monitor and control systemic risks and related risks across the financial system—will require greater regulatory and supervisory intensity that will necessitate increased intervention in the operations of cross-border banking and financial groups and a wider assessment of the risks they pose. As discussed below, the broad area of bank recovery and resolution will necessarily involve authorities in restructuring and disposing of banking assets and using taxpayer funds to bail out and provide temporary support for ailing financial institutions.¹³⁰ Under the SSM, does the ECB have the necessary scope of authority to be an effective macro-prudential supervisor?

Under the initial Commission proposal in September 2012, the ECB/SSB was given broad powers of prudential supervision: for instance monitoring capital adequacy, liquidity buffers and leverage limits¹³¹ and approving bank recovery plans and asset transfers between affiliates within banking groups or mixed financial conglomerates.¹³² However, Council amendments in the December 2012 Presidency compromise limited the use of macro-prudential supervisory powers to national competent authorities. During the tripartite negotiations between the European Parliament and Council, however, the Parliament considered the use of micro-prudential powers alone for the ECB to be inadequate without the use of “limited” macro-prudential supervisory tools. As a result, the Parliament and Council agreed in March 2013 (the March compromise) to final amendments to the SSM Regulation that included additional powers for the ECB, acting through the SSB, to exercise certain macro-prudential powers in exceptional situations. The ECB/SSM’s macro-prudential tasks are set forth in art.5, entitled “Macroprudential tasks and tools”, which include the discretion to impose stricter prudential requirements under the Capital Requirements Directive IV,¹³³ including higher capital buffers, on individual banks based on macro-prudential factors in the country where the bank is based.¹³⁴ Although the exercise of these macro-prudential tools rests primarily with the

¹²⁷ Basel Committee on Banking Supervision (2011), “Macroprudential Policy Tools and Frameworks”, *Progress Report to G20* (2011), <http://www.bis.org/publ/othp17.htm> [Accessed February 24, 2015].

¹²⁸ See generally for a review of the literature, K. Alexander, “Bank Capital Management and Macro-prudential Regulation” (2012) 24 *Journal of Banking Law and Banking* 331, 332.

¹²⁹ See *De Larosière Report* (2009). See also FSA, *A Regulatory Response to the Global Banking Crisis* (Turner Review) (London: March 2009).

¹³⁰ Indeed, the Financial Stability Board has stated in its *Key Attributes of Effective Resolution Regimes* that “[t]o improve a firm’s resolvability, supervisory authorities or resolution authorities should have powers to require, where necessary, the adoption of appropriate measures, such as changes to a firm’s business practices, structure or organisation ... To enable the continued operations of systemically important functions, authorities should evaluate whether to require that these functions be segregated in legally and operationally independent entities that are shielded from group problems” (FSB Key Attribute 10.5).

¹³¹ Commission Proposal 2012 art.5(1)–(4).

¹³² Commission Proposal 2012 art.5(1)(k).

¹³³ The Capital Requirements Directive IV (CRD IV) consists of a Regulation and a Directive. Regulation 575/2013 on prudential requirements for credit institutions and investment firms and amending Regulation 648/2012 [2013] OJ L176/1 (Regulation 575/2013); and Directive 2013/36 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87 and repealing Directives 2006/48 and 2006/49 [2013] OJ L176/338 (Directive 2013/36). The SSM Regulation only applies its substantive requirements to credit institutions and investment firms subject to the CRD IV requirements.

¹³⁴ SSM Regulation 1024/2013 art.5.

national competent authorities (NCAs),¹³⁵ the ECB may intervene and utilise these tools “if deemed necessary”,¹³⁶ and in adopting a particular measure is then required to take the specific circumstances of the Member State’s financial and economic situation into account¹³⁷ as well as “duly consider” any objection of a euro zone national competent authority that seeks to address a macro-prudential risk on its own.¹³⁸

Moreover, the Capital Requirements Regulation permits the ECB/SSM to take macro-prudential measures, other than increased capital buffers, for banks based in a participating Member State where the ECB has identified macro-prudential or systemic risks.¹³⁹ Also, under the Special Resolution Mechanism, the ECB will have limited macro-prudential powers to co-operate with the SRM’s Single Resolution Board in conducting an *assessment* of the extent to which banks and groups under its supervision are resolvable without the assumption of extraordinary public financial support, and to notify the SRB of a supervised entity requiring resolution.¹⁴⁰ In addition, under the Commission’s proposed Regulation to implement structural regulation of banking, the ECB will have the authority to review the trading activities of banking groups under its supervision,¹⁴¹ and to have discretion to initiate the separation of deposit-taking banks from the group’s trading entities.¹⁴² And the ECB may exempt entities under its supervision from the scope of the Commission’s proposed Regulation on structural regulation of banking groups altogether if it deems that they have a sufficiently robust resolution strategy in place.¹⁴³

Although the ECB has exceptional powers to impose higher prudential requirements and additional capital buffers have been carved out in art.5,¹⁴⁴ the use of these tools now rests primarily with the NCAs; the ECB may take over the task “if deemed necessary”,¹⁴⁵ and is then required to take the specific circumstances of the Member State’s financial and economic situation into account¹⁴⁶ as well as “duly consider” any objection of an NCA proposing to address the local situation on its own.¹⁴⁷

The SSM Regulation can be critically analysed on the grounds that it primarily envisions the ECB engaging in micro-prudential supervision of individual credit and financial institutions with limited oversight of financial groups and no oversight of insurance firms or the shadow banking sector. Macro-prudential supervisory powers are largely left to Member States, but the ECB can take certain prescribed macro-prudential measures or tools acting on its own initiative in exceptional circumstances and with discretion. Moreover, the ECB has no competence to conduct macro-prudential supervision and only in exceptional circumstances can adopt and apply macro-prudential regulatory tools, as these functions

¹³⁵ SSM Regulation art.5(1).

¹³⁶ SSM Regulation art.5(2).

¹³⁷ SSM Regulation art.5(3).

¹³⁸ SSM Regulation art.5(2).

¹³⁹ Capital Requirements Regulation 575/2013 art.458. Article 458 is entitled “Macroprudential or systemic risk identified at the level of a Member State” and states in relevant part: “2. Where the authority determined in accordance with paragraph 1 identifies changes in the intensity of macroprudential or systemic risk in the financial system with the potential to have serious negative consequences to the financial system and the real economy in a specific Member State and which that authority considers would better be addressed by means of stricter national measures, it shall notify the European Parliament, the Council, the Commission, the ESRB and EBA of that fact and submit relevant quantitative or qualitative evidence.”

¹⁴⁰ SRM Regulation art.16(1).

