

## **National Report - United Kingdom**

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### **ERRATUM ADDED TO THE PRINTED VERSION:**

The original text, published in the Congress volume was based on a first draft of the UK report and was not submitted to the authors for proof-reading. Unfortunately the names of the authors were not indicated properly in the original version, but are now accurately displayed. The corrected text, which is attached to the current book in a separate brochure, has been approved by the authors. *The editors*

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# National Report - United Kingdom

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## A. General Questions

### Question 1

From a UK perspective, a major challenge posed by the Banking Union is to reconcile the UK's interests as an EU Member State and a major financial centre with the fact that the UK is not (and does not intend to be) part of the Banking Union. Thus, it is common in the UK to associate closer integration within the Economic and Monetary Union (EMU) with potential threats to the integrity of the internal market, the latter being seen as the single most important EU asset – the ‘essential foundation’ of the European Union according to Prime Minister Cameron<sup>1</sup> – for the UK. More specifically, from a UK point of view, the fear is that the activities within the Eurozone/Banking Union might come to impede access to the internal market for UK-based firms or otherwise disrupt the functioning of the internal market.

Concerns over the integrity and unity of the internal market were associated with the idea of a genuine EMU (which the Banking Union is part of) right from the beginning.<sup>2</sup> Provisions underlining the importance of ensuring the integrity and unity of the internal market are found in various legislative acts which underpin the Banking Union: for instance in Council Regulation (EU) No. 1024/2013 (the ‘SSM Regulation’) or in Regulation (EU) No. 806/2014 (the ‘SRM Regulation’).<sup>3</sup>

Admittedly, the reality of these concerns remains to be established. However, the perception that the integrity of the internal market might be at threat was reinforced by the attempt of the ECB to implement its location policy for Central Counterparties (CCPs). The ECB's location policy required CCPs which clear significant amounts of euro-denominated products to be located in the Eurozone area.<sup>4</sup> For the ECB, the objective of this policy, which incidentally had been left unimplemented for a number of years, was legitimate. A failing CCP is potentially a risk to financial stability. From the ECB's standpoint, control over CCPs which clear sizeable amounts of Euro euro-

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<sup>1</sup> David Cameron's Bloomberg speech is available at <https://www.gov.uk/government/speeches/eu-speech-at-bloomberg/>.

<sup>2</sup> See e.g. European Council Conclusions 28/29 June 2012; European Council Conclusions 18/19 October 2012, available at <http://www.consilium.europa.eu/en/european-council/conclusions/>.

<sup>3</sup> See Article 1 of Council Regulation (EU) No. 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions [2013] OJ L 287/63. See also Article 6 of Regulation (EU) No. 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a SRM and a SRF and amending Regulation (EU) No. 1093/2010 [2014] OJ L225/1.

<sup>4</sup> E.g. European Central Bank, ‘Eurosysteem oversight policy framework’ (July 2011) 10 <http://www.ecb.eu/pub/pdf/other/eurosysteemoversightpolicyframework2011en.pdf>.

denominated transactions, should therefore be located within the Eurozone area. For the UK however, the policy was a major concern. Specifically, the UK was concerned about the impact of the location policy on UK-based clearing houses such as LCH.Clearnet which has a vast portfolio of euro-denominated business.<sup>5</sup> Unsurprisingly, the UK sought to challenge the policy before the Court of Justice of the European Union (the ‘Court’). The latter decided in favour of the UK last year.<sup>6</sup>

Related to concerns over the internal market are the UK’s concerns that closer integration, including in the form of the Banking Union, might cause the UK to lose clout within the EU. More specifically, the fear is that closer integration within the Banking Union or EMU generally might come to affect the preferences and interests of Member States which participate in closer integration and which may as a result have incentives to coordinate their positions and vote increasingly as a bloc. Such behaviour could have a significant impact on the influence that the UK can exert. Concerns over a potential marginalisation of the UK were *inter alia* highlighted by the Foreign Affairs Committee of the House of Commons in its enquiry on the Future of the European Union:

‘The Government has been concerned above all about the risk that further integration in the Eurozone might “spill over” into the Single Market and jeopardise the UK’s ability to participate meaningfully in Single Market decision-making.’<sup>7</sup>

Similar concerns were voiced in the context of the Balance of Competences Review in the financial services area.<sup>8</sup> It is also this sort of thinking which explains some of the key changes to Regulation (EU) No. 1093/2010 (the ‘EBA Regulation’).<sup>9</sup> Specifically, for the UK, the fact that a majority of the voting members in the European Banking Authority (EBA) originate from Member States which are part of the Single Supervisory Mechanism (SSM) meant that its interests in EBA were at risk. The resultant asymmetry between Member States which participate in the SSM and those that do not demanded therefore substantial changes to EBA’s voting arrangements, a view which was ultimately accepted by the EU legislature. The latter agreed *inter alia* to change EBA’s voting requirements and to add a new consensus principle to the EBA Regulation.<sup>10</sup>

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<sup>5</sup> A Barker, G Parker and J Grant, ‘Britain to sue ECB over threat to City’ (Financial Times, 14 September 2011).

<sup>6</sup> Case T-496/11 *United Kingdom v. European Central Bank*, ECLI:EU:T:2015:133.

<sup>7</sup> House of Commons (Foreign Affairs Committee), *The Future of the European Union: UK Government Policy* (First Report of Session 2013-14, Volume I), 41, available at <http://www.publications.parliament.uk/pa/cm201314/cmselect/cmfaaff/87/87.pdf>.

<sup>8</sup> HM Government, *Review of the Balance of Competences between the United Kingdom and the European Union - The Single Market: Financial Services and the Free Movement of Capital*, (Summer 2014) 108, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/332874/2902400\\_BoC\\_FreeDomOfCapital\\_acc.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/332874/2902400_BoC_FreeDomOfCapital_acc.pdf).

<sup>9</sup> Regulation (EU) No. 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/78/EC [2010] OJ L331/12, as amended.

<sup>10</sup> See for details, P Schammo ‘Differentiated Integration and the Single Supervisory Mechanism: which way forward for the European Banking Authority?’ in A Biondi and P Birkinshaw (eds) *Britain Alone! The Implications and Consequences of UK Exit from the EU* (Wolters Kluwer 2016).

## Question 2

The Banking Union is based on EU secondary law, which is itself based on the Treaties. As far as the Single Resolution Fund (SRF) is concerned (which is part of the SRM), it is also based on an international agreement (Agreement on the Transfer and Mutualisation of Contributions to the Single Resolution Fund).<sup>11</sup> The Single Rulebook, which represents the substantive law in the banking field, is based on typical internal market legal bases (Article 53 or Article 114 TFEU). The main issues regarding legal bases arise in relation to the institutional aspects of the Banking Union.

Given that amending the Treaties in order to accommodate the establishment of a Banking Union was not considered politically feasible, it was necessary to design the Banking Union's arrangements with Treaty limitations and Court case law in mind (e.g. on Article 114 TFEU or on a delegation to outside bodies).

The SSM Regulation is based on Article 127(6) TFEU which allows the Council to confer 'specific tasks' on the ECB relating to prudential supervision of credit institutions and other financial institutions, but not insurance undertakings. The adequacy of the legal basis has been much discussed. It is plain that the SSM Regulation was drafted in a way which is meant to ensure – formally at least – that the SSM squares with Article 127(6) TFEU and other Treaty provisions governing the ECB (for instance, regarding the governance of the ECB).

The Single Resolution Board (SRB) was set up under Article 114 TFEU. It followed that the limitations traced by the Court on establishing agencies and entrusting them with powers had accordingly to be respected by the EU legislature.<sup>12</sup> The issue was not new to the EU legislature. When it established the European Supervisory Authorities (ESAs), similar questions over how to square a transfer of powers with the Court's case law were raised. As in the case of the ESAs, the EU legislature put in place arrangements to overcome these problems (see e.g., Article 18 SRM Regulation).

All in all, it is plain that the fact that the Treaties could not be amended led to the adoption of some ungainly arrangements and required some 'creative lawyering'. The fact that the shape and content of the SSM and SRM were driven by Treaty limitations was clearly not desirable. Moreover, the risk of judicial challenges remains a concern: for example with respect to the procedures set out in the SRM Regulation (see Article 18(7)) if they are seen as depriving the 'delegator' of a real power of appreciation.<sup>13</sup> Hence, arguably legal certainty remains an issue, although if one can take the Court's decision in the *short selling* case<sup>14</sup> as an indication of the Court's general mood with regard to *Meroni*, the Court is unlikely to be too hard-nosed.

## Question 4

Undoubtedly, the establishment of the Banking Union, as part of a genuine EMU, had an impact on the way in which we conceive of the EU, its underlying constitutional principles, as well as relational aspects between EU institutions and with Member States.

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<sup>11</sup> The agreement, signed in May 2014 is available at <http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%208457%202014%20INIT>.

