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EU financial integration since the Great Financial Crisis: Consequences for EU and national authorities

edited by Diane Fromage

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Introduction.

The impact of EU financial integration on European and national institutional structures

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1. Introduction

The recent banking crises in the US and in Switzerland have, yet again, evidenced the need for adequate regulation and supervision of financial institutions across the globe. This happened a decade after the Great Financial Crisis had already demonstrated the urgency to act to this end, and triggered reforms.

Although deeper integration in this domain within the European Union (EU) may still be required, and although several reforms are either already under discussion or expected in the near future, reforms at the EU and the global levels were already performed at the beginning of the 2010s to try and foster closer cooperation in this domain. European integration in the field of financial services indeed long remained significantly less developed than integration in other areas of the Single market.[1] It is only in the 1980s that progress towards convergence among Member States' practices could be achieved, and that minimum harmonisation could be agreed upon. Additional efforts of coordination with a view to strengthening the free movement of capitals continued to be pursued in the 1990s, and the Lamfalussy process was introduced in 1999 to 'simplify and rationalize European legislation on financial matters'.[2] In particular, a Single Rulebook was adopted and the European System of Financial Supervision (ESFS) replaced the pre-existing Lamfalussy committees in 2010: the European Systemic Risk Board chaired by the European Central Bank (ECB) has since been in charge of macro prudential oversight within the EU, whilst the three European Supervisory Agencies (ESAs) – that is: the European Banking Authority (EBA), the European Securities and Markets Authorities (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA) have assumed (mainly regulatory) tasks in micro prudential supervision in the banking, the securities and the insurance sectors, respectively. These efforts towards the reinforcement of European integration in the financial domain however still proved insufficient, and the project of a European Banking Union (EBU) was launched in 2012.[3] Contrary to the initiatives that preceded it, the EBU is characterised by the transfer of competences in banking supervision and resolution to an EU institution and an EU body (the ECB and an agency, the Single Resolution Board (SRB), respectively). Despite this, the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM) are still heavily reliant on national institutions, i.e. National Competent Authorities (NCAs) and National Resolution Authorities (NRAs), among other reasons because these national institutions remain competent for the supervision and the resolution of smaller banks (so-called Less Significant Institutions), because they support the ECB in

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[1] See for a detailed historical account for instance: G. Boccuzzi, *The European Banking Union: Supervision and Resolution* (Palgrave, 2016), 13 f. and B. Haar, *Organizing regional systems: the EU example*, in N. Moloney, E. Ferran, J. Payne (eds), *The Oxford Handbook of Financial Regulation* (Oxford University Press, 2015), 195 f.

[2] M. de Poli, *Fundamentals of European banking law* (Wolters Kluwer, 2020), 51.

[3] European Commission, Communication from the Commission to the European Parliament and the Council: A Roadmap towards a Banking Union, COM(2012) 510 final, 12.09.2012.

supervising larger credit institutions (Significant Institutions) and because they play a decisive role in the functioning of the SRB (one that is even larger than the one they play in the SSM). Indeed, as an EU agency, the SRB may – in most cases – not implement its decisions directly: it relies on the NRAs to this end.[4]

As mentioned, the changes made to the architecture of financial supervision within the EU are by no means an isolated phenomenon but are, instead, part of a trend of reforms conducted to enhance the resilience of the financial system visible in numerous countries worldwide, as well as in global initiatives.[5] As such, the mechanisms of financial supervision that exist within EU Member States today are shaped by three sources of influence: those specific to their own political and institutional systems and cultures that are also influenced by the individual features of their financial systems; those that result from the efforts of integration within the EU; and those that derive from global trends and standards which, despite being non-binding, still bear significant influence.[6]

The EBU has represented a leap forward in the level of integration in one of the areas of financial supervision, and it has consequently deeply affected the standing of NCAs and NRAs within the institutional systems of their respective Member States after the earlier adoption of the Single Rulebook had modified the content of the applicable rules. Furthermore, its creation may be expected to have an impact beyond the NCAs and the NRAs themselves: it has also affected the functioning of accountability mechanisms. Several institutional models for financial supervision exist, and one single institution may, for instance, fulfil the tasks that are assumed at the EU level by the ESAs, the ECB-SSM and the SRB. Such is, for instance, the cases of Austria, Germany, Latvia and Poland examined further in this edited collection.[7]

Against this background, and at a time when financial integration within the EU is further deepening, notably in the form of a new agency to fight against

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4 Article 29(1) 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 Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No. 1093/2010, OJ L 225/1, 30.07.2014.

5 For an overview of a situation worldwide in the early 2000s, see: J.R. Barth, G. Caprio, R. Levine, *Bank regulation and supervision in 180 countries from 1999 to 2011*, (2013) NBER Working paper series. Concerning the global initiatives, see for examples those pursued by the Basel Committee of Banking Supervision that has adopted standards and core principles for effective banking supervision on several occasions.

6 This is so for several reasons, among which for example the fact that banks established in states that are compliant with global Basel standards will have easier access to the markets of states that also apply them. J. Atik, *EU Implementation of Basel III in the Shadow of Euro Crisis*, (2013) 33 Review of Banking & Financial Law, 283-341, 299. Besides, compliance with global standards contributes to market trust.

7 See for an insightful (though somewhat dated) comparative analysis of the concentration of supervisory functions and the participation of central banks therein: D. Masciandaro, M. Quintyn, *Regulating the Regulators: The Changing Face of Financial Supervision Architectures Before and After the Financial Crisis*, in S. Eijfinger, D. Masciandaro (eds), *Handbook of Central Banking, Financial Regulation and Supervision* (Edward Elgar Publishing, 2011), 454-484.

money laundering and terrorism financing,[8] the question of the *impact of these efforts towards more integration in the financial domain, and especially the Banking Union, on the institutional systems of the EU and its Member States arises*. Specifically, the following questions appear of particular relevance:

- How much of the institutional design for financial supervision and resolution as it currently stands in the Member States was driven by EU reforms, and how much was instead nationally-induced? Indeed, numerous EU and non-EU States have introduced changes to their institutional framework following the Great Financial Crisis (i.e. independently of the changes that have happened at the EU level), and 'this reaction suggests a link between institutional models and supervisory effectiveness'.[9] Nonetheless, other factors including 'political calculations about the impact on public perceptions of different reform options' have been deemed to potentially play a role as well.[10] This thus begs the question of how much the reforms that Member States have conducted in recent years are due to national features, EU obligations, or global trends. Where the National Central Bank (NCB) of a Member State is also entrusted with the functions attributed to NCAs and/or NRAs, it additionally becomes the case that the EU's influence on the national institutional framework may well already be traced back to the creation of the ESCB. Put differently, the impact of the integration efforts in the field of financial supervision may well add to changes already triggered by integration in the area of monetary policy, an assumption, which this edited collection pursues to verify.
- What are the specific consequences of the creation of the BU within which national authorities are more constrained than they are under the ESFS framework? Does the very high level of integration that now exists in the framework of the EBU call for further harmonization of national institutional frameworks and if so, how?
- What are the implications of the additional transfer of competences to the EU level in terms of administrative and democratic accountability?
- Is the 'single supervision system' (*Allfinanzaufsicht*) or consolidated system as it exists in some Member States still the most suitable one? And what can we learn from it for the EU level, and for the other EU Member States (cross-fertilisation potential)? Is the functional divide as it (partially) exists at the global and the EU level and in, for instance, France and Italy better suited?

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8 Regulation (EU) 2024/1620 of the European Parliament and of the Council of 31 May 2024 establishing the Authority for Anti-Money Laundering and Countering the Financing of Terrorism and amending Regulations (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010.

9 E. Ferran in N. Moloney, E. Ferran, J. Payne (eds), *The Oxford Handbook of Financial Regulation*, cit.

10 *Ibidem*.

- How about the national institutions in charge of macroprudential supervision, both in the framework of the EU-wide ESFS and in the BU-specific SSM?

  The BU has, though, not only influenced the institutional systems of the Member States. It has also – among others – significantly affected especially the EBA because the EBA's role and institutional standing changed radically following the creation of the BU. Hence, the following question must be tackled:
- What has the impact of these efforts towards more integration been for the EBA?

This edited collection provides an answer to these interrogations by examining a selection of Member States (Austria, France, Germany, Italy, Latvia, Poland, Portugal) as well as the EBA. These Member States were selected based on their quality as (non)-euro area or BU Member State, their size, geographical balance, the relevance of their banking sector as well as the institutional set up of their supervisory and resolution authorities.

This analysis is pertinent at this point in time for a variety of reasons. Among them is the fact that the EBU has been in place since 2014 for its first pillar (SSM) and 2016 for its second pillar (SRM). It is thus now possible to analyse its impact based on the first few years of its functioning, while taking due account of relevant case law both at the EU and at the national level. This appears particularly important in view of the fact that the conferral of tasks in banking supervision to the ECB (that is the use of the reserve of competence contained in Article 127(6) TFEU) was but one of the possible options.[11] Opting for it undoubtedly had (and still has) significant advantages, but it also bears non-negligible consequences that relate, for example, to its status as independent central bank whose decisions are binding on euro area Member States only, and to the fact that it may not supervise insurance undertakings. Furthermore, discussions on the completion of the EBU in the form of the creation of a European Deposit Insurance Scheme (EDIS) have been stalled for several years but a proposal to reform the Deposit Guarantee Schemes Directive has recently been made, and an assessment of the functioning of the two existing pillars may be helpful in this context. Furthermore, it is important to note that whilst financial regulation had long remained an area reserved to (technical) experts, it has become a highly politicised issues since the euro area crisis, thereby putting accountability issues under the spotlight. In fact, some have deemed this evolution to be the reason why accountability

[11] Article 127(6) TFEU indeed contains a 'reserve of competence' but Member States were under no obligation to make the ECB the main authority in charge as it reads 'The Council […] *may* unanimously […] 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'.

mechanisms between the European Banking Authority (EBA) and the European Parliament (EP) have been established.[12]

2. Setting the scene: the existing rules governing NCAs' and NRAs' institutional set up

In entailing the establishment of the SSM and the SRM, the creation of the EBU has brought about a complete overhaul of the regime for banking supervision and resolution within the EU. Hence, NCAs and NRAs now operate in a significantly different environment. However, whilst their relationships with the ECB-SSM and with the SRB are governed by the SSM and the SRM Regulations, the institutional requirements that NCAs and NRAs must fulfil under EU law are found in norms that are part of the Single Rulebook and which thus apply to all authorities across the EU (and not to EBU-ones only). The EBA's Q&As may, too, be helpful in interpreting these provisions.[13] Note additionally that EU rules incorporate standards developed at the global level in the EU legal order, such that the Basel Committee of Banking Supervision (BCBS)'s Core principles for effective banking supervision[14] as well as the Financial Stability Board's Key Attributes of effective resolution regime[15] are also relevant.