¹⁴¹ The draft Regulation aims to implement some of the recommendations of the Liikanen Committee. See *High-Level Expert Group on reforming the Structure of the EU Banking Sector Chaired by Erkki Liikanen*, Final Report (Brussels: October 2, 2012).

¹⁴² SSM Regulation art.10(2)). Once the separation is initiated, the ECB will review the separation plan submitted by the entity and can require its amendment (art.18).

¹⁴³ SSM Regulation art 5(2).

¹⁴⁴ SSM Regulation art.5(a)(1) (“Macroprudential tasks and tools”).

¹⁴⁵ SSM Regulation art.5(a)(2).

¹⁴⁶ SSM Regulation art.5(a)(3).

¹⁴⁷ SSM Regulation art.5(a)(2).

are largely reserved for NCAs.¹⁴⁸ This very limited role for the ECB as a macro-prudential regulator (and no competence as a macro-prudential supervisor) leaves a gaping hole in the Banking Union prudential regulatory and supervisory framework as the ECB can only exercise micro-prudential supervisory functions on a regular basis (either directly or by acting through NCAs), while macro-prudential regulatory and supervisory functions are carried out largely by the NCAs without direction or guidance from the ECB.¹⁴⁹ These institutional and legal gaps with respect to the ECB's macro-prudential regulatory and supervisory powers suggests that the SSM Regulation fails to recognise that micro-prudential regulation/supervision and macro-prudential regulation/supervision should be directly linked together and should not be treated institutionally as if they were separate activities. Moreover, micro-prudential and macro-prudential regulatory and supervisory measures and bank resolution practices should involve a high degree of institutional co-ordination and coherence in the application of regulatory and resolution principles and rules that aim to achieve the overriding objective of financial stability.

Single Resolution Mechanism

The SRM's rationale and purpose

The European Commission proposed on July 10, 2013 an SRM¹⁵⁰ to serve as one of the three pillars of the Banking Union that would complement the supervisory powers of the ECB in the SSM.¹⁵¹ The Commission's proposal recognised that an effective supervisory and resolution regime in the Banking Union required the exercise of governance at the same institutional level.¹⁵² The SRM aims to create a more uniform and harmonised resolution process and substantive rules across the EU that can more

¹⁴⁸ European Systemic Risk Board, "Flagship Report on Macro-prudential Policy in the Banking Sector" (ESRB, 2014), pp.4–5 (discussing how Member States have made important progress in establishing macro-prudential authorities at the national level, while also recognising that the SSM entrusts the ECB "with important tasks and responsibilities beyond micro-supervision in the area of macro-prudential policy" but does not enumerate these until further notice about the operationalisation of "SSM-specific issues". The ESRB also further observes that "[t]he scope of macro-prudential policy is wider than banking", and that "[f]inancial stability risks, however, can also arise from vulnerabilities that are building up in other parts of the financial system (for example, in the insurance sector, pension funds, financial infrastructures, or shadow banking").

¹⁴⁹ The ECB cannot adopt macro-prudential regulatory tools unless there are exceptional circumstances justifying the ECB in doing so based on certain financial market imbalances, such as disproportionate asset price growth in a particular sector of the economy (e.g. the housing market), and with the consent of the affected national competent authority.

¹⁵⁰ Commission, "Proposal for a Regulation of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Bank Resolution Fund and amending Regulation 1093/2010" COM(2013) 520 (SRM Proposal).

¹⁵¹ Earlier, in May 2013, Germany and France had proposed an alternative single resolution mechanism for countries participating in SSM that would be established on the basis of existing EU treaties and on the following principles: (1) a single resolution board in SSM consisting of national resolution authorities who would have powers to act expeditiously in triggering and implementing a bank resolution; (2) pre-financing by the banking industry in which there would be national funding arrangements that would evolve over time and eventually converge or join up with the European Stability Mechanism, in which the ESM would play a broader role in providing lending facilities to Member States and direct recapitalisation to SSM-regulated banks as part of the SRM mechanism. See "France and Germany—Together for a stronger Europe of Stability and Growth" (Paris: May 29, 2013), pp.4–5.

¹⁵² See SSM Regulation 1024/2013 Recital 85; and Commission, "A Roadmap towards a Banking Union" COM(2012) 510 final, p.9; and European Council, *Conclusions* (December 13–14, 2012), Euco 205/12, para.11, stating "where bank supervision is effectively moved to a single supervisory mechanism, a single resolution mechanism will be required, with the necessary powers to ensure that any bank in participating Member States can be resolved with the appropriate tools". See http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/134353.pdf [Accessed November 14, 2014].

effectively place banks experiencing solvency problems and supervised by the ECB/SSM into resolution with minimal costs to taxpayers and to the broader economy.¹⁵³ The SRM applies the substantive rules of the BRRD to banks that are supervised by the ECB/SSM. Unlike the SSM, the SRM's SRB has direct oversight of resolution matters for over 6,000 credit institutions and certain investment firms based in the euro area.¹⁵⁴ Whereas the ECB is responsible for direct supervision of the largest and systemically important banking institutions, the SRB has direct oversight for *all* credit institutions and certain investment firms—large or small, cross-border or national.¹⁵⁵

Under the BRRD and SRM, the resolution authority requires banks and banking groups to hold higher amounts of loss absorbent capital and to issue a minimum amount of bonds and certain other unsecured debt instruments that are subject to mandatory write-downs based on the broad discretion of the resolution authority if the bank or banking group experiences financial distress.¹⁵⁶ Moreover, banks are required to write recovery plans¹⁵⁷ and resolution authorities are required to write resolution plans (also known as “living wills”) to plan for how the bank would deal with disorderly markets and even its own failure in the event that it became unviable.¹⁵⁸ By imposing bail-in on a bank's creditors and requiring the bank to conduct recovery and resolution planning, the resolution framework not only intends to reduce taxpayer exposure to a bank bailout, but also to reduce excessive risk-taking by banks and other investment firms.¹⁵⁹

The Commission's initial draft Regulation

Under the Commission's July 2013 proposal, the SRM's main requirements were: (1) the ECB would identify when a bank operating in a state subject to SSM was in serious financial difficulties and should be resolved; (2) a Single Resolution Board consisting of representatives from the Commission, the ECB, and national authorities where the bank operates would make a recommendation on resolution; (3) the Commission would have ultimate authority in triggering a bank resolution and in approving the resolution plan; (4) national resolution authorities would implement the approved resolution plan under the supervision of the Single Resolution Board; and (5) a single bank resolution fund would be established under the control of the SRB and would be funded by contributions from the banking industry, thereby replacing the national resolution funds of Member States participating in the SSM.