<sup>12</sup> See especially, Case C-270/12 *United Kingdom v. European Parliament and Council*, ECLI:EU:C:2014:18; Case 9/56 *Meroni v High Authority* [1957-1958] ECR 133.

<sup>13</sup> See in this context, Case 9/56 *Meroni* (n 12).

<sup>14</sup> Case C-270/12 *United Kingdom v. European Parliament and Council* (n 12).

As noted above, the shape and content of the Banking Union testify to the EU's inability to make salient Treaty changes. In order to accommodate specific legal bases (and higher up, principles such as conferral), the Banking Union required some 'creative lawyering', even if, admittedly, creative lawyering has always been part and parcel of the EU.

More generally, the Banking Union testifies to the fact that the equilibrium between the EU and Member States in the field of supervision and enforcement in the banking field has shifted for good. Supervision of, and enforcement against, market actors, hitherto mostly left to national actors in the banking field, has moved centre-stage at Union (Eurozone) level. They are now tools of the ECB. Admittedly, this trend was already perceptible with the establishment of the European System of Financial Supervision. The European Supervisory Authorities (ESAs) were given powers to address binding decisions to national competent authorities as well as market actors in certain circumstances. But there were clear restrictions, including in terms of the powers of the ESAs to address individual decisions to market actors: e.g. the need for directly applicable EU requirements. Moreover, save for the European Securities and Markets Authority (ESMA), the ESAs were not vested with *day-to-day* supervisory powers over market actors. Even ESMA was only given day-to-day supervisory powers in a couple of fields (in relation to Credit Rating Agencies and Trade Repositories). The establishment of the Banking Union marked a qualitative leap in this regard. Moreover, in its role as prudential supervisor, the ECB is empowered to apply national law implementing directives, including any national law giving effect to options granted to Member States in regulations. This is something clearly beyond the reach of the ESAs or other EU bodies for that matter. Thus, the transfer of supervisory and enforcement powers to Union level has had important implications for the institutional landscape at Union level and redefined the relationship between the Union, its institutions and Member States in the banking field.

Besides enforcement and supervision, the establishment of the Banking Union also underscores the willingness of European/Eurozone leaders to overcome the EU's traditional limitations in terms of spending power (a core attribute of how we conceive of the so-called 'regulatory state', according to Majone).<sup>15</sup> Prior to the financial and sovereign bank crises, financial support in case of bank failures was mainly a national matter. This in turn supported, prior to the decision to establish a Banking Union, the argument for keeping supervision at Member State level. The argument was made early on by former Chancellor of the Exchequer, Alistair Darling, in discussions over the future of European financial supervision. According to him:

'[s]upervisory and crisis-management arrangements need to be consistent and aligned. Responsibility for managing the resolution of financial crises - including fiscal support - remains an important consideration in designing supervisory and regulatory structures. Supervisory authority needs to be aligned with *fiscal responsibility* and this will be a very significant factor in limiting the extent to

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<sup>15</sup> E.g. G Majone, 'From the Positive to the Regulatory State: Causes and Consequences of Changes in the Mode of Governance' (1997) 17 *Journal of Public Policy* 139-167.

which national supervisors can devolve responsibility for the supervision of firms to a centralised body.’<sup>16</sup> (emphasis added)

However, the banking and sovereign debt crises also brought the need for substantial collective spending powers into sharp relief: see in this context the establishment of the European Financial Stabilisation Mechanism, the European Financial Stability Facility and subsequently the permanent European Stability Mechanism (ESM) for the Eurozone financed by Eurozone Member States; see also the Single Resolution Fund (SRF) which is part of the SRM and which is fed by bank contributions and will ultimately see a mutualisation of these contributions. The ESM now also offers a ‘last resort’ direct recapitalisation instrument (which is part of the funding arrangements of the SRM and which can be activated under admittedly restrictive conditions). These arrangements increase the ‘fire power’ of the Eurozone and help to overcome the EU’s spending limitations. They also testify to the willingness of European/Eurozone leaders to lift issues out of the confines of the Treaties, including its decision-making procedures, if politically expedient: see the Treaty establishing the European Stability Mechanism and the Agreement on the Transfer and Mutualisation of Contributions to the Single Resolution Fund.<sup>17</sup>

That said, the ‘fiscal responsibility’ issue continues to matter both within and outside the Banking Union, even if in different ways: see e.g. Article 38 of the EBA Regulation; or Article 6(6) and Recital (19) of the SRM Regulation.

### Question 5

The Banking Union is closely linked to the idea of a level playing field. The establishment of the Banking Union was inter alia meant to address the problem of ‘national bias’ of competent authorities towards so-called ‘national champions’. However, it is plain that the very existence of the Banking Union also creates fractures: most obviously between those Member States that are part of the Banking Union and those that do not intend to join. A number of provisions were added to various legislative texts in order to underpin the importance of ensuring equal treatment between market actors<sup>18</sup> – a principle which benefits from constitutional recognition – but also to prevent discrimination between Member States as locations for financial or banking services. Thus, Article 1 of the SSM Regulation states that “[n]o action, proposal or policy of the ECB shall, directly or indirectly, discriminate against any Member State or group of Member States as a venue for the provision of banking or financial services in any currency”.<sup>19</sup> Provisions seeking to prevent discrimination were also included in the SRM Regulation.<sup>20</sup>

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<sup>16</sup> Letter of A Darling to the Czech Presidency ‘European Financial Regulation and Supervision’ (3 March 2009), cited in P Schammo ‘EU Day-to-Day Supervision or Intervention-Based Supervision: Which Way Forward for the European System of Financial Supervision?’ (2012) 32 *Oxford Journal of Legal Studies* 771-797.

<sup>17</sup> The ESM Treaty is available at <http://www.esm.europa.eu/about/legal-documents/ESM%20Treaty.htm>. See n (11) for the Agreement on the Transfer and Mutualisation of Contributions to the SRF.

<sup>18</sup> See e.g. Article 1 SSM Regulation, Article 6(1) SRM Regulation.

<sup>19</sup> See also the duty of care of the same article.

<sup>20</sup> See Article 6(1) SRM Regulation.

The equality concern must be seen in light of the UK's concerns over closer integration within the Eurozone and the ECB's attempt to implement its location policy (see above Question 1). In 2011, the UK had already attempted to obtain certain safeguards, in return for agreeing to Treaty changes which would have buttressed fiscal coordination among Eurozone countries. Specifically, it had (inter alia) asked for:

‘[a]n explicit legal safeguard entrenching the principle of non-discrimination within the single market and, in particular, making it clear that there cannot be discrimination on grounds of the Member State in which a firm is located. This was to put beyond doubt the fact that seeking to force financial services businesses operating in a non euro area Member State to physically relocate to the euro area contravenes the Treaty’.<sup>21</sup>

The UK's attempt at securing safeguards at the 2011 European Council failed and led to the Fiscal Compact being adopted as an intergovernmental treaty. Unsurprisingly, the adoption of Article 1 of the SSM Regulation in 2013 – that is, the non-discrimination requirement of Article 1 – was hailed in the UK as a ‘significant achievement’ which ‘guard[ed] against any restriction of the UK's role as a financial centre in the Single Market’.<sup>22</sup> However, an equality principle, which is meant to guard against discrimination against a Member State as a financial centre, remains a very general provision and thus subject to the whims of the Court. A ‘double-majority’ requirement such as the one found in the EBA Regulation is more effective in terms of protecting the interests of ‘outs’, but such a requirement might ultimately also be at the expense of the functioning of the EBA.<sup>23</sup>

Equality is however not merely an issue as far as the relation between ‘ins’ and ‘outs’ is concerned. It affects the relationship between euro Member States and non-euro Member States that decide to join the SSM. A most obvious example is the governance structure of the ECB in its role as prudential supervisor. Non-euro Member States which participate in the SSM have no say in the ECB's Governing Council, the ultimate decision-maker within the ECB. The issue is somewhat addressed by the establishment of the Supervisory Board as an internal organ for preparing the decisions of the Governing Council. Ultimately, however, it is clear that true equality of say presupposes that the Treaties be amended.

### Question 7

The relationship between the Banking Union and the internal market was addressed above. The Banking Union is an example of differentiated integration. Actions taken by actors within the Banking Union might, as a side effect, disrupt the internal market. In the case of the ECB, this might be because of action taken in the micro-prudential field or in

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<sup>21</sup> Letter from George Osborne to the Chairman of the Treasury Committee, Draft UK Requests on Financial Services at the December 2011 European Council, (February 2012), available at <http://www.parliament.uk/documents/commons-committees/treasury/120228-LetterfromChxtoChair.pdf>.

<sup>22</sup> House of Commons (Foreign Affairs Committee), *The future of the European Union: UK Government policy* (First Report of Session 2013-14, Volume I) 46 (citing evidence given by the Financial Secretary to the Treasury).