In the field of *supervision,* Principle No. 2 is relevant, while it is primarily Article 4 Capital Requirements Directive (CRD) that defines NCAs' features. In doing so however, it only refers to their functional characteristics without any reference to their institutional embodiment being made, the requirement that they be independent from the NRA (with which they should nonetheless cooperate) excluded. As a consequence, Member States are called to guarantee that their respective NCA have access to the information required to perform their tasks, and that they have 'the expertise, resources, operational capacity, powers and independence necessary to carry out the functions relating to prudential supervision, investigations and penalties' (Article 4(3) and (4) CRD). The SSM Regulation[16] additionally demands that (BU) NCAs 'act independently' (Article 19(1)). In turn, Principle No. 2 of the BCBS principles foresees that the 'supervisor possesses operational independence, transparent processes, sound governance, budgetary processes that do not undermine autonomy and adequate resources,

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12 P. Teixeira, *The legal history of the European Banking Union: how European law led to the supranational integration of the single financial market* (Hart Publishing, 2020), 185.

13 See here.

14 Basel Committee on Banking Supervision, Core Principles for Effecitve Banking supervision (2012), Bank for International Settlement.

15 Financial Stability Board, Key Attributes of Effective Resolution Regimes for Financial Institutions (2014).

16 Council Regulation (EU) No. 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, OJ L 287/63, 29.10.2013.

and is accountable for the discharge of its duties and use of its resources. The legal framework for banking supervision includes legal protection for the supervisor'.

The CRD was recently revised and Article 4 be amended. However, the focus is set on the prevention of conflicts of interest and not on the NCAs' institutional features proper.[17]

In the area of *resolution*, standards at the global level (the Financial Stability Board's Key Attributes of effective resolution regime) had already defined some of the characteristics, which resolution authorities should have in 2011,[18] and Article 3 Banking Recovery and Resolution Directive (BRRD) details the characteristics, which NRAs must have across the EU. Despite being somewhat detailed (and arguably more so than those contained in the CRD examined previously), these provisions leave an important margin of manoeuvre to Member States in the implementation of their obligations under this Directive. This is unsurprising, and in line with previous practice in other areas of EU law and with the Treaties, which prescribe that '[t]he Union shall respect the equality of Member States before the Treaties *as well as their national identities, inherent in their fundamental structures, political and constitutional*, inclusive of regional and local self-government' (Article 4(2) TEU, emphasis added).[19] The freedom left to the Member States is visible for instance in the choice they have to designate 'national central banks, competent ministries or other public administrative authorities or authorities entrusted with public administrative powers' as their NRA (Article 3(3) BRRD), and in the sole requirement that it (or they) be 'a public administrative authority or authorities entrusted with public administrative powers' (Article 3(2)). Additional requirements regard expertise, resources and operational capacity, as well as the capacity to 'exercise their powers with the speed and flexibility that are necessary to achieve the resolution objectives' (Article 3(8)). Notwithstanding this, the BRRD still expresses a clear preference in favour of one single entity being in charge of resolution, and against that entity being also entrusted with the functions of an NCA within the SSM (note the strong wording of Article 3(3): 'Member States *may exceptionally* provide for the resolution authority to be the competent authorities for supervision for the purposes of Regulation (EU) No. 575/2013 and Directive 2013/36/EU' (emphasis added)). Where this is the case, safeguards must be established, as for example, operational independence and rules to avoid conflicts of interest must be in place. As is logical in view of the intertwinement between the two tasks they pursue, supervision and resolution authorities are nonetheless required to cooperate effectively in any event. Like it is the case with the SSM Regulation as

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17 See further on this: C. Brescia Morra, D. Fromage, *Recent Developments in EU Institutional Architecture in the Financial Sector as the Illustrations of the Continuing Regulatory Differences and Sources of Fragmentation*, (2023) EU Law Live Weekend Edition, 19 f.

18 The Bank for International Settlements' Financial Stability Institute recently reviewed the implementation of these principles; P. Baudino, C. Sánchez, R. Walters, *Institutional arrangements for bank resolution*, FSI Insights on policy implementation No. 32, May 2021.

19 Note though that the attribution of competences to regional authorities in application of this principle may be the source of tensions with the applicable EU law requirements, like it is the case in Italy.

well, the SRM Regulation,[20] too, sets standards of independence for BU-NRAs: they shall 'act independently and in the general interest'.

It results from this analysis of the criteria defined at the EU level that they leave ample room for manoeuvre to Member States, thus allowing them to implement these obligations in the most efficient manner in view of their institutional structures and political cultures. This also mirrors the fact that several models of institutional arrangements for financial supervision co-exist as shown by the contributions to this edited collection.

In fact, some scholars have attempted to draw a classification of the existing institutional arrangements, and four main institutional models exist.[21] A) The *functional* (or *sectoral*) model where supervision is divided by line of business (classically: banking, insurance and securities market) with each of them being entrusted to a separate entity.[22] A sub-category of this model is the 'two-entity' model where the three lines of business are supervised by two entities only (as in France). B) The *institutional* model in which the responsible supervisor is dependent on the official licensing of the institution (i.e. bank, insurance company, securities firm); It may supervise other lines of business ancillary activities. C) The *single supervisory model* (also known as *integrated* or *consolidated* model) where a single institution is entrusted with supervision of all institutions and all functions. And D) the *twin peaks* (or *objectives*) model in which two supervisors (in most cases) share the responsibility of supervision: one is in charge of prudential objectives whilst the other is responsible for the conduct of business objectives.

The single supervisory model was very popular in the 1990s and the 2000s, but has since become less commonly resorted to because it is deemed to be potentially too demanding on a single institution, because one objective could be prioritised above the others, and because it may lead to central banks being unduly side-lined from financial supervision where the supervisor is too independent from the central bank. The twin peak model thus appears to have become more popular at present.

However, as illustrated by the contributions to this edited collection, some Member States' institutional systems are characterised by their continuity over time (Italy), whilst others have undergone reforms, sometimes in contradictory directions, over the past two decades (Austria, France, Germany, Poland and Spain) or even more recently (Latvia).

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20 Regulation (EU) No. 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No. 1093/2010, OJ L 225/1, 30.07.2014.

21 This section largely relies on E. Ferran in N. Moloney, E. Ferran, J. Payne (eds), *The Oxford Handbook of Financial Regulation*, cit., 129 f. and on D. Calvo *et al.*, *Financial supervisory architecture: what has changed after the crisis*, FSI insights on policy implementation No. 8, April 2018.

22 Variations of this model naturally exist as well, like in Italy where banks are supervised both by the Italian Central Bank and CONSOB depending on the considered activity.

3. Introducing the contributions to this edited collection

The contributions to this edited collection analyze the impact of the efforts towards financial integration pursued within the EU both from a Member State and from an EU perspective. To this end, it first entails eight national case studies, before the analysis turns to the supranational level with one article focusing on the EBA.

The first part on the national level starts with a paper by Paul Weismann who analyses the Austrian case. In particular, he first outlines how banking supervision and resolution are organized thereby underlining the division of tasks and powers as well as the cooperation between the Austrian NCA, the FMA, and the Austrian Central Bank and Ministry of Finance. In so doing, he shows that the design in place mostly results from national institutional dynamics, although the creation of the SRM did lead to an increase of power for the FMA. His analysis also serves to illustrate some points of tensions, which arose over time between the Austrian and the European legal orders. These concern the requirement of independence for the FMA, which the possibility for the EBA, the ECB and the SRB to instruct it could appear to contradict at first sight (but does not upon closer examination). The second aspect relates to the FMA's possibility to impose severe sanctions, which in Austria had been previously reserved to courts. The third one regards the FMA's and the Austrian Central Bank's public liability regime, which is more restricted than Austria's general public liability regime and parts of which appear to conflict with the Austrian constitution and EU law.

The second paper by Diane Fromage focuses on a comparison between France, Germany and Italy, whereby Germany, like Austria, has opted for the integrated model of supervision entrusted with a federal institution established under public law hierarchically submitted to the Ministry of Finance. Italy has more classically entrusted its central bank with supervisory and resolution functions, and operates following a functional divide. France, on the other hand, has opted for a unique model whereby the ACPR is in charge of both banking supervision and resolution and is an independent authority placed within the central bank. The analysis explains how these Member States' institutional structures for banking supervision and resolution have evolved over time, and what factors motivated the reforms performed. Reforms at the EU level have played a minor role if compared to internal, domestic dynamics. However, the Bank of Italy's structures had, for instance, already been subject to significant influence by the European integration process in preparation for the establishment of the European System of Central Banks and its internal structure was modified following the establishment of the SSM. More importantly, the introduction of the BU has led to a further rebalancing of powers between the Italian government and the Italian central bank to the benefit of the latter, following a previously existing trend in this sense. Furthermore, the proposed analysis sheds light on the doubtful independence credentials of the German and the French NCAs, and examines the accountability frameworks in place.

Carlos Martínez and Joaquín Maudos look at the Spanish case. They start by highlighting the peculiarities of the Spanish banking system and its evolution, in particular the circumstances that led Spain to request financial assistance in 2012.This condition as 'crisis Member State' demanded that Spain concluded a Memorandum of understanding, which entailed provisions regarding the system of banking resolution and bank supervision. One of the peculiarities of the Spanish systems, i.e. the fact that its resolution function is shared between two institutions, is described and explained, whilst the influence of the Basel Committee's standards on Spain during its banking crisis especially is emphasized.

Martinho Lucas Pires focuses on another 'crisis Member State' by considering the Portuguese case. As he underlines, the Portuguese case is peculiar for a variety of reasons among which are the facts that its banking sector was in crisis when the BU was enacted, and that it, too, was submitted to a Memorandum of understanding after it had to request external financial assistance. In fact, Portugal created a resolution function within its central bank – which is also competent for banking supervision – even before the enactment of the relevant EU norms as a result of this change having been contained in the Memorandum of Understanding it subscribed to. Also, the institutional set up for banking supervision and banking resolution is peculiar, in as far as the independence between both functions which EU law demands to exist may not be sufficiently guaranteed. The role parliament has played is unique among our sample as well: it has indeed set up several parliamentary inquiry commissions tasked with examining financial supervision in the country.

The last contribution devoted to a euro area-Member State is authored by Mārtiņš Rudzītis who considers the Latvian case. It demonstrates how money laundering scandals have significantly re-shaped the institutional structure for financial supervision and resolution over recent years and describes how the central bank was first released from these functions in 2001 before starting to exercise them again in 2023. To this end, the article offers an analysis of the evolution of the financial supervision architecture since Latvia became independent in 1991 and highlights how the decision to opt for a unified model of supervision in 2001 was inspired by the successful reforms conducted by some of the EU Member States at the time. Hence, EU integration itself did not have any influence in this decision, but cross-fertilization across (then future and current) EU Member States may be observed. The decision to recently revert to a sectoral model was politically driven and it has led the Bank of Latvia to have one of the broadest central bank mandates within the euro area, thus requiring the creation of mechanisms of separation of functions, examined in-depth in the article. Mārtiņš interestingly shows how the ECB served as a source of inspiration to the Latvian legislator.