The Commission adopted art.114 as the legal basis for the initial SRM proposal because of the Commission's intention to delegate day-to-day oversight of bank resolution matters and the funding of the Single Resolution Fund to the SRB. The proposal delegated to the SRB powers to design, oversee and implement bank resolution plans and to ensure that the SRF had adequate financing arrangements in place to support a resolution framework.¹⁶⁰ At the time of proposal, there was considerable opposition led by Germany (supported by Sweden and the Czech Republic) to the SRM on the grounds that there was no legal basis in the Treaty to concentrate such broad authority in the Commission to make the final decision on resolution and that any centralisation of resolution authority with the Commission and the delegation of discretionary authority to the SRB under art.114 to decide resolution funding arrangements involving Member State contributions to the SRF and associated mutualisation of risk between Member States would

¹⁵³ SRM Regulation Recital 12.

¹⁵⁴ SRM Regulation arts 2 and 6(1)–(7).

¹⁵⁵ SRM Proposal art.2. The SRM Regulation applies to investment firms subject to the EU Capital Requirements Directive IV. See fn.125.

¹⁵⁶ SRM Regulation art.27 (“Bail-in tool”).

¹⁵⁷ SSM Regulation art.4(h)(1).

¹⁵⁸ SRM Regulation Ch.1 “Resolution Planning”, art.8 (“Resolution plans drawn up by the Board”).

¹⁵⁹ SRM Regulation Recital 55.

¹⁶⁰ Policy-makers and lawyers have also debated whether the SRM Regulation delegates power to the Commission based on the doctrine of delegated powers under arts 290 and 291 TFEU to take discretionary decisions about whether and when an institution should be put into resolution or insolvency.

require Treaty changes.¹⁶¹ Amending the EU Treaty, however, was considered politically difficult and unlikely to happen any time soon.

Germany's legal position, however, was weakened by a legal opinion from the Council Legal Service (CLS), issued on September 11, 2013.¹⁶² This concluded that art.114 may be the legal basis for the establishment of the SRM and the Single Resolution Fund, as long as safeguards are introduced to protect the budgetary sovereignty of Member States.¹⁶³ Germany's position, however, drew support from the Court of Justice's Advocate General's Opinion on the UK's legal challenge to the Short Selling Regulation (published on September 12, 2013), arguing that art.114 was not suitable to confer wide resolution powers on the Single Resolution Board and that instead a legal base requiring unanimity in Council was required (art.352 TFEU).¹⁶⁴

As an alternative to the Commission proposal, German officials proposed that an SRF could be established and funded by industry contributions along with mutualisation of risks between Member States if these Member States agreed to establish the Fund through an IGA. Under German pressure, the Commission amended the SRM proposal so that art.114 would provide the legal basis for the transfer of powers to the SRB to make recommendations to the Commission regarding the design and implementation of resolution plans and the governance aspects of the SRF, and also would be used to create an IGA that would—outside the EU Treaty—support the transfer and mutualisation of funds between resolution authorities of participating SRM Member States in the Single Resolution Fund. In support of the Commission's approach, the Commission's legal services found that the resort to an IGA under these circumstances was not contrary to the Treaty so long as it was limited to the transfer and mutualisation of funds.¹⁶⁵

The SRM

After much debate involving the Parliament, Commission and Council, final agreement on the SRM framework was reached in March 2014¹⁶⁶ consisting of the following: (1) the ECB would identify when a bank operating in a state subject to SSM was in serious financial difficulties and should be resolved; (2) A Single Resolution Board consisting of representatives from the Commission, the ECB and national authorities of Member States where the bank operates would make a recommendation on resolution to the Commission; (3) the Commission would decide whether to approve the Board's recommendation for a bank resolution and approve a resolution plan and refer its decision to Council for final review; (4) national resolution authorities would implement the approved resolution plan under the supervision of the

¹⁶¹ At the time, Germany's objections to the Commission's SRM proposal had occurred in the context of EU leaders postponing their decision in late June 2013 on euro zone economic integration (including the SSM banking union proposal)—a delay some had ascribed at the time to impending German elections. See P. Spiegel, "German politics puts sand in cogs of EU machine" (June 28, 2013), *Financial Times*, <http://www.ft.com/intl/cms/s/0/74d2d4a4-e007-11e2-9de6-00144feab7de.html#axzz2ZxyjaCUm> [Accessed February 25, 2015].

¹⁶² Council, Opinion of the Legal Service, 2013/0253 (COD), 13524/13, LIMITE, JUR 458, ECOFIN 787.

¹⁶³ Council, Opinion of the Legal Service, 2013/0253 (COD), 13524/13, LIMITE, JUR 458, ECOFIN 787 at 14.

¹⁶⁴ See the summary of the UK case and arguments in the Opinion of A.G. Jääskinen in *United Kingdom v Parliament and Council* (C-270/12) EU:C:2013:562 at [6], [54]–[58].

¹⁶⁵ Opinion of A.G. Jääskinen in *United Kingdom v Parliament and Council* (C-270/12) EU:C:2013:562 at [6], [54]–[58]. The Advocate General concluded that the "emergency powers granted by Short Selling Regulation article 28 to the European Securities and Markets Authority to intervene in the financial markets of Member States so as to regulate or prohibit short selling go beyond what could be legitimately adopted as a harmonising measure necessary for the establishment or functioning of the internal market".

¹⁶⁶ The SRM Regulation was published in the Official Journal on July 15, 2014 and entered into force on January 1, 2015 (Regulation 806/2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation 1093/2010 [2014] OJ L225/1.

Single Resolution Board; and (5) a Single Resolution Fund would be established by inter-governmental agreement (IGA) outside the EU Treaty and administered by the SRB and would be funded beginning in January 2016 by contributions from covered banks and institutions with the fund growing ultimately in size to €55 billion by 2024. During the eight-year phase-in period, the Fund would replace the national resolution funds of participating Member States.

The SRM Regulation explicitly aims to create a uniform set of resolution rules and procedures for Member States to adopt for credit institutions and certain investment firms established in participating Member States with the intention of improving the condition for establishment and functioning of the internal market.¹⁶⁷ To this end, the SRM Regulation establishes a Single Resolution Board to “ensure a coherent and uniform approach” to bank resolution for euro area and participating Member States.¹⁶⁸ The SRB will have responsibility for all preparatory work involving bank resolution plans and resolvability assessments and co-ordinating the implementation of resolution plans with national authorities and interpreting the scope of the systemic crisis exception.¹⁶⁹ The SRB will also make recommendations to the Commission and Council regarding whether a bank should be taken into resolution and the use of resolution tools, including the bail-in tool.¹⁷⁰

The SRM Regulation establishes a Single Resolution Fund (SRF) that is under the control of the SRB.¹⁷¹ The SRF will be funded by contributions from all the banks in the participating Member States of the SRM.¹⁷² The IGA provides for the transfer of national funds towards the SRF, with the Fund reaching a target level of 1 per cent of covered deposits (around €55 billion) in January 2024 after an eight-year transition period that begins on January 1, 2016.¹⁷³ During the transition period, the SRF will consist of “national compartments” corresponding to each participating Member State’s resolution authority and fund. The IGA further provides for the activation of the mutualisation of risk between the national compartments during the eight-year transition period.¹⁷⁴ The national compartments will operate during this period and will become gradually mutualised and will cease to exist at the end of 2023. At the end of the transition period, the Regulation requires a common backstop fund to be established and operational

¹⁶⁷ SRM Regulation art. 1.