<sup>23</sup> See Schammo ‘Differentiated Integration and the Single Supervisory Mechanism’ (n 10) above.

the macro-prudential field. In the latter field, the ECB has limited powers, but they are nevertheless significant.

However, it is important to bear in mind that before the establishment of the Banking Union, there were already examples where actions of national authorities – for instance, so-called ‘ring fencing’ measures – caused internal market disruption. Thus, the Commission reported that:

‘[...] some banking supervisors introduced measures with ‘ring-fencing’ effects between 2008 and 2013, mostly in response to the economic and financial crisis, in order to keep bank assets within national borders or to pre-emptively strengthen the liquidity position of local banks. The main areas concerned were institution-specific quantitative requirements under the supervisory review and evaluation process, the large exposures regime and domestic liquidity frameworks’.<sup>24</sup>

The issue of internal market disruption is hence not one that is unique to the Banking Union, even if it is commonly associated – at least in the UK – with attempts at closer integration by the Eurozone. Moreover, safeguards were put in place in order to address potential issues.<sup>25</sup> It is also reasonable to assume that EU actors are better at safeguarding a European interest than national authorities whose fate is closely intertwined with national interests. That said, given the geographical scope of the Banking Union, the scale of any potential issue is likely to be more significant.

### **Question 13**

The UK is not part of the Banking Union. Measures which require implementation in the UK are those which (assuming that they require transposition (directives)) are considered to be part of the so-called Single Rulebook which underpins the Banking Union, but which extends to all Member States. It includes capital requirements legislation, resolution and recovery legislation as well as legislation on deposit guarantee schemes.

### **Question 13a**

Transposition is typically done through a mixture of measures, including primary legislation (including amendments to primary legislation), subordinate legislation and rules which are made by the Prudential Regulation Authority and the Financial Conduct Authority.

### **Question 13b**

The UK is not part of the Banking Union. From a UK law perspective, any problems are therefore likely to have the Single Rulebook as origin. In particular, UK concerns tend to focus on the issue of striking – from the UK’s standpoint – a proper balance between (i) the EU’s preference for uniformity (maximum harmonisation, use of regulations; no options; no derogations) which post-crisis is considered increasingly desirable, and (ii) a not uncommon preference in the UK for flexibility and discretion at the level of domestic

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<sup>24</sup> European Commission, Commission Staff Working Document on the movement of capital and the freedom of payments, SWD(2015) 58 final, 5 March 2015, p. 27.

<sup>25</sup> E.g. the principle of non-discrimination and the duty of care in Article 1 of the SSM Regulation; see also Article 6 of the SRM Regulation.



law. There have been a number of major upsets for the UK in recent years: for example in relation to capital requirements legislation and the new rules on banker bonuses which the UK considers to be counter-productive. The latter point was recently re-iterated by the Bank of England. Referring to the new rules on banker bonuses in the CRD IV,<sup>26</sup> the Bank of England noted:

‘[...] this measure could have undesirable side-effects for financial stability if it limits the scope for remuneration to be clawed back. In particular, it is likely to make it harder for banks to adjust variable remuneration to reflect the financial health of the individual bank, and could limit the use of deferral arrangements that can better align remuneration with the long-term interests of the bank. Since the introduction of the bonus cap, there has been a marked increase in the proportion of fixed remuneration as a percentage of total pay for staff defined as material risk takers in the major UK banks, from 28% in 2013 to 54% in 2014; overall remuneration has risen only slightly’.<sup>27</sup>

The UK challenged the CRD IV rules on compensation before the Court. However, following the release of the Advocate General’s opinion in November 2014,<sup>28</sup> which proposed to reject the UK’s pleas, the UK government decided to drop the action before the Court.

## **B. The Single Supervisory Mechanism**

### **Question 16a**

Within the SSM, the ECB is in charge of overseeing the functioning of the SSM and assumes exclusive competence for the authorisation of credit institutions based in a participating Member State, for the withdrawal of authorisation, and for the assessment of notifications regarding the acquisition and disposal of qualifying holdings.<sup>29</sup> It also assumes direct (micro-prudential) supervisory competence within the SSM. However, the ECB does not directly supervise all credit institutions. Rather the distribution of supervisory responsibility is based on the ‘significance’ of supervised entities.<sup>30</sup> The ECB has direct supervisory competence over significant supervised entities, while authority to supervise less significant supervised entities remains at national level (even though the ECB can under certain conditions decide to assume direct supervision<sup>31</sup>).

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<sup>26</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC [2013] OJ L176/338.

<sup>27</sup> Bank of England, ‘EU membership and the Bank of England’ (October 2015) 80 <http://www.bankofengland.co.uk/publications/Documents/speeches/2015/euboe211015.pdf>.

<sup>28</sup> AG Opinion in Case C-507/13 *United Kingdom v Parliament and Council*, 20 November 2014, ECLI:EU:C:2014:2394.

<sup>29</sup> Article 4(1)(a) and (c), and Article 6(4) SSM Regulation.

<sup>30</sup> Article 6(4) SSM Regulation. For details, see Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation with the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) [2014] OJ L141/1.

<sup>31</sup> Article 6(5)(b) SSM Regulation.

It is plain that the whole construct in the micro-prudential field rests critically on the definition of ‘significance’. The latter is specified in the SSM Regulation – in an especially tortuous Article 6(4) – and in the SSM Framework Regulation.<sup>32</sup> These rules are clearly complex and would have been much less so had the ECB been given direct supervisory competence over all supervised entities. The existence of quantitative and qualitative criteria is likely to give rise to differences of appreciation, which ultimately might lead to judicial challenges before the Court. Rules such as the ‘particular circumstances’ rule, which allows the ECB to treat a supervised entity as less significant even though it would ordinarily be considered ‘significant’, are especially open-ended.<sup>33</sup> Unsurprisingly, the choice in favour of a differentiated model of supervision based on such criteria creates litigation risks. The point is not just academic. A challenge has already been brought by *Landeskreditbank Baden-Württemberg* before the General Court against the decision of the ECB to treat it as a ‘significant’ entity.<sup>34</sup> See also (b) below on macro-prudential competence.

### Question 16b

The dividing line between the ECB’s competences (under the SSM) and those of Member State authorities are to some extent artificial.<sup>35</sup> It remains to be seen whether this separation will prove problematic in practice, but it is plain that close cooperation between the ECB and Member State authorities will be critical in order to ensure a proper oversight framework.<sup>36</sup>

However, even for matters that are covered by the SSM, there are arguably complexities in terms of competences: e.g. in terms of macro- and micro-prudential supervision. While the ECB benefits from direct supervisory authority and SSM-wide authority in the micro-prudential field, national authorities remain the primary holders of authority in the macro-prudential field. The ECB’s powers in the macro-prudential field are said to be asymmetrical since it can only apply more stringent macro-prudential tools if it deems it necessary. Moreover, the level of harmonisation is also limited because some instruments have purely a national origin and are therefore out of the reach of the already limited powers of the ECB. While the SSM Regulation deals with macro- and micro-prudential tasks separately, there are nevertheless important interconnections (e.g. in terms of data collection) and overlaps in these fields. Specifically, the macro- and micro-prudential toolkits overlap: some tools can be used both for micro-prudential and for macro-prudential purposes.<sup>37</sup> Matters are further complicated by the lack of experience with macro-prudential tools. While there are valid arguments for leaving macro-prudential policy measures in the hands of national actors (since economic and financial cycles are

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<sup>32</sup> See (n 30).

<sup>33</sup> Article 6(4) SSM Regulation and Article 70 SSM Framework Regulation.

<sup>34</sup> Case T-122/15 *Landeskreditbank Baden-Württemberg v. ECB* (pending)

<sup>35</sup> See in this context Recital (28) SSM Regulation.

<sup>36</sup> See e.g., Recital (29) SSM Regulation which requires the ECB to cooperate with Member State authorities ‘competent to ensure a high level of consumer protection and the fight against money laundering’

<sup>37</sup> E.g. I Angeloni, Towards a macro-prudential framework for the single supervisory area, (Belgium Financial Forum, Brussels, 20 April 2015), available at <https://www.bankingsupervision.europa.eu/press/speeches/date/2015/html/se150420.en.html>.

not aligned between Member States and systemic risk might differ between them<sup>38</sup>), it is widely acknowledged that the complexities sketched out here call inter alia for greater levels of coordination between actors. There are provisions to this effect in (inter alia) the SSM Regulation.<sup>39</sup>

#### **Question 16c**

In terms of ensuring meaningful input in the ECB's decision-making processes, the issue is most troubling for non-Euro participating Member States. As already noted, this has to do with the fact that these Member States cannot be represented in the Governing Council of the ECB. Admittedly, the establishment of the Supervisory Board allows these Member States to have a voice. However, there is little doubt that all the arrangements that were adopted fall short of offering non-euro participating states an equal say (see also above).