A non-BU State, Poland, is also included with a view to offering an element of comparison with the EA- and BU-Member States. Poland, like several other Member States, reformed the structure of its NCA before changes happened at the EU level, that is it opted for an integrated model as early as 2008 after banking supervision had previously operated following a functional model. The creation of its NRA intervened very early on as it happened as the relevant EU legislation was still in the making. Furthermore, the NRA was located within the institution in charge of deposit protection, which is an original choice. One additional specific feature of the Polish financial safety lies in the key role played by the government, which to some extent questions the independence of the NCA and the NRA. All in all, these reforms are, however, largely the result of national dynamics as opposed to being induced by changes at the EU levels, although international influence by the World Bank and the International Monetary Fund definitely played a role. Jakub additionally includes an interesting analysis as to why Poland has not joined the BU, and why Poland may be viewed as having implemented the EU's resolution framework in its own 'Polish way'.

This section on national experiences concludes with an article by Donato Salomone who provides an original analysis on the national authorities for macroprudential supervision, a topic, which to date has not attracted any kind of scholarly attention. The article starts by recalling what the framework for prudential supervision is in today's EU, thereby highlighting the essential role which national authorities continue to play therein. Donato also shows that there are in fact two kinds of national macroprudential supervisory authorities at the national level: those established based on the SSM, and those created to comply with requirements set in the EU-wide Capital Requitements Regulation and Directive (CRR and CRD), whilst national and European central banks, too, play a key role in this context. The need for coordination among national authorities, as well as the potential for an overlap of functions between national authorities in charge of macro- and microprudential supervision are also highlighted, alongside the specificities of the ECB's powers in the area of macroprudential supervision.

The second part of this edited collection turns to the EU level by considering the impact of the creation of the BU on the EBA.

The contribution by Despina Chatzimanoli first recalls the historical background in which the BU was introduced and usefully distinguishes between four periods. Thereafter, it examines the changes for the EBA introduced following the creation of the BU, which, as highlighted by Despina, are much more limited than those that have affected NCAs. This notwithstanding, amendments to the EBA's institutional structure and voting arrangements had to be performed, the latter to avoid that BU-outs become hostage of the BU-ins. It is though foreseen that this be reviewed should the number of the Member States that do not participate in the BU significantly drop in the future. The analysis proposed continues by emphasizing aspects related to the practice of the EBA in the various, quasi-adjudicative, quasi-regulatory and quasi-executive tasks it is endowed with. Potential areas of tensions in practice are highlighted, which, while not directly a result of the BU as such, serve to expand the 'footprint' of the ECB already as an EU institution, for instance as a result of the ECB's right to issue opinions on level 1 pieces of legislation, or of the fact that the ECB should receive orders from an EU agency, the EBA. Issues related to the ECB's 'bigness', its more numerous financial, human and data resources are mentioned next in the analysis proposed. A further illustration of this ‘bigness’ may be found in the ECB’s growing role in the international arena, and the consequently diminished role for the EBA therein. As Despina argues, ‘[i]n summary, it would be fair to suggest that the effects of the BU on the EBA have been (and are expected to continue to be) quite profound and multi-faceted in nature, even though not always in obvious ways […to the point that] doubts about the EBA’s continuing relevance [could be cast]’. The author still finds that numerous reasons exist why the EBA will remain relevant in the future not least of which are the supervisory and oversight powers entrusted to it via the recently adopted new legislation relating to the effects of technology on finance, the Markets in Financial Instruments (MiCA) and Digital Operational Resilience Act (DORA) regulations.

4. Conclusion

This edited collection pursued to examine the impact of EU financial integration, and especially the creation of the EBU, on the Member States’ and the EU’s institutional architecture.

The case studies considered in this edited collection reveal that, perhaps unsurprisingly, the creation of the EBU was not the trigger for significant institutional changes, even among EBU Member States. Several of the Member States examined (Austria, France, Germany, Poland) had already followed earlier, more global trends in favour of the concentration of functions by means of the introduction of the single supervisory (or integrated) model. That is: they changed their institutional structure for financial supervision before integration in this domain was deepened at the EU level. The reforms in the area of supervision did not however only result from the fact that Member States, responding to their own national dynamics, followed global trends. Instead, other factors (unrelated to the creation of the EBU) also shaped Member States’ institutional structures for banking supervision. Among these are, for instance, crises: the sovereign debt crisis triggered changes in Portugal and Spain, whilst scandals led Latvia to amend its structure for financial supervision. Poland, on the other hand, was affected by the international influence of the World Bank and the International and Monetary Fund. The fact that the creation of the EBU (or the introduction of the ESFS) did not trigger the creation of new institutions does not, however, mean that EU financial integration did not have any impact at all. It did lead to the attribution of new functions to existing institutions (banking resolution and macroprudential supervision) and, in some instance, it also led to a change in the pre-existing interinstitutional balance (Italy). Furthermore, institutional patterns at the EU level have inspired reforms at the national level (Latvia), and some cross-fertilization among Member States whereby some Member States used the structures existing in other Member States as models is also visible. An additional interesting phenomenon lies in the anticipatory character of some of the reforms performed: Poland and Portugal adapted their resolution framework even before the relevant changes at the EU level had been finalized.

As the eight case studies analyzed in depth by the various authors illustrate, the institutional set ups in place in the various Member States displays great variety. The question therefore arises as to whether the EU legal framework should foster further harmonisation in this domain. This is probably not the case as this high degree of variety among Member States results from the existence of varying national traditions and dynamics, as well as different political factors. Furthermore, some systems are very volatile, whilst others are very stable (the two extremes in our samples being Latvia for the first category, and Italy for the second). Even though some institutional set ups do not evolve, it also does not mean that no reforms are envisaged. This notwithstanding, EU norms could and should probably impose more stringent requirements, for instance as regards guarantees of independence; and this would not go counter the principles of institutional autonomy and Member States' constitutional identity as the EU would still leave the choice to the Member States to have the institutional set up they see fit, only that it would have to comply with some more clearly defined requirements.

Another important finding of this edited collection lies in the existence of a misalignment, or at least some inconsistency between, on the one hand, what EU norms recommend and, on the other, the reality of Member States' institutional structures. As previously noted, the BRRD foresees that 'Member States *may exceptionally* provide for the resolution authority to be the competent authorities for supervision for the purposes of Regulation (EU) No. 575/2013 and Directive 2013/36/EU' (emphasis added). This notwithstanding, the case studies analyzed here, like a survey conducted by the EBA in 2021,[23] reveal that a concentration of functions in one and the same institution commonly exits in reality. In fact, the Latvian example shows that this phenomenon may, in fact, be worsening. This trend should not necessarily be assessed negatively: there are enough valid reasons why one single institution should be entrusted with financial supervisory tasks and a resolution function (provided that sufficient safeguards of independence among these functions are in place). For instance, this may allow the development of a specific (and rare though crucial) technical expertise, the better exchange of information, or a more efficient of scarce resources, especially in smaller Member States. However, this certainly questions the validity of the quasi requirement of separation contained in the BRRD.

Actually, the mismatch between Member States and EU realities or conceptualisations is not limited to this aspect. It appears that the institutional frameworks at the EU level and in numerous Member States are growing ever more apart. This is illustrated by the fact that the EU still operates following a functional model (with the three ESAs) whereas, as underlined here, numerous Member States have not only opted for a concentration of functions, but on numerous occasions, they have also entrusted their central banks with these functions (and not independent institutions). This misalignment is also visible

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[23] European Banking Authority, EBA Report on the supervisory independence of competent authorities EPA/REP/2021/29 (2021).

in the strict divide between supervisory and resolution function existing at the EU level with the ECB being in charge of banking supervision, whereas the SRB is the main resolution authority. In no few occasions have Member States attributed those functions to one and the same institutions. The situation is not only problematic because these functions are separated. It is also an issue because the ECB and the SRB do not have the same institutional standing being an agency and an institution. Among the resulting differences are the fact that their powers do not have the same reach and thus their relationship to and their powers vis-à-vis national institutions vary significantly. It must thus be noted that the EU's institutional system is in numerous respects more complex than the one existing at the national level, as a result of the existence of two groups of Member States (euro area and non-euro area), and as a result of the choice for a functional model and of the additional attribution, within the EBU, of supervisory and resolution functions to the ECB and the SRB.

This edited collection additionally shows how the influence of European integration is not limited to banking resolution and supervision but, instead, also extends to the area of macroprudential supervision, where the requirements set at the EU level have led to a very complex institutional architecture. Member States have to designate authorities in charge of macroprudential authorities in two different frameworks and, as shown here, these may, or may not, be one and the same institution.

Moreover, the evolution of the EU integration in the financial domain over the past decade and notably the creation of the EBU has had an impact on the EU's own institutions and bodies and their role and standing within the EU's institutional system generally. As shown, changes for the EBA have been profound, and this may be expected to remain this way in the future, as the divide between euro area and non-euro area Member States, which nowadays arguably primarily justifies the EBA's existence, is narrowing but becoming ever more permanent. Indeed, whereas on the one hand an ever increasing number of Member States choose to adopt the common currency, on the other hand the group of Member States that refuse to take this step is become more steady and permanent. Furthermore, although some shortcomings in the framework in place have become visible over time (to name but a few of these in addition to those already mentioned above: limitations to the delegation of powers to agency, massive resort to soft law and its limited judicial review, division of responsibilities among supervisory authorities and between supervisory and resolution authorities), significant reforms may not be expected to happen any time soon. This is because of shortcomings inherent to the existing Treaty framework, of the continuing co-existence of euro area and non-euro area Member States, and probably also of lack of political willingness as Member States appear to be satisfied with the framework currently in place, which (still) leaves them significant margin of influence. The current situation can, though, hardly be viewed as satisfactory as numerous sources of fragmentation continue to exist, even within the EBU, whose purpose was to create a level playing level among Member States. And one of these sources of fragmentation is certainly related to the variety of institutional set ups existing at the national level, whose compliance with EU and international requirements, for instance in terms of independence, appears doubtful in some instances. Whereas the absence of strict institutional separation among functions may not appear to threaten the success of the attempts at financial integration within the EU, lack of independence may. Hence why the absence of any reform proposal in this sense in the framework of the current reform of the CRD may be viewed as a missed opportunity.