¹⁶⁸ SRM Regulation arts 5 and 7.

¹⁶⁹ SRM Regulation art. 18.

¹⁷⁰ SRM Regulation art. 27.

¹⁷¹ SRM Regulation Ch. 2, “Single Resolution Fund”, arts 67–79.

¹⁷² On October 21, 2014, the Commission adopted a delegated act and a draft proposal for a Council implementing act to calculate the contributions of banks to the national resolution funds and to the SRF, respectively. The delegated act will determine how much individual credit institutions will have to pay each year to their respective resolution funds according to the bank’s size and risk profile by setting out in detail: (1) the fixed part of the contribution, which is based on the institution’s liabilities (excluding own funds and covered deposits), as the starting point for determining the contribution; and (2) how the basic contribution is adjusted in accordance with the risk posed by each institution. There is a special lump sum regime for small banks, as they are less likely to need support from resolution funds. For example, banks representing 1 per cent of the total assets would pay 0.3 per cent of the total contributions by institutions in the euro area.

¹⁷³ The Commission’s draft proposal for a Council implementing act adapts the methodology to the specificities of a unified system of contributions pooled in the SRF on the basis of a European target level. According to a Commission working document, French banks would contribute around €17 billion (30 per cent) and German bank €15 billion (27 per cent) of the €55 billion target fund over eight years. French banks will pay 68 per cent more into the SRF than under the BRRD, German banks and Spanish banks pay 9 per cent less and 44 per cent less respectively. The Commission working document acknowledges that the possibility of introducing a mechanism to limit these deviations is offered by Recital 114 and art. 70(2) (b) of the SRM Regulation, which provide that no distortions shall be created between banking sector structures of the Member States.

¹⁷⁴ Council, Legislative Acts and other Instruments, Agreement on the transfer and mutualisation of contributions to the Single Resolution Fund, 8457/14, LIMITE, EF 121, ECOFIN 342, art. 3.

by January 1, 2024. The common backstop will facilitate borrowing by the SRF and will ultimately be reimbursed by contributions from the banking sector.

The SRM Regulation provides that bridge financing arrangements for a bank in resolution should be operational by the time the SRF is established on January 1, 2016 and available until the end of the transition. Bridge financing will be available from national sources, paid for by bank levies, or from the European Stability Mechanism (ESM) in accordance with existing procedures.¹⁷⁵ Temporary transfers between national compartments of the SRF will also be possible.¹⁷⁶

The SRM's legal basis—the *Meroni* doctrine and Article 114 TFEU

The controversy regarding whether the Commission was the appropriate institutional body to exercise such broad powers should be seen in light of the constraints imposed by the *Meroni* doctrine and art.114 TFEU that restricts the exercise of discretionary authority by EU agencies to the development and interpretation of technical standards that are legally non-binding and which do not involve decision-making of a policy-making nature and that the agency's authority must be based in a legislative framework that has as an important objective the harmonised implementation of EU laws aimed at improving the conditions for the functioning of the internal market.¹⁷⁷

The Court of Justice of the EU (ECJ) case law provides that art.114 may provide a legal basis for the establishment of EU bodies entrusted with the responsibility to adopt non-binding technical standards and other supporting and framework measures to promote the harmonised implementation of EU laws by Member States.¹⁷⁸ In *Smoke Flavourings*, the ECJ held that the EU legislative authorities have discretion, especially in complex and technical fields, to use the “harmonisation technique most appropriate for achieving the desired result”.¹⁷⁹ The desired harmonisation technique may include the establishment of an EU agency or body, whose responsibilities must be closely linked to the objectives of the underlying legislation.¹⁸⁰ Moreover, the agency's responsibilities must derive from its founding legislation and demonstrate, as a threshold issue, how the agency aims to improve the conditions for the establishment and functioning of the internal market.¹⁸¹ The ECJ has upheld most EU legislation that relies on art.114 as a legal basis when the legislation expressly states an important objective of improving the conditions for the establishment and functioning of the internal market.¹⁸²

¹⁷⁵ The Task Force on Coordinated Action (TFCA) is considering possible bridge financing arrangements for the SRF ahead of it being fully funded, which should be operational by the time the SRF is established on January 1, 2016. Bridge financing options that are being considered include: (1) inter-compartmental lending within the SRF; (2) borrowing from private sources; and (3) public financial arrangements. The TFCA is also considering ways to deliver “equivalence” of treatment for non-euro zone Member States who have signed up for the SRM, but will not have access to the ESM as a sovereign backstop.

¹⁷⁶ The negotiation of these arrangements will include all participating Member States in the SSM/SRM.

¹⁷⁷ Article 114 TFEU provides that: “The European and Council shall, acting in accordance with 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.”

¹⁷⁸ See *United Kingdom v Parliament and Council* (C-66/04) [2005] E.C.R. I-10553; [2006] 3 C.M.L.R. 1 at [41]–[50] (*Smoke Flavourings*); see also *United Kingdom v Parliament and Council* (C-217/04) [2006] E.C.R. I-3771; [2006] 3 C.M.L.R. 2 at [42]–[45] (*ENISA*).

¹⁷⁹ *Smoke Flavourings* (C-66/04) [2005] E.C.R. I-10553 at [45].

¹⁸⁰ *ENISA* (C-217/04) [2006] E.C.R. I-3771 at [45].

¹⁸¹ *Smoke Flavourings* (C-66/04) [2005] E.C.R. I-10553 at [44]; and *ENISA* (C-217/04) [2006] E.C.R. I-3771 at [42].

¹⁸² Cf. *Germany v Parliament and Council* (C-376/98) [2000] E.C.R. I-8419; [2000] 3 C.M.L.R. 1175, however, holding that the Directive on advertising and sponsorship of tobacco products did not have as its genuine objective the establishment and functioning of the internal market, but instead public health considerations.