#### **Question 16d**

See above point (a).

#### **Question 19**

The SSM Regulation was based on the view that a strict separation between monetary and supervisory functions is essential in order to avoid conflicts of interests between the two functions.<sup>40</sup> The ECB in its prudential role was given distinct statutory goals.<sup>41</sup> Article 25(2) states, inter alia, 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'. Chinese walls were put in place at an operational level.<sup>42</sup> Moreover, in order to ensure an effective separation, the SSM Regulation provides inter alia for the Governing Council to operate in a differentiated manner with respect to monetary and supervisory functions.<sup>43</sup> As noted earlier, the Supervisory Board is entrusted with preparing decisions, which will be treated as adopted by the Governing Council following a non-objection procedure. Meanwhile, a mediation panel was set up in order to address divergences between the Governing Council and the Supervisory Board 'with a view to ensuring separation between monetary policy and supervisory tasks'.<sup>44</sup> Moreover, the ECB's internal organisational structure has also been amended in order to reflect the separation principle.<sup>45</sup> Its rules of procedure now also differentiate

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<sup>38</sup> Cf. Opinion of the European Central Bank of 25 January 2012 on a proposal for a Directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and a proposal for a Regulation on prudential requirements for credit institutions and investment firms (CON/2012/5) 5.

<sup>39</sup> See Article 5 SSM Regulation.

<sup>40</sup> See Recital (65); Recital (73); Recital (77) and especially Article 25 SSM Regulation.

<sup>41</sup> Article 1 SSM Regulation.

<sup>42</sup> Article 25(2) SSM Regulation.

<sup>43</sup> Article 25(4) SSM Regulation.

<sup>44</sup> Article 8(1) Regulation (EU) No. 673/2014 of the European Central Bank of 2 June 2014 concerning the establishment of a Mediation Panel and its Rules of Procedure [2014] L179/72.

<sup>45</sup> Decision of the European Central Bank of 22 January 2014 amending Decision ECB/2004/2 adopting the Rules of Procedure of the European Central Bank (ECB/2014/1) [2014] OJ L95/56.

between the decision-making procedure in micro-prudential matters and macro-prudential matters.<sup>46</sup>

However, none of the above safeguards can do away with the ECB's Treaty-based governance structure which centres around the Governing Council. Likewise no legislative text can do away with the ECB's primary constitutional objective which is to maintain price stability. Like other aspects of the SSM, politically acceptable arrangements for safeguarding an institutional separation between monetary and supervisory functions were thus tightly constrained by existing Treaties. The agreed arrangements mostly safeguard the separation principle at the operational level,<sup>47</sup> but at the decisional level the separation principle is less tightly secured, notwithstanding the existence of the Supervisory Board; a mediation panel (which cannot overrule the Governing Council); a statutory principle of separation enshrined in Article 25(2) sub-para 1 of the SSM Regulation; and the obligation for the Governing Council to operate in a differentiated manner (including regarding meetings and agendas). The point is that final authority for prudential supervision will continue to rest with the Governing Council and hence with those that also decide monetary policy.

Clearly the arrangements that were adopted do not therefore represent a first best solution as far as the separation principle is concerned. Having said that, it is also important to acknowledge that – notwithstanding the arguments in favour of separation between the monetary and prudential functions – it is not desirable that each function takes place in a total vacuum.

## **Question 21**

See also earlier answers.

As a general comment, from a UK point of view, the establishment of the SSM gives rise to concerns over (negative) externalities in the micro- or macro-prudential field which might cause the UK and especially the City of London to suffer detrimental effects. Whilst the reality of these concerns remains to be established, the attempt by the ECB to implement the CCP location policy is an example commonly cited in the UK in order to illustrate the potential dangers of greater integration within the Eurozone, even if the actions of the ECB in this area were unrelated to the SSM.

To properly appreciate the effect of the SSM on 'outs' (that is, on 'non-participating Member States'), EBA's role must also be evaluated. The ECB is a 'competent authority' for the purposes of the ESFS. It will be subject to EBA's intervention powers (such as dispute settlement, including in relation to supervisory colleges). In theory, EBA has therefore a crucial role to play between 'ins' and 'outs'. That said, it remains to be seen whether EBA will be able to play this role effectively. EBA is a collective actor and has no preferences of its own: its preferences are those of its members – national authorities – as determined through the voting procedures laid down in EBA's founding regulation. These voting procedures have been amended as a result of the establishment of the SSM in order to safeguard the interests of authorities from Member States which are not part of

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<sup>46</sup> See Article 13(g) and Article 13(h) of the Decision of the European Central Bank of 19 February 2004 adopting the Rules of Procedure of the European Central Bank (ECB/2004/2) [2004] OJ L80/33, as amended by Decision ECB/2014/1.

<sup>47</sup> Article 25(2) sub-para 2 SSM Regulation.

the Banking Union. As noted earlier, this may well be at the expense of the effectiveness of EBA.

#### **Question 21a**

The SSM Regulation does not change the allocation of powers between ‘ins’ and ‘outs’. These powers are based on the home-host model and are determined in accordance with EU law.<sup>48</sup> The home-host model will thus continue to matter greatly in relationships between ‘ins’ and ‘outs’. As far as groups are concerned, supervisory colleges will also continue to matter as vehicles for cooperation between competent authorities from within and outside the SSM. However, what changes is the fact that within the SSM space, the ECB will assume functions which were previously exercised by national authorities that are now part of the SSM. Where it exercises direct supervisory competence (based on the ‘significance’ criteria), the ECB will act – in its relations with national authorities of ‘outs’ – as either the competent authority of the home Member State (in case of ‘passporting out’) or as competent authority of the host Member State (in case of ‘passporting in’).<sup>49</sup> The ECB may also act as consolidating supervisor.<sup>50</sup> Cooperation and coordination arrangements, as well as supervisory colleges, remain therefore crucial mechanisms for ensuring a smooth functioning of the supervisory framework.

From the UK standpoint, the critical issue is thus arguably less about powers than about how the ECB intends to *exercise* these powers. It is apparent that the ECB may adopt a supervisory and enforcement culture that represents a marked departure from previous (national) approaches.

#### **Question 21b**

See point (a) above.

### **C. The Single Resolution Mechanism**

#### **Question 22**

The Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR) stand at the epicentre of the EU legal framework of bank resolution.<sup>51</sup> Under the SRMR, the Single Resolution Board (SRB) has the overall

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<sup>48</sup> See Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC [2013] OJ L176/338.

<sup>49</sup> See the SSM Framework Regulation for details. Note however that in relation to the free provision of services, in the case of ‘passporting in’, the ECB will carry out the tasks of the authority of the host Member State irrespective of the ‘significance’ criterion (see Article 16 of the SSM Framework Regulation).

<sup>50</sup> See the SSM Framework Regulation for details.

<sup>51</sup> Directive 2014/59/EU of the European Parliament and of the Council (15 May 2014) known as the Bank Recovery and Resolution Directive (BRRD) was published in the Official Journal of the European Union, L 173/190, 12 June 2014. The Regulation (EU) No. 806/2014 of the European Parliament and of the Council of 15 July 2014 known as the Single Resolution Mechanism Regulation (SRMR) was published in the Official Journal of the European Union, L 225/1, 30 July 2014. Both EU legal instruments were adopted on the basis of Article 114 of TFEU for the approximation of laws of Member States for the

responsibility for the effective and consistent functioning of the Single Resolution Mechanism (SRM).<sup>52</sup> The operation of the SRM is based on a division of tasks between the SRB and the national resolution authorities of Member States participating in the Banking Union. The allocation of competences between the SRB and the national resolution authorities is determined in light of the systemic significance of the bank (or investment firm) in question according to a range of complex and open-ended SSM rules.<sup>53</sup> The SRB has direct authority over the resolution of systemically significant banks.<sup>54</sup> In this regard, the role of the national resolution authority is confined in assisting the SRB in resolution planning, in contributing to the preparation of the resolution decisions and in taking measures for the implementation of resolution schemes adopted by the SRB. Institutional dynamics change in relation to less systemic banks, namely banks other than those referred to in Article 7(2) of SRMR. Typically, these are small and medium size domestic banks. National resolution authorities remain directly responsible for the resolution of those banks, subject to certain exceptions as, for example, when the SRF is to be used.<sup>55</sup> In the latter case, it is for the SRB to decide the resolution scheme according to the procedure of Article 18 SRMR.

The need to resort to SSM rules to determine the allocation of competences between the SRB and national resolution authorities suggests that the SRM is endowed with the same legal problems that were identified in previous parts of this report in relation to the SSM. Accordingly, any observations made above apply here as well. At this juncture, it is worth noting that Article 7(4) SRMR adds a further layer of complexity. According to this provision, the SRB has the discretion to exercise directly all the relevant powers under the SRMR ‘[w]here necessary to ensure the consistent application of high resolution standards under this Regulation’. It is difficult to predict the circumstances under which the SRB is likely to use this discretion. The SRMR does not provide guidance to this effect. Furthermore, the reference to ‘high resolution’ standards raises more questions than answers, as it is not clear how to distinguish ‘high’ resolution standards from other types of resolution standards, in the absence of a system of normative hierarchical order in the legal text.