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Part I: The EBU's impact on Member States

The supervision and resolution of banks in Austria. Three cases illustrating the varied intertwining of EU law and constitutional law

Paul Weismann[*]

Summary. 1. Introduction – 2. The supervision and resolution of banks in Austria: Requirements under constitutional law, the relevant authorities, the compatibility of their set-up with EU law and their representation at the EU level – 2.1. Requirements under constitutional law – 2.2. The main supervisory/resolution authority: the Finanzmarktaufsichtsbehörde (FMA) – 2.3. The role of the Oesterreichische Nationalbank (OeNB) – 2.4. The FMA/OeNB as part of the SSM/SRM – 3. Constitutional requirements under the influence of EU law: selected questions – 3.1. The constitutionally required independence of the FMA – 3.2. The FMA's power to sanction banks – 3.3. Liability for unlawfully caused damages – 4. Conclusion

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1. Introduction

Banking supervision and regulation in the European Union (EU) has seen an impressive development over the past 20 years. More recently, it was complemented by a comprehensive regime on bank resolution. On the institutional side we have seen the introduction of the Lamfalussy procedure, resulting in the establishment of financial market supervisory committees which were then transformed into EU agencies, the so-called European Supervisory Authorities (ESAs), which together with the European Systemic Risk Board (ESRB) and the national supervisors form part of the European System of Financial Supervision (ESFS), the empowerment of the European Central Bank (ECB) and the foundation of the Single Resolution Board (SRB).[1]

The purpose of this article is not to trace these reforms at the EU level, but to address their effects on the national level, more concretely: in Austrian constitutional law. After outlining the competence and institutional set-up regarding the supervision and resolution of banks in Austria – with the financial market supervisory authority called FMA and the national central bank OeNB[2] as its core actors – and the involvement of these authorities at the EU level, three selected cases shall exemplify the manifold ways in which EU and Austrian (constitutional) law interact or even conflict with each other in this policy field.

More concretely, in part 2 of this contribution, an account of the requirements under constitutional law, of the relevant authorities, of the compatibility of their set-up with EU law and of their representation at the EU level will be provided. Subsequently, in part 3, three examples will be given in order to describe and analyse the interplay of EU law and Austrian constitutional law, namely (1) the constitutionally required independence of the FMA, (2) its power to sanction banks, and finally (3) the liability of the FMA and the OeNB for unlawfully caused damages. Eventually, a conclusion on the findings of this article will be drawn (part 4).

2. The supervision and resolution of banks in Austria: Requirements under constitutional law, the relevant authorities, the compatibility of their set-up with EU law and their representation at the EU level

2.1. Requirements under constitutional law

Austrian federal constitutional law can be adopted or amended by the federal legislator. In order for an act of constitutional law to be passed, principally a two thirds majority in the *Nationalrat* (which, together with the

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[1] For a more encompassing overview of these reforms see the introduction to this compilation.

[2] These abbreviations stand for *Finanzmarktaufsichtsbehörde* and *Oesterreichische Nationalbank*, respectively.

Bundesrat, forms the federal parliament) is required, with at least one half of the MPs being present. Politically speaking, this means that for a federal government coalition disposing of a two thirds majority in the *Nationalrat* the adoption or amendment of constitutional law is feasible without having to bring (parts of) the opposition on board. From the foundation of the (second) Federal Republic in 1945 until the end of the 20th century the so-called 'grand coalition' (composed of social democrats and conservatives) was in government for more than thirty years in total. At that time, this coalition still disposed of a two thirds majority in the *Nationalrat*.[3] It is part of the heritage of this grand coalition that Austrian federal constitutional law nowadays is an inhomogenous mix of statutes and single provisions, because the coalition has used its constitutional majority in the *Nationalrat* to adopt various laws in the form of constitutional law not (necessarily) because of their fundamental importance, but simply to shield them from constitutional review by the constitutional court (*Verfassungsgerichtshof*, hereinafter VfGH) and to impede future reforms (by coalitions without constitutional majority). That is why apart from the core constitutional code, the *Bundes-Verfassungsgesetz* (Federal Constitutional Law, B-VG),[4] which has been amended repeatedly and significantly over time, and special constitutional statutes like the *Staatsgrundgesetz* on fundamental rights, the constitutional law on the protection of personal freedom or the European Convention on Human Rights which, in Austria, in addition to its ratification as an international treaty was adopted as a statute of constitutional law, there is a multitude of other federal constitutional laws: various acts or provisions in otherwise simple laws, e.g. parts of the law on the organisation of federal schools or certain provisions in the road traffic act.[5]

For reasons of publicity, constitutional acts/provisions need to be officially named 'constitutional law' or 'constitutional provision.'[6] From a constitutional law perspective, the only material limit to such amendments are the so-called construction principles of the Constitution, as enshrined in the B-VG – the republican, the democratic, the federal and the liberal principle, the rule of law, and the principle of checks and balances.[7] These principles

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[3] Only in the period after the elections of 1994 the coalition has lost its constitutional majority in the *Nationalrat*. After the premature elections in 1995 the coalition has regained this majority. After the elections in 1999, when the social democrats and the conservatives have lost their constitutional majority again, an unprecedented coalition between conservatives and the freedom party was founded; for the distribution of MP seats in the Nationalrat see here.

[4] When references to Austrian statutes are made in this article, the respective translation (if provided for) on Austria's official online platform for laws and court cases will be used: see here.

[5] For these and other specificities of Austrian constitutional law and policy see T. Öhlinger, *Verfassung und Demokratie in Österreich zu Beginn des 21. Jahrhunderts*, in C. Brünner *et al.* (eds), *Kultur und Demokratie. Festschrift für Manfried Welan* (Böhlau, 2002), 217.

[6] Article 44 para 1 B-VG.

[7] For a more nuanced account see W. Berka, *Verfassungsrecht* (Verlag Österreich, 8th edn, 2021), paras 114-117.

can only be amended after a positive referendum (so-called 'total revision').[8] In the history of the B-VG, such constitutional referendum has been held only once, namely on the Federal Constitutional Act on the Accession of Austria to the European Union, on the basis of which Austria joined the EU in 1995.[9] From the perspective of Austrian constitutional law, these construction principles also form the constitutional limits to the supremacy of EU law. While the VfGH has confirmed that EU law principally trumps Austrian law,[10] including Austrian constitutional law, the construction principles of the Constitution may not be interfered with even by Union law, unless these principles have been amended before pursuant to Article 44 para 3 B-VG, that is to say by means of constitutional law, adopted by the legislator with a two thirds majority in the *Nationalrat* after a positive referendum.[11]

In terms of competence, Article 10 para 1 No. 5 B-VG stipulates that in matters of the monetary, credit, stock exchange and banking system the Federation has the powers of legislation and execution.[12] This includes rules on the supervision and resolution of banks. In deviation from the principle of execution of federal legislation by the authorities of the *Länder* (indirect federal administration), Article 102 para 2 B-VG provides for the possibility that the above matters can be directly executed by federal authorities (direct federal administration). The federal legislator has made use of this possibility. With regard to the sanctioning powers of the FMA also the competence clause of Article 10 para 1 No. 6 B-VG (civil and criminal law affairs[13]) is relevant.

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8 Article 44 para 3 B-VG.

9 Federal Law Gazette No. 744/1994. The first referendum in the Second Republic was held in 1978 on the federal act passed by the *Nationalrat* on the peaceful uses of nuclear energy. (The political background was that Austria by then had built its first nuclear power plant, and the opposition against its connection to the grid was on the rise.) Since this simple law did not amend the construction principles (apparently it was not intended to amend the Constitution at all), the referendum was not required by Article 44 para 3 B-VG. Thus, it was not a constitutional referendum but a merely facultative one which the federal government held for political reasons. Shortly after the (negative) referendum, a rule prohibiting the use of nuclear fission for energy supply in Austria was adopted, Federal Law Gazette No. 676/1978. In 1999, a more comprehensive rule prohibiting the uses of nuclear energy was adopted as federal constitutional law (without a prior referendum), Federal Law Gazette No. 149/1999.

10 In view of this, specific provisions on the supervision of banks, according to which the FMA exercises its powers only to the extent that they are not exercised by the ECB, have a merely declaratory value: see e.g. § 77d BWG, § 12a FKG, § 3 para 10 BaSAG; similarly: B. Raschauer, *Finanzmarktaufsichtsrecht* (Verlag Österreich, 2015), 95.

11 See S. Griller, *Verfassungsfragen der österreichischen EU-Mitgliedschaft*, (1995) Zeitschrift für Rechtsvergleichung, 89, 96; T. Öhlinger, *Staatlichkeit zwischen Integration und Souveränität*, in S. Griller *et al.* (eds), *20 Jahre EU-Mitgliedschaft Österreichs* (Verlag Österreich, 2015), 123 ff.

12 With regard to the supervision of insurance companies – of which the FMA is in charge, as well – see Article 10 para 1 No. 11 B-VG. For the scope of Article 10 para 1 No. 5 B-VG – in particular its inclusion of rules on the authorisation and exercise of banking activities – see B. Raschauer, *Finanzmarktaufsichtsrecht*, cit., 89.

13 Including administrative penal procedures not falling within the autonomous sphere of competence of the *Länder*.

With regard to public law judicial review, apart from the VfGH the supreme administrative court (hereinafter VwGH[14]) and, hierarchically below these two, the administrative courts (of the federation and the nine provinces, i.e. the *Länder*) are to be mentioned.

2.2. *The main supervisory/resolution authority: the Finanzmarktaufsichtsbehörde (FMA)*

2.2.1. 2002: A new body in charge of financial market supervision – the FMA

Up until the year 2002, banking supervision was performed by the federal minister of finance (hereinafter referred to as BMF), together with the OeNB.[15] Since then a new authority, the FMA, has been in charge of the supervision and later on also of the resolution of banks (both together with the OeNB), and the supervision of the securities and the insurance market.[16] In this context, the FMA also assesses the supervised entities' compliance with anti-money laundering rules and rules countering the financing of terrorism (AML/CFT).[17] In the banking sector the FMA takes supervisory/resolution decisions (including the imposition of sanctions) *vis-à-vis* the supervised entities, while the OeNB supports the FMA by collecting data and making expert assessments (for the OeNB's powers see 2.3. below). The main federal statutes in this context are the *Finanzmarktaufsichtsbehördengesetz* (Statute on the FMA, FMABG), the *Bankwesengesetz* (Banking Code, BWG) and the *Bankensanierungs- und -abwicklungsgesetz* (Statute on bank recovery and resolution, BaSAG). The FMA's organisation follows the model of authorities created some years earlier for the supervision of the agricultural and the securities market,[18] respectively, and was an attempt to keep up with international trends, as reflected upon e.g. in a recommendation of the Basel Committee on Banking

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14 This abbreviation stands for *Verwaltungsgerichtshof*.

15 This abbreviation stands for *Bundesfinanzminister*. The BMF so far has prepared most of the legislation in the field of financial market law (which was subsequently adopted by the Parliament). In this context, the correlation of executive action and legislative initiative by one authority may have had a positive effect on the quality of the (prepared) legislation. This synergy effect has disappeared after 2002; see B. Raschauer, *Finanzmarktaufsichtsrecht*, cit., 102; for the cooperation between BMF and OeNB before 2002 see O. Schütz, *Bankenaufsicht neu – Die Zusammenarbeit von FMA und OeNB aus Sicht der Praxis*, in C. Jabloner, O. Lucius, A. Schramm (eds), *Theorie und Praxis des Wirtschaftsrechts. Festschrift für H. René Laurer* (Springer, 2009), 497-500.

16 For the transferral of officials of the BMF to the FMA see § 15 FMABG.

17 See in this respect the Commission's legislative proposal COM(2021) 421 final, suggesting the establishment of an EU agency for AML CFT.