The SRM Regulation explicitly aims to create a uniform set of resolution rules and procedures for Member States to adopt for credit institutions and certain investment firms established in participating Member States with the intention of improving the condition for establishment and functioning of the internal market.¹⁸³ To this end, the SRM Regulation establishes a Single Resolution Board to “ensure a coherent and uniform approach” to bank resolution for euro area and participating Member States.¹⁸⁴ Thus far, the SRM Regulation’s creation of an EU agency—the SRB—to “ensure a coherent and uniform approach” to bank resolution does not per se violate art.114.

A more difficult issue, however, arises regarding the type and extent of powers allocated to the agency. The ECJ has adopted narrow limits to the powers that can be delegated to EU agencies. In the often-cited 1958 *Meroni* case, the ECJ held that delegation of powers to EU agencies can only relate to clearly defined executive powers, “the use of which must be entirely subject to the supervision of the [Commission]”.¹⁸⁵ In contrast, the EU legislator cannot delegate discretionary powers of a policy-making nature from the Commission to an EU agency because the ECJ has interpreted the *Meroni* doctrine as precluding EU agencies from making policy choices in place of the delegating authorities (i.e. the Commission), as this would upset the EU institutional balance established by the Treaty.¹⁸⁶

The SRB will be an EU agency in the SRM. Therefore the scope for it to take discretionary decisions is limited by *Meroni* case law. The Commission has explained that this is why ultimate decision-making authority regarding whether to take a bank into resolution rests with the Commission and Council. Nonetheless, without a firm legal basis, a resolution decision recommended by the SRB to the Commission could potentially be challenged in the courts. On October 7, 2013, the Council Legal Services (CLS) provided a legal opinion on the delegation of power to the SRB.¹⁸⁷ The CLS concluded that the Board’s powers in relation to resolvability assessments, implementation of resolution tools such as bail-in and the use of the resolution fund need to be either further specified in order to exclude that a wide margin of discretion is entrusted to the SRB or else these functions should be carried out by an EU institution, such as the Commission.¹⁸⁸

In considering whether the SRB’s discretionary authority contradicts the *Meroni* doctrine one should consider that the SRB possesses much discretion about what it decides to monitor, investigate and recommend to the Commission in respect of a bank resolution. However, the SRB’s discretionary authority covers only its preparatory powers in drafting a resolution plan and in recommending the use of resolution tools, such as bail-in or a bridge bank, which must also be approved ultimately by the Commission and Council. The purely preparatory and recommendatory mandate of the SRB, however, raises concerns regarding what criteria it uses to assess the resolvability of banks and how and when it will make recommendations regarding the use of resolution tools, such as bail-in involving a decision by the SRB with Commission approval to convert certain bondholders’ interests into equity as part of an effort to recapitalise the bank, and whether these discretionary decisions comply with the *Meroni* doctrine.

¹⁸³ SRM Regulation art.1.

¹⁸⁴ See SRM Regulation arts 67–79.

¹⁸⁵ *Meroni & Co Industrie Metallurgiche SpA v High Authority of the European Coal and Steel Community* (9/56) [1958] E.C.R. 133 at 152. See recent discussion of the *Meroni* doctrine in S. Griller and A. Orator, “Everything Under Control? ‘The Way Forward’ for European Agencies in the Footsteps of the *Meroni* Doctrine” (2010) 35 E.L. Rev 3. See also M. Chamon, “EU Agencies: Does the *Meroni* Doctrine Make Sense?” (2010) 17 *Maastricht Journal European and Comparative Law* 281.

¹⁸⁶ *Meroni* (9/56) [1958] E.C.R. 133 at 152.

¹⁸⁷ Council, Opinion of the Legal Service, “Delegation of powers to the Board” 2013/0253 (COD), 14547/13, LIMITE, JUR 523, EF 89, ECOFIN 867.

¹⁸⁸ Council, Opinion of the Legal Service, “Delegation of powers to the Board” 2013/0253 (COD), 14547/13, LIMITE, JUR 523, EF 89, ECOFIN 867, p.2.

In addition, the SRM's operations are limited by Member States' fiscal sovereignty, that is, the right not to be compelled by the Commission and Council in approving a SRB recommendation that a bank should be restructured with temporary public financial support from the national resolution authority's public fund if the Single Resolution Fund has inadequate funds. This means that supra-national EU resolution powers end where the Single Resolution Fund proves to be inadequate. The *Meroni* doctrine and Member State fiscal sovereignty may therefore likely prove to be obstacles to the effective operation of the SRM.¹⁸⁹

The UK's legal challenge to the EU's short selling regulation

The amount of discretion an EU agency can exercise based on a delegation of power from an EU institution was tested in the UK's legal challenge to a Regulation that delegated authority to the European Securities and Market Authority (ESMA) to ban or control the short selling of certain financial instruments, such as credit default swaps (CDS), referencing a bank or EU sovereign during periods of market turbulence.¹⁹⁰ Article 28 of the Regulation delegated power to ESMA to intervene, under certain conditions, by taking measures that were binding acts under the laws governing the financial markets of Member States if there was a "threat to the orderly functioning and integrity of financial markets or to the stability of the whole or part of the financial system in the Union". The UK sought to annul the Regulation on the grounds that the powers it afforded to the ESMA were incompatible with the Treaty.

The UK's first two arguments averred that the powers conferred on the ESMA to regulate the short selling of these instruments in EU markets were incompatible with the ECJ's judgments in *Meroni* and *Romano*. According to *Meroni*, the UK argued that the delegation of power to the ESMA to decide which financial instruments would be subject to a prohibition on short selling and when such prohibitions would take place resulted in a delegation of authority to an EU agency that was too broadly and inadequately defined and that this would upset the institutional balance between EU institutions created by the Treaty. It was also argued that the decision to ban or restrict short selling of financial instruments was too normative and essentially of a quasi-legislative nature and therefore lacked legal criteria to be subject to judicial review according to the *Romano* ruling.¹⁹¹ The UK also argued that arts 290 and 291 TFEU only allowed the delegation of powers to the Commission to adopt measures of general application, and that therefore the EU legislature could not delegate powers to an EU agency to make decisions of a general application involving the decision to intervene in financial markets by banning or restricting certain financial instruments based on financial stability considerations.

The Advocate General's Opinion concluded that the delegation of authority to ESMA was not a violation of the *Meroni* doctrine because an agency can exercise a much wider degree of discretion under *Meroni* than what most commentators previously had thought possible, provided there are specific criteria against which decisions can be assessed and the scope of the delegation is well defined and restricted to "implementation" of the legislative act.¹⁹²

Addressing the *Meroni* issue, the ECJ held that art.28 "does not confer any autonomous power on that entity [ESMA] that goes beyond the bounds of the regulatory framework established by the ESMA Regulation"¹⁹³ and that the exercise of those powers is limited by various criteria which sufficiently limit ESMA's discretion. The Court then specified the various substantial and procedural limitations that were

¹⁸⁹ The Commission's powers as a resolution authority do not include the power to require a Member State to provide extraordinary public support to a bank. SRM Regulation art.6(4).