The SRB is not the sole EU level agency with an explicit bank resolution mandate. A key task of the European Banking Authority (EBA) is to contribute to the consistent application of EU law as, for example, the bank recovery and resolution requirements as

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purposes of the establishment and functioning of the internal market. Financial Stability Board, *FSB Key Attributes of Effective Resolution Regimes for Financial Institutions* (15 October 2014). The 2014 publication is an updated version of the original 2011 publication, available at [http://www.financialstabilityboard.org/2014/10/r\\_141015/](http://www.financialstabilityboard.org/2014/10/r_141015/).

<sup>52</sup> Article 7(1) SRMR. Where decisions and actions bear out adverse effects on the UK as, for example, threats to the financial stability of the domestic financial market, the Single Resolution Board (SRB) should take into consideration those adverse effects. This arrangement is not necessarily reassuring for the UK. The SRMR does not go as far as to legally mandate the SRB to ensure the amelioration of those adverse effects. See Article 6(3) and Recital (54) of the Preamble to the SRMR. According to Article 42(1) of SRMR, the SRB is an EU agency with legal personality. It was launched on 1 January 2015 and became fully operational as of 1 January 2016.

<sup>53</sup> See Article 7(2) SRMR.

<sup>54</sup> See Article 5(1) SRMR.

<sup>55</sup> See Article 7(3) SRMR.

these are set out in BRRD.<sup>56</sup> To this effect, the EBA acts as a quasi-standard setter, supervisor, coordinator, mediator and enforcer according to the founding Regulation of the EBA (EBAR). On paper, the functions of the EBA complement those of the SRB, however, the co-existence of these two EU agencies is potentially troubling. Take the example of EU agency enforcement action.<sup>57</sup> The SRMR highlights the leading role of the SRB in the SRM. At the same time, it preserves the role of the EBA as the guardian of the consistent application of EU bank resolution rules in all 28 Member States including those participating in the Banking Union. Experience with the EBA so far suggests that most probably the EBA will follow a strategy of ‘enforcement inertia’ as a recognition of the leadership of the SRB in the SRM.<sup>58</sup> That said, it is interesting to note that the enforcement powers of the SRB are very limited in scope.<sup>59</sup> This being the case, it is conceivable that certain breaches of EU law will be left untreated because they fall outside the enforcement remit of the SRB.<sup>60</sup> To pre-empt this problem, one might be tempted to interpret the ambiguous legal text to the effect of recognising that the EBA should come to the aid of the SRB and act in its enforcement capacity in those instances where the SRB cannot.<sup>61</sup> This approach is expedient and pragmatic but it comes with the cost of added legal and institutional complexity. In addition, it is controversial because it ignores the fact that EBA interference does not sit well with the introduction of a

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<sup>56</sup> See Regulation 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority) amending Decision No. 716/2009/EC and repealing Commission Directive 2009/77/EC, 2010 OJ (L331/12). The EBA’s role in recovery and resolution is enshrined in Articles 25 (‘Recovery and resolution procedures’) and 27 (‘European System of Bank Resolution and funding arrangements’) of the BRRD. In the same spirit, Article 125(1) of the BRRD also brought resolution authorities within the definition of ‘competent authority’ of Article 4(2) EBA Regulation and thus within the remit of the EBA. None of these provisions is successfully drafted, however, they arguably highlight certain key aspects of the role of the EBA as an EU-level resolution agency for matters falling beyond the outreach of the SRB.

<sup>57</sup> In the SRM, it is legally mandatory for national resolution authorities to implement the decisions and instructions of the SRB. See Article 21(11) and 29(1) SRMR. National resolution authorities are also ‘competent national authorities’ for the purposes of EBAR. Accordingly, they also fall under the parallel supervision and guidance of the EBA. See Article 125(1) BRRD.

<sup>58</sup> Article 17 EBAR endows the EBA with quasi-investigatory and enforcement powers but does not go as far as to vest the EBA with sanctioning powers. By contrast, the SRB is empowered to impose sanctions, in particular, fines (Article 38 SRMR) and periodic penalties (Article 39 SRMR).

<sup>59</sup> Article 29(2) SRMR. This power is significantly circumscribed. Furthermore, it is not enough to establish that the national resolution authority in question has failed to apply the measure or that it failed to apply the measure to the satisfaction of the SRB. In addition, the failure of the national resolution authority must be demonstrably grave enough to pose a threat to any of the resolution objectives under Article 14 SRMR or to the efficient implementation of the resolution scheme. Finally, the measure that is communicated through the decision of the SRB to the bank must be capable of addressing the threat to the relevant resolution objective or the threat to the relevant resolution scheme. The SRB decisions are binding for both the noncomplying bank and the national resolution authority and they prevail over previous decisions of the national resolution authority on the same matter. On this point see Article 29(3) and (4). For a more detailed discussion see A. Georgosouli, ‘Regulatory incentive-realignment and the EU legal framework of bank resolution’ (2016) 11 *Brooklyn Journal of Corporate, Financial and Commercial Law* (forthcoming).

<sup>60</sup> Especially, in relation to the resolution of small and medium sized banks, which fall outside the immediate authority of the SRB.

<sup>61</sup> There are also pragmatic reasons that arguably militate against enforcement inertia. For a detailed discussion see A. Georgosouli, ‘Regulatory Incentive-realignment and the EU legal framework of bank resolution’ (2016) 11 *Brooklyn Journal of Corporate, Financial and Commercial Law* (forthcoming).

streamlined decision making procedure for matters pertaining to the functioning of the SRM under the leadership of the SRB. Although the practical implications of this arrangement remain to be seen in the future, it should be noted that the inter-relation of the SRB (as the competent EU-level resolution agency) and the EBA (as the guardian of the consistent application of the substantive requirements of the Single Rulebook including those on bank resolution) is a source of confusion which is likely to be strategically exploited by resentful Member States and other stakeholders.<sup>62</sup>

Alongside the SRB and the EBA, other EU institutions and agencies are also involved in bank resolution. Below, I consider briefly the respective roles of the European Central Bank (ECB), the Commission and the Council.

The ECB is responsible for the operation of the SSM. Bank resolution is not considered to be part of its mandate.<sup>63</sup> The ECB contributes to the recovery and resolution of Eurozone banks as a prudential supervisor. For example, the ECB determines the systemic significance of the bank in question and it takes early intervention measures to promote its financial stability objective. It has the power to impose requirements, to carry out stress tests as well as a range of other supervisory tasks in relation to recovery and resolution plans under certain circumstances.<sup>64</sup> The ECB also determines whether a bank is failing or likely to fail, at the request of the SRB.<sup>65</sup> The division of competences between the ECB and the SRB is not always clear. For example, in the context of early intervention where the ex officio involvement of the ECB is most pronounced, the same set of events may give rise to potentially conflicting measures by the ECB as the prudential supervisor and the SRB as the resolution agency, where there is a failure to coordinate action effectively.<sup>66</sup>

The Commission and the Council have a strong presence in the SRM. This should not come as a surprise. Only institutions of the Union are empowered to establish the resolution policy of the Union.<sup>67</sup> In view of the margin of discretion that is essential for the adoption of each specific resolution scheme, it is necessary to provide for the adequate involvement of the Council and the Commission. As a rule, the Commission is

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<sup>62</sup> See A. Georgosouli, 'Regulatory incentive realignment and the EU legal framework of bank resolution' (2016) 11 *Brooklyn Journal of Corporate, Financial and Commercial Law* (forthcoming).

<sup>63</sup> Strictly speaking, the ECB is responsible for price stability through the implementation of monetary policy and for financial stability through macro-prudential supervision. See Article 127 (1), (2) and (6) TFEU. According to the prevailing interpretation of Article 127(6) TFEU, bank resolution does not fall within the scope of the competences that can be conferred to the ECB.

<sup>64</sup> Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks to the European Central Bank concerning policies relating to the prudential supervision of credit institutions (29.10.2013 Official Journal L287/63). Article 6(6) SSMR (setting out the supervisory responsibilities that fall within the exclusive competence of the ECB) in conjunction with Article 4(1)(f) and (i) SSMR.

<sup>65</sup> If the ECB fails to make such a determination, the SRB retains the right to assess whether a bank is failing or likely to fail. The ECB power to withdraw authorisation is set out in Article 4(1)(a) SSMR.