18 For the outsourcing of securities supervision to a newly established authority in 1996 and the related legal debates (including the VfGH's case law) see M. Oppitz, *Kapitalmarktaufsicht* (Linde, 2017), 115-117. This authority was replaced by the FMA in 2002.

Supervision (BCBS).[19] According to the legislative proposal of the federal government on the creation of the FMA, there was no EU law obliging Austria to reform its financial market supervision in that way, though.[20]

The FMA was created as an independent authority,[21] that means it cannot be the subject of instructions from any (Austrian) public authority. Its decisions can be reviewed by the *Bundesverwaltungsgericht* (one of the two lower administrative courts of the Federation)[22] whose judgments may again be reviewed by the VwGH and/or the VfGH. At the time of the establishment of the FMA, an authority not integrated in the hierarchical organisation of (direct or indirect) federal administration (including the submission to instructions from the respective higher or highest authority) was a rare exception and, according to the VfGH's case law, constitutional only under strict conditions.[23] Meanwhile, the pertinent Article 20 para 2 B-VG has been amended by a two thirds majority in the *Nationalrat* and is now much more allowing, not least to ensure the constitutionality of national authorities which – as a matter of Union law – need

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19 For further relevant international sources see EBA, Report on the supervisory independence of competent authorities, EBA/REP/2021/29, 88 f. (Annex 3). The underlying reason for these pleas for independent supervisors is that 'the financial system rests on one major support – confidence'; D. Wood, *Governing Global Banking. The Basel Committee and the Politics of Financial Globalisation* (Ashgate, 2005), 6, with further references. It is this longing for customers' trust in the financial system that may lead to irrational decisions on the part of the supervisors. Supervisors which are largely shielded from political influence may be more likely to withstand this temptation and to take rational decisions. This viewpoint can be criticised as it questions the suitability of politicians (accountable to the people) to do what they are destined to do, that is to take difficult decisions; with regard to the FMA's (reduced) democratic accountability see B. Raschauer, 'Die Zulässigkeit der Übertragung von öffentlichen Aufgaben auf ausgegliederte Rechtsträger und Private vor dem Hintergrund der parlamentarischen Kontrolle', in P. Bussjäger (ed), *Parlamentarische Kontrolle und Ausgliederung* (Braumüller, 2009), 19, 30; see also 3.1.1. below.

20 See the government proposal RV 641 BlgNR XXI. GP 65; however, it is to be noted that the EU's influence on the BCBS is considerable; see D. Fromage, *The (multilevel) articulation of the European participation in international financial fora: the example of the Basel Accords*, (2022) 23 Journal of Banking Regulation, 54.

21 See also C. Johler, *§ 69*, in M. Dellinger (ed), *Bankwesengesetz* (LexisNexis, 2016), para 68 f. Because of the lack of a constitutional majority in the *Nationalrat* in 2001 (when the FMA's founding statute was adopted), the FMA's independence could be introduced only later, but in time for its taking up of operations on 1 April 2002; see H.P. Rill, *Verfassungsrechtliche Fragen der Finanzmarktaufsicht*, in Österreichische Juristenkommission (ed), *Neuere Entwicklungen des österreichischen Bankenrechts im europäischen Zusammenhang – eine verfassungsrechtliche und grundrechtliche Analyse* (Neuer Wissenschaftlicher Verlag, 2002), 29, 33; on the FMA's independence see also A. Schramm, *Finanzmarktaufsicht verfassungsrechtlich abgesichert. Oder: Wie man die Verfassung weiter demontiert*, (2003) Juristische Blätter, 19. Arguably, it was not the proposed freedom from instructions of the FMA that lead the opposition in the *Nationalrat* to initially refuse its consent, but other concerns; see here and the statements of MPs from the opposition parties in the stenographic minutes of the session in the *Nationalrat* in which the constitutional majority was eventually achieved, 159 and 165.

22 For the general lack of suspensory effect of the underlying complaints (unless they relate to administrative sanctions) according to § 22 para 2 FMABG and the repeal of this provision see VfGH, 2 March 2018, G257/2017; for the even more restrictive regime in resolution law see § 118 BaSAG (and Article 85 BRRD).

23 See in particular VfGH, 14 March 1996, in cases B2113/94, B2114/94, B2126/94, B663/95.

to operate independently from any other (public) authority.[24] After all, and in spite of the principle of procedural and institutional autonomy, in a variety of cases EU secondary law requires the Member States to provide for independent authorities in charge of executing this secondary (and related national) law. An example for this is the Austrian energy authority *E-Control* which was, due to the requirements of Directives 2009/72/EC and 2009/73/EC, created as an independent authority.[25]

2.2.2. The FMA today: organisation, cooperation and independence

The FMA is a legal person established by public law (i.e. not established on a private law basis, like e.g. a *GmbH*, that is a limited liability company), seated in Vienna[26] and largely[27] financed by the contributions of the supervised entities.[28] It is represented by the Executive Board (*Vorstand*), composed of two full-time chairpersons appointed by the Federal President of Austria for five years (with the possibility of a reappointment) on a proposal by the Federal Government (following the nomination of one candidate each by the BMF and the OeNB).[29] A reduction to one chairperson (with the OeNB losing its right to nominate) and the introduction of a new management layer below the chair – one executive director each for banking, insurance and securities – was planned under the centre-right government 2017-2019 as part of a larger reform of financial market supervision in Austria. After the disintegration of the coalition, this reform was off the agenda under the subsequent centre-green government.[30] The Executive Board leads the operations of the FMA.[31] For that purpose, it normally meets

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[24] For the limitations to this regime see B. Raschauer, *Finanzmarktaufsichtsrecht*, cit., 94; for its relevance in the context of the FMA see M. Oppitz, *Kapitalmarktaufsicht*, cit., 125, with many further references.

[25] See § 5 para 2 Energie-Control-Gesetz, Federal Law Gazette I No. 110/2010; with regard to Article 20 para 2 B-VG see ErlRV 994 BlgNR XXIV. GP 10; sceptically: B. Müller, *"Agentur hat Konjunktur" – "Agencification" und demokratische Verwaltungslegitimation*, in G. Lienbacher, G. Wielinger (eds), *Jahrbuch Öffentliches Recht 2011* (Neuer Wissenschaftlicher Verlag, 2011), 261, 271; for the sectors energy and banking see M. Oppitz, *Der unions- und verfassungsrechtliche Rahmen aufsichtsbehördlichen Handelns*, in F. Rüffler, N. Raschauer (eds), *Reform der Finanzmarktaufsicht. Verfassungs- und verfahrensrechtliche Aspekte* (Manz, 2018), 1, 16 f. and 20.

[26] § 1 paras 1 f. FMABG; sceptical as regards the original necessity of granting legal personality in case of the FMA: B. Raschauer, *Finanzmarktaufsichtsrecht*, cit., 93, with further references. He argues that only in view of its new competences under the SRM, e.g. to acquire shares of a bridge institution, the FMA's legal personality is *legally* necessary.

[27] That means to nearly 90%; see EBA, Report on the supervisory independence of competent authorities, EBA/REP/2021/29, 38, with a comparison to banking supervisors in other Member States.

[28] Apart from that, the Federation contributes to the financing of the FMA; see § 19 FMABG; for the compliance of this regime with the Federal Constitution see VfGH, 30 September 2002, B891/02 and others.

[29] For further details of their appointment see § 5 FMABG. For the termination of office see § 7 leg. cit.

[30] See here and here; for the implemented parts of the reform see here.

[31] § 6 para 1 FMABG.

biweekly and takes its decisions unanimously.[32] The Executive Board is controlled by the Supervisory Board (*Aufsichtsrat*), to which it submits a quarterly report.[33]

The Supervisory Board is composed of its chairperson, its deputy chairperson and six further members who are all appointed by the BMF. For the posts of the deputy chairperson and three further members of the Supervisory Board the OeNB shall designate appropriate candidates.[34] In addition to that, the Supervisory Board shall co-opt two persons named by the Austrian Economic Chambers. They do not have a right to vote. The term of office for members of the Supervisory Board is five years, a reappointment is possible.[35] The Supervisory Board normally meets once every three months. For its decisions to be adopted a simple majority and the presence of at least four of its voting members (including either the chairperson or the deputy chairperson) are required.[36] Particularly important decisions of the Executive Board, e.g. certain investments or borrowings, or the adoption/amendment of the FMA's Rules of Procedure, require the approval of the Supervisory Board.[37]

The FMA is advised by and reports to the Financial Market Stability Board (*Finanzmarktstabilitätsgremium*), an advisory body in charge of macroprudential supervision situated at the BMF, which is composed of experts from the ministry, the FMA itself, the OeNB and the Fiscal Advisory Council (*Fiskalrat*), an independent body in charge of 'monitoring the fiscal discipline of government entities in Austria.'[38] This composition should allow for bringing together the perspectives of all actors involved in financial market supervision. It aims at ensuring the exchange of information between the bodies involved.[39] The Financial Market Stability Board may address recommendations to the FMA, thereby pointing at risks to financial stability. The FMA has to justify any non-compliance with these recommendations – both in matters of banking supervision and bank resolution.[40] Since they focus on financial stability as a whole[41] and do not qualify as (binding) instructions within the meaning of § 1 para 1 FMABG, the FMA's constitutionally guaranteed independence is not affected by this constellation. Neither does this seem to go against the requirements of

32 § 4 of the FMA's Rules of Procedure.

33 § 6 para 5 FMABG.

34 § 8 para 1 FMABG. For the time being, these Board members are not only designated by but also come from the BMF and the OeNB, respectively; see here.

35 § 8 FMABG.

36 § 9 FMABG.

37 For further details see § 10 FMABG.

38 For the Financial Market Stability Board see §§ 13 f. FMABG; for further information on the Fiscal Advisory Council see here.

39 See O. SCHÜTZ, *Bankenaufsicht neu*, cit., 497, 507 (with regard to the predecessor committees).

40 § 13a FMABG.

41 This focus makes recommendations on the supervision/resolution of single banks unlikely; for the threat such recommendations would pose to the FMA's independence see O. SCHÜTZ, *Bankenaufsicht neu*, cit., 507.

Article 19 SSM Regulation on the ECB's and National Competent Authorities' (NCA's) independence.