¹⁹⁰ *United Kingdom v Parliament and Council* (C-270/12) EU:C:2014:18; [2014] 2 C.M.L.R. 44 (*Short Selling*).

¹⁹¹ *Romano v Institut National d'Assurance Maladie Invalidité* (98/80) [1981] E.C.R. 1241; [1983] 2 C.M.L.R. 698.

¹⁹² Opinion of A.G. Jääskinen in *United Kingdom v Parliament and Council* (C-270/12) EU:C:2013:562 at [88].

¹⁹³ Regulation 1095/2010 establishing a European Supervisory Authority (European Securities and Market Authority), amending Decision 716/2009 and repealing Decision 2009/77 (Regulation 1095/2010).

in place under the Regulation and held that because those limitations were precisely delineated that made any ESMA decision under the Regulation amenable to judicial review in light of the objectives established by the delegating authority and therefore it did not violate *Meroni*.¹⁹⁴

Responding to the UK's argument based on arts 290 and 291 TFEU, the ECJ first clarified that these articles did not represent a closed system of delegation.¹⁹⁵ The Court observed that,

“while the treaties do not contain any provision to the effect that powers may be conferred on a Union body, office or agency, a number of provisions in the Treaty nonetheless presuppose that such a possibility exists”¹⁹⁶

and then referred to a number of treaty articles to show that acts of EU bodies (like ESMA) are subject to judicial review by the Court.

The Court then held that ESMA's decision to ban short selling of certain financial instruments was very different to the type of decisions of general policy that are subject to arts 290 and 291 TFEU.¹⁹⁷ The Court reasoned that art.28 of the Regulation had “vest[ed] ESMA with certain decision-making powers in an area which requires the deployment of specific technical and professional expertise”.¹⁹⁸ The Court held therefore that art.28 cannot be considered in isolation but as part of a broader EU regulatory framework that is designed to empower national competent authorities working with ESMA to intervene and address adverse market developments that can threaten financial stability within the Union.¹⁹⁹ To protect the EU financial system, it was necessary to allow EU bodies with a high level of professional expertise to work closely together and to intervene in the markets as they did on this occasion by imposing temporary restrictions on the short selling of certain stocks, credit default swaps and other financial instruments in order to prevent a sharp fall in the price of those instruments.²⁰⁰ The Court concluded that art.28 of Regulation 236/2012, read together with other EU regulatory measures, “cannot be regarded as undermining the rules governing the delegation of powers laid down in Articles 290 TFEU and Article 291 TFEU”.²⁰¹

Meroni and the SRB's power to reorganise a bank

In addition, the *Meroni* doctrine may be implicated by the broad powers provided to the SRB the SRM Regulation to require banks or banking groups to change their organisational structure if the SRB determines that the bank or banking group's organisational structure is a substantial impediment to a feasible and credible resolution of the bank or group.²⁰² If the SRB, acting in consultation with national resolution authorities, determines that there are substantial impediments to the implementation of the resolution plan, it may order the institution to remove the impediments, including changing its organisational structure or business activities.²⁰³ Indeed, this could involve changes to the legal, operational and financial structure

¹⁹⁴ *Short Selling* (C-270/12) EU:C:2014:18 at [46]–[53].

¹⁹⁵ *Short Selling* (C-270/12) at [46]–[53].

¹⁹⁶ *Short Selling* (C-270/12) at [79].

¹⁹⁷ *Short Selling* (C-270/12) at [82]–[83].

¹⁹⁸ *Short Selling* (C-270/12) at [82]–[83].

¹⁹⁹ *Short Selling* (C-270/12) at [82]–[83].

²⁰⁰ *Short Selling* (C-270/12) at [86].

²⁰¹ *Short Selling* (C-270/12) at [85].

²⁰² Bank Recovery and Resolution Directive art. 17(5). Under art. 17(5) BRRD the resolution authority is empowered to conduct a resolvability assessment to identify whether or not there are substantial impediments to the implementation of a credible and feasible resolution plan.

²⁰³ In considering whether to order a bank to remove such organisational impediments, arts 15 and 16 BRRD and SRM Regulation provide that the resolution authority must consult the competent supervisory authority regarding the resolution authority's determination of whether or not there are substantial impediments to the resolvability of a firm.

of institutions or the group itself and their business activities.²⁰⁴ In ordering the removal of such organisational impediments, the SRM Regulation sets out procedural and substantive rules about how the institution or group can be required to reduce or remove these impediments.

To this end, the SRM Regulation requires the SRB to draw up resolution plans after consultation with the national competent authorities (including the European Central Bank) and national resolution authorities, including the group resolution authority. Article 10(11) SRM Regulation requires the SRB, when drafting and revising the resolution plan, to identify any material impediments to resolvability and, based on the EU legal principles of necessity and proportionality, to instruct the relevant national resolution authority to take the necessary measures to address those impediments.²⁰⁵ The SRB can also require the relevant national resolution authority to take specific measures to require the institution to remove the impediments, if the institution subject to resolution powers can potentially draw on funds from the SRF.²⁰⁶

The SRB and the relevant national resolution authority are required to notify the firm in writing of any substantial impediments they have identified, and the firm or group will have the opportunity to address these concerns and propose measures to eliminate these impediments. The SRM Regulation provides that if the firm's or group's proposals are considered inadequate, the resolution authority will have the power to take specific actions that address or remove the impediments to resolvability.²⁰⁷ In selecting the appropriate

²⁰⁴ The European Banking Authority has developed Guidelines on Conditions for Measures to Overcome Obstacles to Resolvability for resolution authorities to rely on in considering whether to take measures under art.17(5).

²⁰⁵ SRM Regulation art.10(11) states: "For the purpose of paragraph10, the Board, where applicable, shall instruct the national resolution authorities to take any of the following measures: (a) to require the entity to revise any intragroup financing agreements or review the absence thereof, or draw up service agreements (whether intra-group or with third parties) to cover the provision of critical functions; (b) to require the entity to limit its maximum individual and aggregate exposures; (c) to impose specific or regular additional information requirements relevant for resolution purposes; (d) to require the entity to divest specific assets; (e) to require the entity to limit or cease specific existing or proposed activities; (f) to restrict or prevent the development of new or existing business lines or sale of new or existing products; (g) to require changes to legal or operational structures of the entity or any group entity, either directly or indirectly under their control, so as to reduce complexity in order to ensure that critical functions may be legally and operationally separated from other functions through the application of the resolution tools; (h) to require an entity to set up a parent financial holding company in a Member State or a Union parent financial holding company; (i) to require an entity to issue eligible liabilities to meet the requirements of Article 12; (j) to require an entity to take other steps to meet the requirements referred to in Article 12, including in particular to attempt to renegotiate any eligible liability, Additional Tier 1 instrument or Tier 2 instrument it has issued, with a view to ensuring that any decision of the Board to write down or convert that liability or instrument would be effected under the law of the jurisdiction governing that liability or instrument. Where applicable, the national resolution authorities shall directly take the measures referred to in points (a) to (j) of the first subparagraph."