<sup>66</sup> According to Article 16(2) of SSMR, the ECB can remove members of the management board that are not "fit and proper". This power overlaps with Title III (Articles 27 to 30) of the BRRD, which deals with early intervention in bank resolution. Specifically, Article 28 BRRD empowers the resolution authorities to remove senior management when the latter has failed, for example, to draw up a plan of negotiation and restructuring of the debt with the creditors of the bank. As long as the failure described in Article 28 of the BRRD can be seen as a species of failure to comply with fit and proper test, the same chain of events potentially activates both the powers of the ECB as prudential supervisor and the powers of the resolution authority.

<sup>67</sup> Recital (24) of the Preamble to SSMR.



endowed with the task of assessing the discretionary powers of the SRB. In its turn, the Council is empowered to make determinations about the impact of the resolution scheme on the fiscal sovereignty of Member States and their financial stability. In the context of the SRM, the Commission performs the following key functions: (a) it participates in the resolution procedure of the SRB,<sup>68</sup> (b) it sets out the details of the SRF,<sup>69</sup> (c) it appoints and removes the Chair, the Vice Chair and other Members of the SRB,<sup>70</sup> (d) it holds the SRB accountable<sup>71</sup> and, last but not least, (e) it provides State Aid and Fund Aid.<sup>72</sup> The Council complements the functions of the Commission especially in respect of the approval of SRB resolution schemes, according to the resolution procedure of Article 18 SRMR, the appointment and removal of board-members of the SRB, the operation of the SRF. However, together with the European Parliament, the Council acquires a far more prominent role in keeping the SRB accountable.<sup>73</sup>

In theory, the tasks of the Commission and the Council are clearly demarcated in the SRMR. In practice, complications are likely to arise as a result of the complexity of the decision-making process and the open-ended nature of the involvement of the Council. The procedure for the adoption of the resolution scheme when the SRF is to be used demonstrates this point.

Once it is established that a troubled bank is failing or likely to fail, the SRB must *inter alia* determine whether the resolution of the bank in question is in the ‘public interest’. In determining whether the resolution is ‘in the public interest’, the SRB must consider whether it is ‘necessary’ for the attainment of the resolution objectives as these are set out in Article 14 SRMR and ‘proportionate’.<sup>74</sup> Provided that it is, the SRB adopts the resolution scheme. When the resolution action involves the use of the SRF, the SRB notifies the Commission and the Commission makes assessments about the proposed use of the SRF with respect to any distortions to competition, impact on trade between Member States and compatibility with the internal market.<sup>75</sup> In making this assessment, the Commission applies the State Aid criteria as these are set out in Article 107 TFEU. Upon the conclusion of this assessment, the Commission adopts a decision on the compatibility of the use of the Fund with the internal market. The use of the word ‘shall’ conveys that the involvement of the Commission is certain in the decision-making procedure for the resolution scheme. The opposite holds for the involvement of the Council. The use of the word ‘may’ leaves beyond doubt that the involvement of the Council is contingent on the discretion of the Commission and it is not to be assumed

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<sup>68</sup> Article 18 SRMR.

<sup>69</sup> Article 19 SRMR.

<sup>70</sup> On the appointment and removal of the Board see Article 56(6) and (9) SRMR.

<sup>71</sup> The SRB is accountable to the European Parliament and to the Council for any decisions taken on the basis of SRMR. Furthermore, the SRB is accountable to national Parliaments of participating Member States. For example, a national Parliament has the power to invite the Chair to participate in an exchange of views in relation to the resolution of institutions in that Member State together with a representative of the national resolution authority. According to Article 45 (accountability) SRMR, the SRB is also accountable to the Commission for the implementation of the Single Resolution Mechanism Regulation.

<sup>72</sup> Article 19 SRMR (State aid and Resolution Aid). See further Recitals (30), (57) and (75) of the Preamble to the SRMR.

<sup>73</sup> Article 45 SRMR.

<sup>74</sup> See Article 18(5) SRMR.

<sup>75</sup> On the bearing of competition in the determinations of the Commission see notably Recital (9), (19) and (21) of the Preamble to the SRMR.

simply by virtue of the fact that the resolution scheme calls for the use of the SRF. In any case, should the Commission decide to implicate the Council, the Council is empowered to object, on a proposal of the Commission, to the Board's resolution scheme only on the grounds specified in Article 18(7) of the SRMR. Specifically, the Council may object the resolution scheme either on the ground that it is not in the public interest (contrary to the initial determination of the SRB) or for the purposes of modifying the amount of the use of the SRF as proposed by the SRB.<sup>76</sup> The resolution scheme enters into force only if, within 24 hours from its adoption, there are no objections from the Council or the Commission, or the resolution scheme is approved by the Commission.

The participation of the Council is also open-ended in relation to the use of State Aid or Resolution Funds according to the procedure of Article 19 SRMR. In both cases the Commission must *inter alia* assess the impact on competition and the compatibility of State Aid or SRF with the internal market according to State Aid criteria. However, by way of derogation from Article 19(3) SRMR, the Council may decide that the use of the SRF shall be considered compatible with the internal market.<sup>77</sup> The Council has the discretion to take this decision unanimously, on the application of a Member State and only in exceptional circumstances. The SRMR does not point to any criteria for the assessment of the circumstances as 'exceptional', in a similar fashion that it does, for example, for the purposes of guiding the determinations of the SRM as to whether a resolution scheme is in the public interest in the course of the resolution procedure of Article 18 of the SRMR. Moreover, the SRMR does not provide for a specific timeframe within which the Council must act. It only stipulates that the Council 'must make its attitude known within seven days of the said application being made.' This introduces ambiguity that is to be regretted in view of the onerous time constraints that apply to bank resolution and the politically charged nature of the use of State Aid or the Resolution Fund.

As a final note, special reference should be made to the fact that the SRB and virtually all other EU-level institutions and EU-agencies are legally bound by delegated acts, regulatory and implementing technical standards, guidelines and recommendations of the EBA.<sup>78</sup> The EBA lacks the institutional clout to turn against EU-level institutions (e.g. the ECB or the Commission) in order to ensure compliance with these rules.<sup>79</sup> It also seems unlikely to see the EBA in the future openly contesting the judgments of the SRB taking into account the expertise and leadership of the SRB in the SRM and granted that more often than not the SRB will be acting with a strong backing from the ECB. It is to be expected that any matters will be resolved on the basis of Memoranda of Understanding and *ad hoc* communications in a spirit of mutual cooperation and coordination. This arrangement is pragmatic and flexible but not transparent enough to convey confidence as to the legitimacy of the decisions taken. It also raises questions as

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<sup>76</sup> The use of the SRF is further discussed below in a separate section.

<sup>77</sup> Article 19(10) SRMR.

<sup>78</sup> Article 5(2) SRMR which is to be read in conjunction with Articles 10 to 15 and 16 of Regulation (EU) No1093/2010 (EBA Regulation) and in respect of the EBA standard setting powers within the scope of the BRRD.

<sup>79</sup> According to Recital (54) of the Preamble to SRMR, '[t]he Board, the national resolution authorities and the competent authorities, including the ECB, should, where necessary, conclude a memorandum of understanding describing in general terms how they will cooperate with one another in the performance of their respective tasks under Union law. The memorandum should be reviewed on a regular basis.'

to the robustness of the existing mechanisms of accountability and procedural due process opening thus a window of opportunity for the legal contestation of EU-level decisions by means of judicial review.

### **Question 23**

Below, I provide an overview of certain legal and institutional aspects of the SRM which point to key strengths and weaknesses of this arrangement. The rules on the SRF will be discussed separately.

To appreciate the perceived strengths of the SRM, it helps to keep in mind the problems that it seeks to address and how it fares when compared to the BRRD system of a coordinated network of bank resolution outside the Banking Union, as it is put into operation by national resolution authorities albeit under the supervision and guidance of the EBA.<sup>80</sup> Compared to the BRRD, the SRMR establishes a quasi-supranational arrangement as a response to a plethora of problems including the following: (a) fragmentation, (b) policy diversity and, (c) negative feedback loopholes between sovereigns and banks. Bringing bank supervision and bank resolution to the same level is also expected to ameliorate tensions between EU-level and Member State level resolution authorities. The SRM also addresses the need for swift and decisive action. Compared to national resolution authorities, the SRB is endowed with a greater pool of resources and experience. Thus, it is thought to be better placed to handle a bank resolution more effectively. The SRF draws on a pool of significant resources from bank contributions and therefore it has greater capacity to protect taxpayers compared to the protection afforded by national resolution financing arrangements. At the same time, it provides a level playing field across participating Member States.