Notwithstanding its independence, the FMA as a whole is supervised by the BMF to ensure that it completes its legally prescribed tasks, that it does not violate any law when performing these tasks and that it does not overstep its remit.[42] For that purpose, the FMA has to report to the BMF and to the financial committee of the *Nationalrat* (which again controls the Federal Government, to which the BMF belongs).[43] The FMA meets this obligation by adopting annual reports which are also published online.[44]

As regards the internal organisation of the FMA, the management positions below the Executive Board are those of heads of department (*Bereichsleiter*) and heads of division (*Abteilungsleiter*).[45] There are six departments within the FMA (I: Banking Supervision, II: Insurance and Pension Supervision, III: Securities Supervision, IV: Integrated Supervision, V: Services, VI: Banking Resolution) which may again be divided in various divisions.[46] Apart from that, there are two internal bodies which do not qualify as departments, but are still obliged to report directly to the Executive Board, namely 'Enforcement and Law' and 'Internal Audit.' The former is i.a. in charge of legal questions concerning the FMA as an organisation, certain administrative sanctioning procedures against financial institutions or official searches on their premises.[47] The latter internal body is i.a. in charge of examining the lawfulness, the regularity and the expediency of the FMA's actions (e.g. in the context of procurement procedures initiated by the FMA).[48]

2.2.3. The resolution of banks: some particularities within the FMA

The FMA is not only in charge of banking supervision (together with the OeNB) and hence supervisory authority, under the SRM it also functions as

42 See N. Raschauer, *Art. 16 FMABG*, in M. Gruber, N. Raschauer (eds), *Wertpapieraufsichtsgesetz: Kommentar* (LexisNexis 2011), para 2 with regard to the various dimensions of the supervision exerted by the BMF; for the BMF's power to ask the FMA to perform specific examinations pursuant to § 16 para 4 FMABG (against the background of the FMA's independence) see *ibid.*, para 12. For the BMF's role in other areas of financial market law see B. Raschauer, *Finanzmarktaufsichtsrecht*, cit., 101 f.

43 § 16 para 1 FMABG; see M. Oppitz, *Kapitalmarktaufsicht*, cit., 128; for the particular role of State Commissioners (*Staatskommissäre*), to be appointed by the BMF but subject to instructions by the FMA, and other supporting organs see *ibidem*, 130-133 and here; see also N. Raschauer, *Aktuelle Strukturfragen des europäischen und österreichischen Bankenaufsichtsrecht* (Springer, 2009), 809 ff.; B. Raschauer, *Finanzmarktaufsichtsrecht*, cit., 105 f.

44 See here.

45 §§ 5 f. of the FMA's Rules of Procedure.

46 See organisation chart; for the tasks assigned to these departments and divisions see § 11 (2)-(7) of the FMA's Rules of Procedure.

47 These searches are normally performed by the OeNB upon request by the FMA; see 2.3. below.

48 For the tasks of these internal bodies see § 11 (1) of the FMA's Rules of Procedure.

recovery and resolution authority (again supported by the OeNB).[49] Because the legislator did not intend to found a new authority, within the FMA a new organisational branch (Division VI: Banking Resolution) was established which is exclusively in charge of recovery and resolution tasks,[50] as laid down particularly in Regulation 806/2014 (SRM Regulation) and Directive 2014/59/EU (BRRD; as transposed into Austrian law by the BaSAG).[51] These tasks need to be performed independently from the FMA's supervisory competences.[52] This is because EU law does not only require the independence of supervisory and resolution authorities, it also demands the independence from each other.[53]

The head of the FMA's recovery and resolution branch is subordinated directly to the FMA's Executive Board and needs to report only to the two chairpersons.[54] FMA officials may work either in the supervisory or in the recovery and resolution branch, not in both at once.[55] At the same time, both branches ought to cooperate closely with each other. This is relevant above all because in the context of bank resolution not all powers are exercised by the resolution authorities. In a number of cases the SRM Regulation and the BRRD also provide for the involvement of supervisory authorities, e.g. with regard to early intervention measures or the assessment of recovery plans.[56]

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49 See § 3 para 1 BaSAG, referring to Article 3 para 1 No. 3 f. SRM Regulation; see also § 11 (7) of the FMA's Rules of Procedure. From a constitutional perspective, the VfGH does not appear to have reservations against vesting the FMA with banking resolution powers; VfGH, 3 July 2015, G239/2014 and others, V14/2015 and others; sceptical: B. Raschauer, *Finanzmarktaufsichtsrecht*, cit., 94, with further references.

50 See B. Raschauer, *Finanzmarktaufsichtsrecht*, cit., 93, who speaks, in this context, of organisational 'duplication' by means of a kind of cell division ['in einer Art Zellteilung organisatorisch "verdoppelt"'].

51 While the BaSAG, as mentioned above, aims at transposing the BRRD, it also supports the taking effect of the SRM Regulation; see Article I BaSAG ('Umsetzungshinweis') and VwGH, 6 April 2021, Ra 2021/02/0018, para 15. The BaSAG is to be interpreted in accordance with Union law (in particular the BRRD and the SRM Regulation). In case of a collision between the BaSAG and the SRM Regulation the latter prevails.

52 A similar situation under the SSM occurs at the EU level: monetary policy and banking supervision, both of which are performed by the ECB, are to be strictly separated within this institution ('Chinese walls'); see also P. Weismann, *The ECB's Supervisory Board under the Single Supervisory Mechanism (SSM) – a Comparison with European Agencies*, (2018) European Public Law, 311, 322-324, with further references.

53 Article 3 para 3 BRRD takes a relative perspective, requesting the mutual independence of supervision and resolution; see also Article 3 of the SRB's Code of Conduct, SRB/PS/2020/16. The operational independence of the FMA as a resolution authority was challenged before the VwGH which, however, examined the underlying concerns only in a preliminary manner, and eventually refused them; VwGH, 13 July 2020, Ro 2020/02/0001, paras 13 f.

54 The recovery and resolution branch eventually was organised as a department. The above requirements (direct subordination, reporting duties) apply to the heads of all departments within the FMA. Thus, the recovery and resolution department is not treated differently from the other departments.

55 § 3 para 3 BaSAG.

56 See e.g. Article 27 para 1 and Article 5 para 1 BRRD; see also M. Cossa, R. D'Ambrosio, *Recovery plans, early intervention measures and structural measures*, in R. D'Ambrosio (ed), *Law and Practice of the Banking Union and of its governing Institutions (Cases and Materials)*, Quaderni di Ricerca Giuridica della Consulenza Legale della Banca d'Italia No. 88, April 2020, 287; for the requirement of a close cooperation see also Article 3 para 4 BRRD.

Apart from that, not only the OeNB shall cooperate with the FMA's recovery and resolution branch and *vice versa*,[57] but also the BMF plays a considerable role in bank resolution. It is the 'competent ministry' according to Article 3 para 5 BRRD which is involved in the application of government financial stabilisation tools according to Article 56 BRRD.[58] The FMA (as a resolution authority) has to report to it and, where a resolution decision has immediate fiscal or systemic effects, ask for its approval.[59] Prior to the introduction of the SRM, the FMA's action only exceptionally required the consent of the BMF, in particular for the adoption of general rules by the FMA.[60] Under the BaSAG it has become more varied and more frequent.[61] This nuances the FMA's independence from the BMF in bank resolution matters (see also 2.4.1. below).

2.3. The role of the Oesterreichische Nationalbank (OeNB)

Apart from the FMA and, to a limited extent, the BMF, also the OeNB plays a role in the supervision and resolution of banks. The OeNB is Austria's central bank. In its monetary policy function (as part of the ESCB), it is independent and may, in principle, receive instructions only from the E(S)CB.[62] The OeNB is a legal person established in accordance with private law (incorporated company with a share capital of EUR 12 million owned entirely by the Federation[63]), seated in Vienna.[64] It can only be wound up by an act of federal legislation.[65] Its lead organs are the Board of Directors (*Direktorium*) and the General Council (*Generalrat*).[66] The Board of Directors is the OeNB's management organ, composed of Governor (*Gouverneur*), Deputy Governor (*Vize-Gouverneur*) and

57 § 3 paras 4 and 5. BaSAG; see also FMA-OeNB-Memorandum of Understanding (2020) 9 f.; hereinafter: FMA-OeNB-MoU.

58 § 3 para 2 BaSAG; for the involvement of the competent ministry see also Recital 96 BRRD.

59 § 3 para 6 BaSAG.

60 See e.g. § 13b para 2 FMABG, § 39 para 5 BWG or § 26 para 5 *Zahlungsdienstegesetz* (Statute on payment services).

61 See e.g. § 83 para 3 or Article 123b para 2 BaSAG. The BMF also decides, upon a proposal from the FMA, which FMA official shall act as a representative in the plenary sessions of the SRB; § 3 para 13 BaSAG.

62 See § 2 para 5 *Nationalbankgesetz* (Statute on the national central bank, NBG) and the foundation of the national central banks' independence in EU law, i.e. Article 130 TFEU. Under special regimes it may (exceptionally) be subject to instructions, though; see e.g. § 2 in conjunction with § 10 para 2 *Sanktionengesetz*, i.e. provisions on the OeNB's competence to freeze assets and related competences in transposition of sanctioning measures taken by the UN or the EU, requiring the approval by the Federal Government and the main committee of the *Nationalrat*, respectively, for regulations the OeNB adopts in this context, and laying down instruction rights of the BMF; see also FMA-OeNB-MoU, 11; for the E(S)CB's instructions see Article 12.1 subpara 2 Statute of the E(S)CB; see also §§ 1 and 32 para 1 NBG.

63 §§ 8 f. NBG. Before 2010 ownership was more diverse and involved interest groups, banks and insurance companies. Since then the Federation has owned 100% of the OeNB's shares. In 2011 this was even made a legal requirement.

64 § 2 para 1 and § 6 NBG.

65 § 78 NBG.

66 For another important body, the *Generalversammlung* (general meeting), and its tasks see §§ 10 and 15 f. NBG.

two further members, all appointed by the Federal President upon a proposal from the Federal Government for a (renewable) period of six years. It represents the central bank and regularly reports to the General Council. The department 'central bank policy' is headed by the Governor and the department 'financial market stability, banking supervision and statistics' is headed by the Deputy Governor.[67] The General Council is composed of its President, Vice-President and eight further members (often encompassing representatives of banks and other companies, professors and officials of the BMF), each appointed by the Federal Government for a (renewable) period of five years. It regularly meets once a month and monitors the activities not falling within the remit of the ESCB.[68] Otherwise it consults the Board of Directors and takes part in the OeNB's decision-making.[69]

The OeNB's role in the supervision and resolution of banks is entirely different from its position with regard to monetary policy. While the FMA clearly takes the lead, the OeNB supports the FMA. In contrast to this subordination, the OeNB has an influence on the composition of the FMA's organs (see 2.2.2. above).[70]

In the field of banking supervision, the OeNB acts as an expert body which submits opinions and may provide its assessment or perform, upon request by the FMA, examinations on banks' premises.[71] It also collects data from credit and financial institutions on loans and loan risks in accordance with § 75 BWG.[72] In the field of bank resolution the division of roles and the cooperation set-up are similar. Here again the FMA is in the driving seat, while the OeNB has a variety of supporting competences ranging from receiving and complementing information from the FMA or banks,[73] uttering its opinion,[74] allowing for access to information[75] or performing on-site inspections.[76]

The practical details of the cooperation between FMA and OeNB are laid down in a Memorandum of Understanding (MoU) concluded between these two bodies. It fleshes out the distribution of tasks according to the pertinent laws. Fit & proper-procedures and procedures on bank authorisations or the assessment of acquisitions, for example, belong to the tasks of the FMA, whereas analyses on business models or on loan, market and operational risks are for the OeNB to set up.[77] More generally, the MoU stresses the importance of principles such as fair

67 For more details on the internal structure of the ECB see here.

68 § 20 NBG.