²⁰⁶ SRM Regulation art.10(11) ("Where applicable, the national resolution authorities shall directly take the measures referred to in points (a) to (j) of the first subparagraph.").

²⁰⁷ BRRD art.17(5) provides a non-exhaustive range of powers for authorities to remove firm impediments to resolvability in advance of failure, which may be used if measures proposed by firms are insufficient to ensure resolvability. Article 17(5) provides a detailed list of these powers to include:

- (a) require the institution to revise any intragroup financing agreements or review the absence thereof, or draw up service agreements, whether intra-group or with third parties, to cover the provision of critical functions;
- (b) require the institution to limit its maximum individual and aggregate exposures;
- (c) impose specific or regular additional information requirements relevant for resolution purposes;
- (d) require the institution to divest specific assets;
- (e) require the institution to limit or cease specific existing or proposed activities;
- (f) restrict or prevent the development of new or existing business lines or sale of new or existing products;
- (g) require changes to legal or operational structures of the institution or any group entity, either directly or indirectly under its control, so as to reduce complexity in order to ensure that critical functions may be legally and operationally separated from other functions through the application of the resolution tools;

measure to remove the impediments, resolution authorities have wide discretion to choose a measure based on the nature of the impediment. These measures can be classified in three categories—structural, financial and information-related or data management. The use of these measures involves a large degree of technical analysis of bank balance sheets and corporate group structures, but nevertheless also involve a substantial amount of discretionary decision-making based on criteria that fall within a large range and are not prioritised in any meaningful way. This means that the SRB’s decision to order a bank to reorganise itself does not have to be based on any specific set of criteria, even though it could have a major distributional effects on the local economy and on the economies of other Member States where the bank operates. The lack of specificity regarding which criteria should be relied on or not in issuing an order to reorganise—and the absence of any prioritisation of factors to determine what type of reorganisation should be undertaken—affords a very wide margin of discretion to the SRB and Member State resolution authorities in preparing and making reorganisation or restructuring recommendations. Indeed, the SRB’s recommendations are likely to be given great weight by the Commission and Council in deciding whether to accept the SRB recommendations. This complex structure and process of deciding on whether a bank or banking group operating either within a Member State or across Member States will probably raise *Meroni* issues that may have to be submitted for judicial review.

SRM and financial stability policy

As discussed above, the SRM’s rationale and purpose is to provide European authorities with an orderly means to manage failures of banks, large banking groups and certain investment firms. For example, as the use of early intervention resolution tools are now permitted under the Bank Recovery and Resolution Directive, the SRB will decide whether and when to use bail-ins, in which shareholders and unsecured creditors, including certain bondholders, can be compelled to incur losses on their investments in order to recapitalise a distressed bank.²⁰⁸ Although the SRM is an important institutional development to enhance cross-border crisis management in the Banking Union, its institutional complexity and the vast discretion (and uncertainty) regarding how SRB can use its powers will have a significant impact on property rights and the broader economy. This raises important concerns regarding its effectiveness and legality under EU constitutional law.

For the SRM’s resolution powers to be effective in a financial policy sense, they must be credible and predictable. An effective resolution regime should therefore require the resolution authorities to adhere to the rules governing the use of resolution tools during a bank restructuring and even in a broader financial crisis. For example, regarding the use of the bail-in tool in a bank resolution, market participants should

- (h) require an institution or a parent undertaking to set up a parent financial holding company in a Member State or a Union parent financial holding company;
- (i) require an institution or entity referred to in point (b), (c) or (d) of Article 1(1) to issue eligible liabilities to meet the requirements of Article 45;
- (j) require an institution or entity referred to in point(b), (c) or (d) of Article 1(1), to take other steps to meet the minimum requirement for own funds and eligible liabilities under Article 45, including in particular to attempt to renegotiate any eligible liability, additional Tier 1 instrument or Tier 2 instrument it has issued, with a view to ensuring that any decision of the resolution authority to write down or convert that liability or instrument would be effected under the law of the jurisdiction governing that liability or instrument; and
- (k) where an institution is the subsidiary of a mixed-activity holding company, requiring that the mixed-activity holding company set up a separate financial holding company to control the institution, if necessary in order to facilitate the resolution of the institution and to avoid the application of the resolution tools and powers referred to in Title IV having an adverse effect on the non-financial part of the group.”

²⁰⁸ SRM Regulation art.27(1)–(7).

have clarity about the order in which various types of bondholders will be expected to take losses. A predictable resolution mechanism is necessary to secure public acceptance and reduce market panic.

The SRM allows the SRB and Member State resolution authorities substantial discretion in deciding whether or not to put a failing bank into resolution, if the prospect of putting the bank into resolution might, in the view of the resolution authority, cause significant adverse consequences to the economy or financial instability.²⁰⁹ This type of financial crisis exemption can serve valid regulatory objectives by allowing regulators flexibility in responding to the unique circumstances of a crisis or severe economic dislocation. The SRM, however, provides no discernible criteria for determining whether a bank resolution is likely to cause severe adverse consequences, financial instability or a systemic crisis. The lack of agreement between resolution authorities and policy-makers about what might cause financial instability or a systemic crisis may result in unjustified regulatory forbearance. Influential investor groups and financial institutions, facing potentially substantial losses in a bank resolution, may pressure politicians and regulators during a crisis to forbear in the use of resolution tools and to use taxpayer money instead to bail out a bank. Moreover, the SRB's task is especially difficult because the definition of a systemic financial threat or systemic crisis is much debated and there is no agreed upon definition by economists nor under EU law.²¹⁰

The SRM Regulation also permits resolution authorities to delay or waive the apportionment of losses among bank creditors and shareholders by not recognising the full losses on a bank's assets and liabilities or by using taxpayer funds directly to recapitalise a bank, even though the bank itself has not reached the point where it has lost access to private capital markets.²¹¹ And, even when a bank has lost access to private markets, the Regulation states that extraordinary public financial support should not automatically trigger a bank resolution in a situation where the bank otherwise complies with regulatory capital requirements.²¹²

In addition, under exceptional circumstances the Regulation permits the SRB to exclude or partially exclude certain bank investors (i.e. bondholders) from mandatory write-downs or debt-to-equity conversions on their investments.²¹³ Exceptional circumstances are not defined in the Regulation and can be subjectively assessed by the SRB in its broad discretion. The discretions and exceptions to the application of resolution powers and tools in the regulation undermine legal certainty and the predictability of the SRM for market participants.