This notwithstanding, there are several weaknesses in the current inception of the SRM. The scope of application of the SRMR is fragmented. The SRM applies to credit institutions as these are defined under the Capital Requirements Regulation (CRR) (that is banks and certain other deposit takers), parent undertakings including financial holding companies and mixed financial holding companies that are subject to consolidated supervision of the ECB under the SSM, and investment firms and financial institutions when covered by consolidated supervision of the parent undertaking under the CRR.<sup>81</sup> The resolution of insurance firms and Central Counter-parties is not covered.<sup>82</sup> As it was pointed out above, the division of competences between the SRB and national resolution authorities is based on assessment of the systemic significance of the troubled financial institution in question. Although it is not difficult to trace the legal and political grounds for it, the wisdom of this arrangement is questionable. Entrusting national resolution authorities with the direct responsibility for the resolution of less systemic banks is liable

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<sup>80</sup> Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms OJ L 173, 12.6.2014, p. 190–348. See also European Commission, ‘EU Bank Recovery and Resolution Directive –Frequently Asked Questions’ *Memo 14/297* (Brussels, 15 April 2014), available at [http://europa.eu/rapid/press-release\\_MEMO-14-297\\_en.htm](http://europa.eu/rapid/press-release_MEMO-14-297_en.htm).

<sup>81</sup> Article 2 SRMR.

<sup>82</sup> This marks a notable departure from the recommendations of the Financial Stability Board and, in particular, Key Attribute 1 which sets out the scope of resolution regimes for systemically significant financial institutions. See FSB, *FSB Key Attributes of Effective Resolution Regimes for Financial Institutions* (2014).

to preserve well-intended but short-sighted introversion and protectionist attitudes in the Banking Union.<sup>83</sup> One of the grounds for a centralised system of decision-making for bank resolution in the Banking Union is the need to reduce the tension between EU-level and Member State level authorities. With the advent of the SRB and a quasi-centralised system of decision making, it is to be expected that the likelihood of unilateral action will be reduced on those occasions where the SRB replaces national resolution authorities in deciding crucial aspects of bank resolution. That said, the SRB relies on national resolution authorities in two important respects: It relies on national resolution authorities for the implementation of the resolution measures and for the taking of enforcement action at Member State level.<sup>84</sup> Their cooperation is important for the effective and timely resolution of banks in the Banking Union but it is not to be taken for granted.

The problem becomes worse once we take into account that the BRRD does not harmonise all aspects of bank resolution. Take the example of the bail-in tool. The BRRD defines the scope of the bail-in tool excluding secured, collateralised and guaranteed claims as well as certain kinds of unsecured liability – most notably deposits protected under the Deposit Guarantee Directive 2014/49/EC and certain liabilities of the employees of the failing institution. However, Member States have the discretion to exclude other liabilities.<sup>85</sup> Furthermore, with the exception of the ranking of deposits, which is harmonised by virtue of article 108 BRRD, the rankings of all other claims are to be determined under the applicable domestic insolvency law.<sup>86</sup> Consequently, disagreements may crop up with respect to (a) the scope of the bail-in tool, in other words the determination of liabilities that may be subject to the write down or conversion powers of the resolution authority and (b) the ranking of claims.

Where incentives are not properly aligned at Member State and EU levels, points of friction are preserved and new sources of resentment are created. The mounting tension does not serve the objectives of the EU legal framework of bank resolution.<sup>87</sup> It undermines cooperation, impedes information sharing, causes delays and breeds litigation risk. In this respect, it is to be regretted that the investigatory and enforcement powers of the SRB against national resolution authorities and directly against banks are very limited

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<sup>83</sup> N. Veron, 'Europe's Radical Banking Union' (2015) 33 *Bruegel Essay and Lecture Series* at 20-22, available at [http://bruegel.org/wpcontent/uploads/imported/publications/essay\\_NV\\_CMU.pdf](http://bruegel.org/wpcontent/uploads/imported/publications/essay_NV_CMU.pdf).

<sup>84</sup> It is worth mentioning that contrary to the EBA, articles 38 and 39 SRMR endow the SRB with powers to directly impose sanctions on noncomplying banks under certain circumstances. These take the form of administrative penalties and, in particular, fines and periodic penalty fines.

<sup>85</sup> According to Article 44(3) BRRD, 'In exceptional circumstances, where the bail-in tool is applied, the resolution authority may exclude or partially exclude certain liabilities from the application of the write-down or the conversion powers.'

<sup>86</sup> Article 27(3) SRMR defines the scope of the bail-in tool in a manner that is consistent with the BRRD. Not unlike the national resolution authorities of non-Banking Union participating member States acting subject to BRRD provisions, the SRB has also the discretion to exclude certain liabilities in part or as a whole. Article 27(5) SRMR replicates Article 44(3) BRRD. With respect to the treatment of shareholders in bail-in and the writing down and conversion of capital instruments including the sequence of write-down and conversion, the SRMR makes reference to articles 47 and 48 BRRD. With respect to the ranking of deposits it makes references to Article 108 of BRRD.

<sup>87</sup> The resolution objectives are set out in Article 31(2) of the BRRD.

in scope when all other informal and voluntary means of coordination and communication (e.g. Memoranda of Understanding) fail.<sup>88</sup>

### Question 30

The SRF is set up under the ownership and administration of the SRB.<sup>89</sup> It is financed by the private sector. Specifically, the banking industry is mandated to make ex ante and, under certain circumstances, ex post contributions. The SRB can also borrow or take other measures to support the funding of the SRF.<sup>90</sup> The SRF is not part of the Union budget and it is not meant to trigger budgetary liabilities for Member States. The SRF has a target level of 55 billion euros.<sup>91</sup> This equates to at least 1% of the amount of covered deposits of all banks in the Banking Union. It is to be filled over a period of eight years. The funds will be first raised at a national level and then they will be transferred to the SRF in accordance with the principles established by an Inter-Governmental Agreement (IGA) between participating Member States.<sup>92</sup> The use of the SRF follows the same rules that govern the provision of national financing arrangements under the BRRD.<sup>93</sup> The SRF can be used for a range of purposes, including providing guarantees, making loans, purchasing assets and providing compensation to shareholders or creditors. It can also provide capital to a bridge bank or asset management vehicle. By contrast, the SRF is not intended to provide funding for the direct absorption of losses of a failing institution or for direct recapitalisation.<sup>94</sup> More generally, the SRF serves as a back-up option.

As it was noted above, certain key elements relating to the functions of the SRF are regulated by an Inter-Governmental Agreement (IGA). The IGA covers (a) the transfer of contributions raised at Member State level by the national resolution authorities, (b) the progressive mutualisation of the funds available in the national compartments (c) the replenishment of national compartments, (d) the order in which financial resources are mobilised to cover resolution costs and (e) possible participation to the SRF of non-euro area Member States. All participating Member States signed the IGA on 21 May 2014. The IGA will enter into force once it is ratified by the national Parliaments of the participating Member States.<sup>95</sup>

The provision of the SRF is certainly a move in the right direction. Its actual potential is yet to be tested, however, even at this early stage there are some issues of concern. It is not certain that the target level will actually be enough to provide medium term support

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<sup>88</sup> For an extensive discussion see A. Georgosouli, 'Regulatory incentive realignment and the EU legal framework of bank resolution' (2016) 11 *Brooklyn Journal of Commercial, Financial and Corporate Law* (forthcoming).

<sup>89</sup> Article 67(3) SRMR.

<sup>90</sup> Article 70 (ex ante contributions), Article 71 (extra ordinary ex post contributions) and Article 73 (alternative funding means) SRMR.

<sup>91</sup> Article 69 SRMR.

<sup>92</sup> See Council of the European Union, 'Agreement on the transfer and mutualisation of contributions to the Single Resolution Fund' 8457/14 (Brussels, 14 May 2014) [<http://data.consilium.europa.eu/doc/document/ST-8457-2014-INIT/en/pdf>] and European Commission, 'A Single Resolution Mechanism for the Banking Union – frequently asked questions' MEMO/14/295 (Brussels, 15 April 2014). On the SRF, see articles 64-66 and 71 SRMR.

<sup>93</sup> Articles 99 to 109 BRRD.

<sup>94</sup> On this point, see article 76 (Mission of the Fund) SRMR.

<sup>95</sup> As of 26 November 2015 only 14 out of 26 Countries have ratified the IGA, available at [https://en.wikipedia.org/wiki/Single\\_Resolution\\_Mechanism#cite\\_note-depositary-3](https://en.wikipedia.org/wiki/Single_Resolution_Mechanism#cite_note-depositary-3).

in the future.<sup>96</sup> The eight-year period of transition is also a long period of time, during which the SRB will have to operate relying on national resolution funds. There is also a time mismatch between the development of the SRF and the establishment of an EU level Deposit Insurance Scheme as the third pillar of the Banking Union. As I explain in a separate section below, progress has been slow in this respect with a lot of crucial details to be decided in the future. Although the SRF is not part of the Union budget the distinction between financing arrangements that affect the Union budget and those that do not touch on Union budget is elusive and a constant source of legal uncertainty absent a Fiscal Union to back up and complement the operation of the SRF.