69 § 21 NBG.

70 Critical: M. Oppitz, *Kapitalmarktaufsicht*, cit., 126 f.

71 See § 70 para 1 No. 3 or § 70a para 2 BWG; for the FMA's own use of examination rights see VwGH, 15 June 2023, Ro 2021/02/0011.

72 Further competences are laid down in particular in § 70 BWG.

73 See e.g. §§ 4a, 114 para 3 No. 5 and § 116 para 5 No. 4 BaSAG.

74 See e.g. §§ 4 para 3 and 115 para 2 BaSAG.

75 § 3 para 4 BaSAG.

76 §§ 44 para 1 No. 9 and 113a para 2 BaSAG.

77 See FMA-OeNB-MoU, 5.

cooperation, comprehensive and timely exchange of information, proportionality or cost-consciousness.

There has been a cooperation between the FMA and the OeNB for more than 20 years now. The dual system of banking supervision in Austria bears the risk of a duplication of bureaucratic structures. While it was one of the aims of a legislative reform in 2008 – which led to the reinforcement of the OeNB's powers – to do away with them,[78] even after the reform the co-existence of two actors in banking supervision remains challenging and requires a good deal of pragmatism to work smoothly.[79] In 2017 the *Rechnungshof* (Federal Court of Auditors, RH) recommended to consider potential cost efficiencies which could be achieved if banking supervision was performed by only one actor.[80] Should the legislator decide to maintain the dual system, though, the RH demands an improvement of the cooperation between the FMA and the OeNB in the case of on-site-inspections at the premises of supervised entities.[81] In a study from 2020 on bank resolution the RH pressed, among other things, for increased time efficiency and a more comprehensive consideration of the available information in the FMA on the one hand and the OeNB on the other hand. While it also criticised the long time the two bodies took to set out the details of their cooperation, it did not principally question the dual structure in the field of bank resolution.[82]

2.4. The FMA/OeNB as part of the SSM/SRM

2.4.1. The compatibility of the FMA/OeNB structure with EU law

The most important EU law requirements with regard to the national authorities operating in banking supervision are the following: Article 2 para 1 No. 40 Regulation 575/2013 (Capital Requirements Regulation, CRR) defines as a competent authority a 'public authority or body officially recognised by national law, which is empowered by national law to supervise institutions as part of the supervisory system in operation in the Member State concerned.'[83] This is also the definition to which the SSM Regulation refers in its Article 2 para 2. Directive 2013/36/EU (Capital Requirements Directive, CRD) adds that there may be

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78 This reform is laid down in Federal Law Gazette I No. 2007/108; see FMA/OeNB, Bankenaufsicht in Österreich (unknown year of publication) 7 and *passim*; A. Schramm, *Die neue Systematik der Bankenaufsicht in Österreich – Teil 1*, (2008) Zeitschrift für Finanzmarktrecht, 48; A. Schramm, *Die neue Systematik der Bankenaufsicht in Österreich – Teil 2*, (2008) Zeitschrift für Finanzmarktrecht, 99; O. Schütz, *Bankenaufsicht neu*, cit., 497, 500 ff.

79 See O. Schütz, *Bankenaufsicht neu*, cit., 516.

80 In 2019, the centre-right government planned to transfer most supervisory tasks of the OeNB to the FMA – a reform which was highly contested and eventually failed together with the government; see here and here.

81 RH, Bericht: Österreichische Bankenaufsichtsarchitektur (20/2017), final recommendations 2, 21-23 on the one hand and 10-12 on the other hand.

82 RH, Bericht: Bankenabwicklung in Österreich (18/2020), 39 and 152-158.

83 In addition to that, (participating) Member States must dispose of a 'designated authority' (in Austria this is again the FMA); see Article 2 No. 7 SSM Regulation which (implicitly) refers to Article 458 para 1 Regulation 575/2013 or Article 136 para 1 Directive 2013/36/EU.

'competent authorities' (plural) in the Member States and that the Commission and the EBA shall be informed of 'any division of functions and duties' between them (Art 4 para 1).[84] It further demands that competent authorities have 'the expertise, resources, operational capacity, powers and independence necessary to carry out the functions relating to prudential supervision, investigations and penalties set out [in the CRD and the CRR]' (Art 4 para 4).[85]

In addition to that, Article 19 para 1 SSM Regulation stresses that the competent authorities of the participating Member States shall 'act independently.'[86] This provision which also deals with the independence of the members of the Supervisory Board and the steering committee suggests that independence essentially means freedom from influence by other bodies, e.g. Member States' governments.

With regard to the resolution of banks, EU law requires that each Member State has 'one or, exceptionally, more resolution authorities.' They shall have the status of 'public administrative authority or authorities entrusted with public administrative powers' (e.g. national central banks, competent ministries). The relevant powers may 'exceptionally' be exercised by the competent supervisory authority.[87] Where the authority in charge in a Member State does not only have responsibilities regarding the resolution of banks, the Member State shall provide for the 'operational independence' of the resolution branch from the other branch(es), e.g. the supervisory branch, of the authority. This includes the structural separation of staff. Nevertheless, the actors in charge of supervision and resolution shall 'cooperate closely in the preparation, planning and application of resolution decisions.'[88]

With a view to shielding resolution authorities from external influences, Article 47 para 1 SRM Regulation requests them to 'act independently and in the general interest.' This is confusing: On the one hand, the BRRD allows for ministries to act as resolution authorities, on the other hand the SRM Regulation requires the resolution authorities' independence. Even though the

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84 It can be doubted whether that actually means that Member States are entitled to have two 'competent authorities' within the meaning of Article 2 para 1 No. 40 CRR. But it certainly can be deduced that apart from the 'competent authority' there may be another authority (regularly the national central bank) which exercises selected supervisory powers; see here. The SSM Regulation explicitly refers to the possibility of installing the respective national central bank as competent authority (Article 26 para 1 subpara 2).

85 For similar requirements in other pertinent acts, e.g. Directive 2015/849 (AML-CFT-Directive) see EBA, Report on the supervisory independence of competent authorities, EBA/REP/2021/29, 86 f. (Annex 3).

86 See also Recital 83 SSM Regulation, according to which the SSM shall provide 'supervision of the highest quality, unfettered by other, non-prudential considerations'.

87 For the advantages and disadvantages of both options see R. D'Ambrosio, *The liability regimes within the SSM and the SRM*, in R. D'Ambrosio (ed), *Law and Practice of the Banking Union*, cit., 503, 524-526.

88 For this and the preceding criteria see Article 3 BRRD; for the sepration between supervision and resolution see also Article 4 para 7 CRD.

SRM Regulation explicitly refers to Article 3 para 3 BRRD twice,[89] it can be assumed that it is intended to introduce a threshold of independence which goes beyond that of the BRRD (which, as we have seen, does not focus on political independence, but on the independence from other branches).[90] In comparison to the independence required for competent authorities under the SSM Regulation, however, the SRM Regulation seems to lag behind. Given the fact that the SRM Regulation provides for different tasks of the Commission, the Council and the ECB, its concept of independence with regard to the SRB – and with regard to resolution authorities more generally – appears less demanding than the respective concept of the SSM.[91]

Against the background of these requirements under EU law, the institutional set-up in Austria is to be assessed as follows. The distribution of supervisory and resolution tasks between the FMA and the OeNB, with the FMA being the 'competent authority' and the 'resolution authority' arguably is in compliance with EU law. Also the fact that one and the same authority, the FMA, takes the lead in both areas – supervision and resolution – is 'exceptionally' covered by EU law, given the structural separation of the two branches within the FMA. While we have not closely examined these bodies in respect of their expertise, resources, operational capacity and powers, it can be assumed that the respective requirements of the CRD are met. The critical question here is, beyond doubt, whether the set-up meets the degree(s) of independence provided for in EU law. Here we shall focus on the FMA as the lead authority in both branches. The financial independence seems to be sufficient, given the FMA is largely financed from banks' contributions.[92] In terms of the personal independence we have seen that the OeNB and, even more so, the BMF and the Federal Government determine the personal composition of the decision-making boards within the FMA. In particular the influence of political organs like the BMF is to be assessed critically in the context of personal independence, and practice shows that political influence is indeed exerted, both on the FMA and on the OeNB.[93]

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89 See Recital 25 and Article 19 para 1 SRM Regulation.

90 See also German *Bundesverfassungsgericht*, 30 July 2019, 2 BvR 1685/14 and 2 BvR 2631/14, para 283.

91 This seems to marry well with the distinction which is made between the 'interest of the Union' and the 'general interest'; see below. For the relationship between the SRB, the Commission and the Council in terms of 'operational independence' see Recital 26 SRM Regulation; see also Opinion of AG *Ćapeta* in case C-551/22P *Commission/SRB,* ECLI:EU:C:2023:846, para 101 (and in particular its footnote 84). That EU law applies varying degrees of independence, sometimes even for one and the same body – depending on the concrete task at issue –, was made clear in case C-45/21 *Banka Slovenije*, ECLI:EU:C:2022:670, para 95.

92 See the FMA's self-assessment in EBA, Report on the supervisory independence of competent authorities, EBA/REP/2021/29, 90 (Annex 4); see also the principles recently published by the ESAs: Joint European Supervisory Authorities' criteria on the independence of supervisory authorities, JC 2023 17, 14.

93 See here and here. These cases illustrate how thin the line between legitimate 'institutional relations' and illegitimate 'close relationships' at times may become; see Joint European Supervisory Authorities' criteria on the independence of supervisory authorities, JC 2023 17, 11 (para 42).

Below this level the FMA's freedom e.g. to hire employees and to increase their salary seems to be satisfactory.[94]

In terms of operational independence, we need to distinguish between the supervisory and the resolution branch. As argued above, EU law sets a higher threshold with regard to supervision. While the FMA is mostly only supported by the OeNB (which is why there does not seem to be undue influence of this body), the FMA is influenced by the BMF. The latter has to consent to general administrative rules (so-called *Verordnungen*) of the FMA. Otherwise the BMF monitors the FMA – e.g. in respect of the lawfulness of its actions – on the basis of the reports it has to submit.[95] The FMA's reporting duties *vis-à-vis* the BMF (and the *Nationalrat*) amount to a classical measure of *ex post* control (accountability).[96] The BMF may not address instructions to the FMA. According to its self-assessment, the FMA can operate 'on a day-to-day basis without external political interference' and 'without interference from commercial or other sectoral interests'.[97] In the field of bank resolution the influence of the BMF on the FMA is broader in that both the decision-making powers of the BMF and the FMA's actions which require the consent of the BMF are more numerous. This may be seen as part of the more politicised character of bank resolution which is reflected upon also in the set-up at the EU level. The FMA's independence from the banking sector (i.e. from the supervised entities) appears to be sufficient.