An important objective of the BRRD and the SRM Regulation was to put an end to direct taxpayer bailouts of banks and certain investment firms.²¹⁴ The SRB's considerable discretion in setting aside the rules governing the implementation of a bank resolution undermines its credibility as a resolution authority and the predictability necessary for market participants to have confidence in the effectiveness of the bank resolution framework. Although SRB forbearance is necessary in exceptional circumstances which pose a systemic threat, it does not adequately prevent the SRB from devising various forms of bailouts for banks that should be taken instead into resolution with losses imposed fully on bank investors. Instead,

²⁰⁹ SRM Regulation art.14(2)(a)–(e). Specifically art.14(2)(b) provides that resolution objectives include avoiding “significant adverse effects on financial stability, in particular by preventing contagion, including to market infrastructures, and by maintaining market discipline”. The wide range factors relied on by the SRB in determining whether a resolution is in the public interest grants the SRB broad discretion in deciding whether to put a bank into resolution or not. SRM Regulation art.18(5).

²¹⁰ See G. Schinasi, *Safeguarding Financial Stability: Theory and Practice* (Washington, D.C.: International Monetary Fund), p.81 (citing the Group of Ten 2001 report stating that “[s]ystemic financial risk is the risk that an event will trigger a loss of economic value or confidence in, and attendant increases in uncertainty about, a substantial portion of the financial system that is serious enough to quite probably have significant adverse effects on the real economy”). G10, *2001 Report*, pp.126–127).

²¹¹ SRM Regulation art.27(6)–(7).

²¹² SRM Regulation art.14(1)–(3).

²¹³ SRM Regulation arts 14 and 27(5)(a)–(d).

²¹⁴ Bank Recovery and Resolution Directive 2014/59 art.32(4); SRM Regulation art.14(2)(c).

the SRB has discretion to waive losses for certain unsecured bondholders in situations subjectively interpreted by the SRB as a “crisis” or to avoid “serious disturbance to the economy”.²¹⁵ The lack of stated criteria that can be considered by the SRB in deciding whether and how to impose losses in a bank resolution raises concerns under the *Meroni* doctrine as well as the economic effectiveness of the SRM regime.

Unresolved issues for the European Banking Authority and the SRM

The Regulation establishing the European Banking Authority provides it with a range of tasks. Some are binding in terms of process and outcome including: (1) preparing draft technical implementing standards; (2) determining whether there has been a breach of Union law and taking the necessary action to ensure the rapid enforcement of Union law; (3) taking action in emergency situations; (4) binding mediation between Member State authorities. Some are non-binding in terms of process only, for example: guidelines and recommendations and peer reviews. The BRRD extends the scope of the EBA’s tasks and powers to resolution authorities, including the SRB based on the SRM Regulation. This is consistent with the wider role envisaged for the EBA in connection with drafting technical implementing standards and related standards in respect of recovery and resolution procedures, deposit guarantee schemes and bank resolution and funding arrangements.²¹⁶

Drawing on the precedent of the SSM Regulations, the UK, Sweden and other delegations have raised the need for *all* of the EBA’s tasks and powers to apply in relation to the Commission and the Single Resolution Board in the same way as it would for any Member State resolution authority. This pertains to both the process which the EBA follows when exercising its powers and the result of the exercise of those powers (which in some cases is legally binding). This is essential in order to secure equality of treatment between resolution authorities and credit institutions located in different Member States; and to ensure coherence in the exercise of the EBA’s tasks and powers.

A more narrow interpretation of the EBA’s extended powers might logically lead to a more limited application of its powers. This could potentially result in a violation of the principle established under art.4(2) TFEU (equality of Member States before the Treaties) on the following grounds: first, it is not acceptable for national resolution authorities in the non-participating Member States to be within the scope of tasks and powers of the EBA which are not applicable to those authorities performing identical tasks in participating Member States. Secondly, it is not acceptable for national authorities in non-participating Member States to be denied the opportunity to refer to the EBA the key decision-making authority (the Commission) under the SRM, particularly in view of the need for issues concerning the application of Union law to be remedied quickly. Thirdly, the absence of powers over the Commission would undermine the performance by the EBA of its tasks, for instance, under art.25 of the EBA Regulation concerning recovery and resolution procedures.²¹⁷

Although the Commission may object to being bound by EBA decisions, there is no legal reason why the Commission cannot be bound by decisions of the EBA. To ensure that it can achieve its aims in respect of the SRM, however, the EBA Regulation should be amended to clarify that the EBA can perform tasks in relation to the Commission in the same way as it can in relation to any Member State resolution authority. Because of the Commission’s role in deciding whether to accept the recommendations of the SRB to put a bank into resolution and the use of resolution tools and related decisions regarding SRF funding, the EBA tasks—in terms of both process and outcome—should apply equally to the Commission and national resolution authorities.

²¹⁵ SRM Regulation art.27(5)(c).

²¹⁶ Regulation 1093/2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision 716/2009 and repealing Decision 2009/78, Recital 37 and arts 25–27.

²¹⁷ Regulation 1093/2010 art.25.

Conclusion

The article analysed the major transformation underway in the European Banking Union regarding the centralisation of competences with the European Central Bank acting through the Single Supervisory Mechanism as a bank supervisor for euro zone and other participating Member States and with the creation of a Single Resolution Mechanism to co-ordinate and oversee bank recovery and resolution. A major objective of the Banking Union was to sever the link between banking fragility and over-indebted sovereigns. Although the SSM and SRM Regulations have been praised as necessary reforms to enhance banking supervision and resolution for participating Member States in the Banking Union, they raise important institutional issues regarding the accountability and effectiveness of the European Central Bank as a bank supervisor and of the SRM's SRB in co-ordinating and overseeing bank recovery and resolution.

The SRM Regulation can be critically assessed on institutional and legal grounds because of the wide discretionary powers it provides the Single Resolution Board that may contravene the *Meroni* doctrine and art.114 TFEU. Moreover, the SRB's broad discretion to require banks to change their institutional structure so that they can become more resolvable and its power to set aside the bail-in provisions in bank bond contracts may worsen moral hazard conditions and legal uncertainty with the effect of increasing financial instability.

The Banking Union ushers in dramatic changes that are important steps in building a more effective EU banking supervisory system and resolution framework, but its current design raises serious legal risks and institutional weaknesses that may undermine its overall effectiveness.