## **D. The Single Rulebook**

### **Question 33**

The Single Rulebook is the epitome of maximum harmonisation and the principal means to attain substantive legal uniformity in the single market for financial services. Maximum harmonisation has led to a proliferation of multi-tiered EU legislation. Part of this growing volume of legislation is technical, detailed and directly applicable to Member States including the UK. At the same time it is subject to review. This on-going review aims to ensure that EU legislation is always up to date but it comes at a price. It undermines the durability of the legal text. This is not a trivial matter. Quite apart from increasing the cost of compliance as the industry must always be vigilant of the latest changes in the legislation, the temporary nature of regulatory requirements erodes any sense of legal certainty and predictability. Seeing things from the angle of the UK and irrespective of the substantive merits of the legislation in question, the current form of the Single Rulebook is concerning. For instance, the direct applicability of technical requirements is perceived as a serious threat to the discretion of the UK (through the Bank of England and the PRA) especially on matters of crisis prevention and management. It also raises issues of legitimacy to the extent that it can be argued that that EU-level institutions and agencies force Member States to bear risks that nationally accountable regulators consider to be excessive.<sup>97</sup>

The case for maximum harmonisation is premised inter alia on the assumption that regulatory competition (or at least some degree of it) is not desirable because it preserves diversity and may lead to a race to the bottom. There is no logical necessity why this should be the case at all times. Regulatory competition may bear out the opposite result. It may also be justified on the grounds that it allows breathing space to think outside the box as national regulators do not have to decide and act within the strict normative confines of EU legislation. Moreover, it makes room for flexibility so that national regulators are able to tailor their responses to the peculiar circumstances that apply to the jurisdictions where they operate.

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<sup>96</sup> For a more detailed discussion see notably, W. P. De Groen and D. Gross, 'Estimating the bridge financing needs of the Single Resolution Fund: How expensive is it to resolve a bank?' *Centre for European Policy Studies, provided at the request of the Economic and Monetary Affairs Committee, European Parliament* (November 2015) and, in particular, at page 5.

<sup>97</sup> M. Wolf, 'The case against "maximum harmonisation" in EU banking' *Financial Times* 8 May 2012, available at <https://next.ft.com/content/b9981af5-c0a4-3d8a-82e3-55cd16d33ab6> (commenting on the implementation of the Capital Requirements Directive IV and the Capital Requirements Regulation).

The Single Rulebook is wedded to the idea of maximum harmonisation because the presence of a heterogeneous regulatory environment is thought to complicate significantly cross-border supervision and regulation. However, the Single Rulebook itself is a source of legal complexity. To all intents and purposes, it has not reduced complexity. At best, it has replaced one source of complexity (diverse regulatory environment) with another (convoluted and notoriously technical legal requirements). Assuming that there is a case to be made in favour of substantive legal uniformity in the single market for financial services, one might also question whether the Single Rulebook is 'single enough'.<sup>98</sup> Substantive legal uniformity calls for an EU-level system of centralised regulation. Although progress has been made in this direction, the present institutional arrangement is not supra-national. It exhibits a range of inter-governmentalist features the purpose of which is to leave ample room to Member State level regulators to exercise domestic options, directions and practices.<sup>99</sup>

### Question 35

The Deposit Guarantee Directive provides minimum harmonisation requirements for depositor protection in the EU and it is currently under review.<sup>100</sup> The Directive does not introduce a centralised system of deposit insurance in the EU. There are benefits to be gained out of a centralised framework for the administration of deposit guarantee schemes in the Banking Union. A centralised administration allows for quick decisions and greater policy convergence. It reduces fragmentation and competitive distortions across the Single Market. It is also instrumental to the alignment of the use of resolution funds in the course of a bank resolution and the use of funds specifically for the purposes of depositor protection.<sup>101</sup>

Despite its perceived benefits, the actual potential of a centralised administration for deposit guarantee schemes in the Banking Union should not be blown out of proportion. A fundamental issue in the completion of the Banking Union is the link between banks and sovereigns. As long as this link is preserved, the location of the bank will continue to be the key factor for the determination of the riskiness of bank deposits. Moreover, funding costs for national Deposit Guarantee Schemes will continue to vary across

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<sup>98</sup> For a comprehensive discussion see A. Enria (Chairman of the European Banking Authority) 'The Single Rulebook in banking: is it 'single' enough?' *Speech* (University of Padova 28 September 2015), available at <http://www.mondovisione.com/media-and-resources/news/the-single-rulebook-in-banking-is-it-single-enough-andrea-enria-chairman-of/>.

<sup>99</sup> For a general discussion on the perceived tension and concomitant trade-offs between inter-governmentalism and inter-institutionalism see M. Saeter, 'Comprehensive Neofunctionalism: Bridging realism and Liberalism in the study of European Integration' in W. Sandholtz and A. Stone Sweet eds., *European Integration and Supranational Governance* (OUP, 1998).

<sup>100</sup> Directive 94/19/EC of the European Parliament and of the Council (30 May 1994) on deposit guarantee schemes *Official Journal L 135*. The aim of the review is to improve depositor protection, maintain depositor confidence and strengthen the safety net. European Commission 'Deposit Guarantee Schemes – Frequently Asked Questions' *MEMO* (Brussels, 15 April 2014), available at [http://europa.eu/rapid/press-release\\_MEMO-14-296\\_en.htm](http://europa.eu/rapid/press-release_MEMO-14-296_en.htm).

<sup>101</sup> The existing resolution regime allows the use of DGS funds for bank resolution. In that sense bank resolution funds and DGS funds complement each other. Resolution funds maintain the systemic functions of banks. The DGS pre-empts bank runs and can help avoiding bank crises. Covered deposits are exempt from bail-in and they get preferential treatment in insolvency and resolution. See European Commission 'Deposit Guarantee Schemes – Frequently Asked Questions' *MEMO* (Brussels, 15 April 2014), available at [http://europa.eu/rapid/press-release\\_MEMO-14-296\\_en.htm](http://europa.eu/rapid/press-release_MEMO-14-296_en.htm).

Eurozone countries. A conclusion to be drawn out of these preliminary observations is that the completion of the Banking Union is not undermined by the lack of a centralised administration of deposit insurance as much as by the lack of a scheme for the mutualisation of the bank risks associated with depositor protection in the Banking Union.

Generally speaking there are two options for the funding of deposit guarantee schemes in the Banking Union: The provision of a credit line to various national DGSs or the mutualisation of risks of losses on depositors across borders.<sup>102</sup> The provision of an EU-level credit line to national DGSs (either directly or indirectly) would be useful but, for all intents and purposes it would still preserve the link between banks and sovereigns. By contrast, the mutualisation of risks of losses on depositors across borders by way of a European Deposit Insurance Scheme seems to be a more credible solution. A third and arguably more pragmatic option in view of the present institutional set up is the provision of a European re-insurance scheme whereby national insurance schemes are asked to pay risk-premia.<sup>103</sup>

As of 24<sup>th</sup> November 2015, the Commission proposed as an Euro-wide deposit insurance scheme (EDIS) the creation of a Single Resolution and Deposit Insurance Board within the SRB for the administration of EDIS and the progressive establishment of a European Deposit Insurance Fund. National DGSs would remain in place and they would be part of EDIS. EDIS is to be funded by the banking industry by way of ex ante contributions and it is to be established in three sequential stages: During the first stage there will be a re-insurance stage (until 2020). During the second stage there will be a co-insurance scheme (until 2024) and, in the final stage, EDIS would fully insure deposits and would cover all liquidity needs and losses in the event of a pay-out or resolution procedure.

## **E. Banking Union in Context**

### **Question 39**

The establishment of the Banking Union does not change the Court's Treaty-based role. However, it is undeniable that the establishment of the Banking Union will further increase the Court's workload. For instance, given the ECB's new role under the SSM and its powers to take supervisory measures vis-à-vis supervised entities, the Court will see an entirely new line of cases emerging regarding the legality of the ECB's decisions. This will arguably not be without challenge: not only because of the additional workload, but also because the ECB is empowered to apply national law transposing directives, including national law giving effect to options granted to a Member State under EU law. Moreover, it should be recalled that the Banking Union is an example of differentiated

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<sup>102</sup> For a comprehensive discussion of the available options see, D. Schoenmaker and G. B. Wolff, 'What options for European Deposit insurance?' *Bruegel Bog post* (8 October 2015), available at <http://bruegel.org/2015/10/what-options-for-european-deposit-insurance/>.

<sup>103</sup> Mutualisation is resisted by Germany. Reinsurance may be an alternative to mutualisation but it does not fully resolve the problem of fiscal back stop. Through reinsurance large losses can be spread beyond national borders although the latter depends on the percentage of insurance that remains national under this scheme. The smaller the national first-loss tranche, the closer the resemblance of that system to a consolidated and centrally administered system of European deposit insurance. See D. Schoenmaker and G. B. Wolff above.



integration: it does not extend to the EU as a whole. The Court will therefore also be the final arbiter of disputes between ‘ins’ and ‘outs’ on matters relating, for instance, to disruptions to the internal market.