In conclusion, it is to be remarked that, against the backdrop of EU law requirements, the FMA's financial independence is satisfactory; that the personal independence of the highest officials of the FMA leaves quite something to be desired;[98] that the FMA's operational independence is relativised by the powers of the BMF – more strongly in the field of recovery and resolution than in the field of supervision.[99] Whether this set-up meets the independence requirements laid down in pertinent EU law is hard to tell. After all, the legal concept of (operational)

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94 See the FMA's self-assessment in EBA, Report on the supervisory independence of competent authorities, EBA/REP/2021/29, 90 (Annex 4); see also § 14 FMABG.

95 Note the Joint European Supervisory Authorities' criteria on the independence of supervisory authorities, JC 2023 17, 7, and in particular the openness of the wording of para 10.

96 For this concept see M. Busuioc, *Accountability, Control and Independence: The Case of European Agencies*, (2009) 15 European Law Journal, 599, 607 f.

97 See EBA, Report on the supervisory independence of competent authorities, EBA/REP/2021/29, 90 (Annex 4). The rather recent report of the RH, Bankenaufsicht durch FMA und OeNB, BUND 2024/3, criticises a number of shortcomings in the set-up of Austrian banking supervision, but it does not specifically address the FMA's or the OeNB's independence.

98 Personal independence seems to leave room for improvement also in other Member States; see EBA, Report on the supervisory independence of competent authorities, EBA/REP/2021/29, 43 (with regard to the appointment/removal of members of the authority's governing body). For the personal independence of banking supervisors required as part of the second core principle for effective banking supervision of the BCBS see R. D'Ambrosio, *The SSM: Allocation of tasks and powers between the ECB and the NCAs and organisational issues*, in R. D'Ambrosio (ed), *Law and Practice of the Banking Union*, cit., 25, 68 f.

99 A relationship of the supervisor to a government ministry seems to be quite common in the Member States; see the FMA's self-assessment in EBA, Report on the supervisory independence of competent authorities, EBA/REP/2021/29, 15.

independence – even after its elaboration by the ESAs[100] – is malleable and it has different meanings in different contexts. With regard to the data protection supervisory authority pursuant to Article 28 Directive 95/46 the Court held that it should not only be free from instructions but also from 'indirect influence which is liable to have an effect on the […] authority's decisions'.[101] It appears that this is the most demanding standard of independence, given the fact that the above provision required the authority's 'complete independence' and given the fact that the Court later applied this threshold also to national courts.[102] On the other side of the scale there is the mere freedom from instructions. The requirements for national authorities under the Banking Union are somewhere between these two poles. Suffice it to say here that the FMA certainly meets the minimal requirement of independence, and that, in parallel to EU law, the degree of independence is higher in the supervisory branch than in the resolution branch. In comparison with the other Member States, the degree of independence the FMA as a supervisor disposes of is neither particularly high nor particularly low.[103]

2.4.2. The representation of the FMA/OeNB at the EU level

Representatives of Austrian authorities in the field of the supervision[104] and resolution of banks take part in the pertinent decision-making at the EU level in multiple ways. Officials of the FMA (as a banking supervisory authority) are represented in the EBA's Board of Supervisors[105] and in the ECB's body in charge of banking supervision, the Supervisory Board. The FMA is also represented in the General Board of the ESRB, though without voting rights. In its function as a resolution authority, the FMA is represented in the plenary sessions of the Single Resolution Board, the EU agency in charge of bank resolution.[106]

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100 Joint European Supervisory Authorities' criteria on the independence of supervisory authorities, JC 2023 17.

101 Case C-614/10 *Commission/Austria*, ECLI:EU:C:2012:631, para 43; see also case C-518/07 *Commission/Germany*, ECLI:EU:C:2010:125, para 42.

102 See case C-619/18 *Commission/Poland*, ECLI:EU:C:2019:531, para 112.

103 See EBA, Report on the supervisory independence of competent authorities, EBA/REP/2021/29. As a matter of course, this comparative position does not affect the question whether the requirements of independence under EU law are met.

104 This goes hand in hand with a role in the (delegated and implementing) regulation of banks, in particular in the context of the EBA.

105 The FMA is as well represented in the ESMA's and the EIOPA's respective Board of Supervisors and, for the time being, also in the ESMA's Management Board.

106 Interestingly, there appears to be a difference in the interests national representatives ought to serve. According to Article 26 SSM Regulation, the members of the Supervisory Board (including those coming from the MS) shall act in the interest of the Union as a whole. In the SRB, only the Chair, the Vice-Chair and the four full-time members shall act 'independently and objectively in the interest of the Union', whereas the Board as such and the national resolution authorities (arguably also if they participate in the SRB's plenary sessions) shall act only 'independently and in the general interest'. Thus, national representatives may pursue their respective national interests in resolution matters if that contributes to the general interest. The line between the two interests in practice will be difficult to draw and thus the effects of this nuancing seem to be limited, but it is remarkable that the EU legislator apparently acknowledged the fact that in resolution matters national interests may be less easy to renounce than in banking supervision; see M. Cossa, R. D'Ambrosio, A. Vignini, *The SRM: Allocation of tasks and powers between the SRB and the NRAs and organisational issues*, in R. D'Ambrosio (ed), *Law and Practice of the Banking Union*, cit., 315, 327.

The OeNB is represented in the Supervisory Board and the Governing Council of the ECB, as well as in the General Board of the ESRB.

On the level of the Joint Supervisory Teams (JST) – in charge of everyday supervision of banks – or in CRD-colleges of supervisors the FMA and the OeNB are represented if the concrete institution falls within their responsibility.[107] In matters of bank resolution, the FMA may be represented in internal resolution teams or resolution colleges.[108]

The BMF is represented in the Council (Ecofin) which is not only the core legislative body of the EU (next to the European Parliament), but also is involved in bank resolution (see Article 1 SRM Regulation).[109]

3. Constitutional requirements under the influence of EU law: selected questions

3.1. The constitutionally required independence of the FMA

3.1.1. The collision between national law and EU law

So far we have discussed the criterion of independence of national authorities under EU law (2.4.1.), but only briefly touched upon the FMA's independence under Austrian law (2.2.). We shall now take a closer look at this latter requirement. § 1 para 1 FMABG, a provision of constitutional law, stipulates that the FMA when performing its tasks shall not be bound by instructions.[110] This freedom from direct interference by third parties, in particular other authorities such as the BMF,[111] is an important component of the FMA's operational independence. The reason that this provision was adopted as constitutional law was the following: At the time of the FMA's establishment, the Constitution provided for a strictly hierarchical body of administrative authorities. Under this regime, only the highest administrative authorities (e.g. the Federal Government) were free from instructions. An independent administrative authority outside this regime was not provided for.[112] Thus, the Constitution had to be amended in order to render the creation

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107 See the Annual Report of the Financial Market Authority (2022), 67 f.

108 For these two bodies see here.

109 Since Austria belongs to the Eurozone, the BMF also participates in the Euro Group.

110 Even though this provision in its first sentence explicitly refers only to financial market supervision, not to bank resolution, the FMA's independence is imperative also in the latter field. This is not least due to the requirement of the national resolution authorities' independence as laid down in Article 47 para 1 SRM Regulation. The wording of the second sentence of § 1 para 1 FMABG does not itself suggest, but it allows for this interpretation, because it only says that 'it' (i.e. the FMA) shall not be bound by instructions when performing its duties. The VfGH seems to support this interpretation (in accordance with EU law); VfGH, 3 July 2015, G239/2014 and others, V 14/2015 and others; sceptical: M. Oppitz, *Kapitalmarktaufsicht*, cit., 124.

111 For the still existing monitoring role of the BMF see 2.2.2. and 2.2.3. above.

112 Meanwhile the pertinent Article 20 para 2 B-VG has been amended; see 2.2.1. above.

of the FMA as a new independent authority lawful. As mentioned earlier, the legislator thereby sought to adapt Austrian financial market supervision to international standards, in particular to recommendations set up by the BCBS and its sister organisations, the IOSCO and the IAIS[113].[114]

This constitutional guarantee contrasts with the EBA's and, even more so, the ECB's and the SRB's competences to give instructions to the FMA. The FMABG and the BaSAG take account of these competences.[115] With regard to the EBA, for example, the FMABG does not only oblige the FMA to fully cooperate (§ 21a para 1 No. 1), it also provides for special ('integration-friendly') procedural rules for cases in which the EBA acts (in a legally binding or in a legally non-binding way) on the basis of Article 17, 18 or 19 of the EBA Regulation, be it *vis-à-vis* the FMA or *vis-à-vis* a supervised entity (§ 21b).[116] Also in the BaSAG the legislator obliges the FMA to cooperate with the relevant EU bodies and to follow the guidelines, recommendations and other measures taken by the EBA as well as the ESRB's warnings and recommendations. From 'these guidelines and recommendations' (*diese[] Leitlinien und Empfehlungen*) it may deviate only for justified reasons, in particular where there is a conflict with federal law.[117] The legislator thereby partly allows for a higher authority of EU soft law than provided for in EU law itself.[118] Since this higher authority is laid down in regular law, it must not deviate from the constitutional provision of § 1 para 1 FMABG.

What looks like a conflict with constitutional law partly can be remedied with a view to the supremacy of EU law. Since the competences of the EBA, the ECB and the SRB to instruct national authorities like the FMA are rooted in EU law, deviating national law (even, for most parts, constitutional law)

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113 The abbreviations stand for International Organization of Securities Commissions and International Association of Insurance Supervisors.

114 See the legislative proposal of the Federal Government on the creation of the FMA: RV 641 BlgNR XXI. GP 65-67; see also the report of the parliamentary committee: AB 714 BlgNR XXI. GP 1.

115 See also P. Weismann, *Zur ebenenübergreifenden Verflechtung des Einheitlichen Aufsichtsmechanismus (SSM) aus Sicht des Unions- sowie des österreichischen Rechts*, (2021) 76 Zeitschrift für Öffentliches Recht / Journal of Public Law, 799, 826 with regard to the FMABG.

116 See also § 69 para 5 BWG on EBA and ESRB soft law; for national soft law to be considered by the FMA see § 13a FMABG.

117 § 3 para 12 BaSAG. Thereby the Austrian legislator seems to limit the scope for a deviation from EU soft law beyond the requirements of EU law; see e.g. Article 16 para 3 of the ESA Regulations which allows a deviation if (any) 'reasons' are given, or Article 16 para 2 ESRB Regulation which only provides for a 'specified timeline for the policy response' on the part of the Member States to be set, but does not otherwise limit the room for non-compliance. Also the relevant provision with regard to recommendations of the SRB, § 3a para 4 BaSAG, by setting a duty to give the reasons for non-compliance seems to go beyond the requirements of the SRM Regulation (which does not contain any such rule).

118 For the already high authority of legally non-binding norms under EU law see M. Busuioc, *Rule-Making by the European Financial Supervisory Authorities: Walking a Tight Rope*, (2013) 9 European Law Journal, 111, 118 f.; for EBA soft law see cases C-501/18 *Balgarska Narodna Banka*, ECLI:EU:C:2021:249, and C-911/19 *Fédération bancaire française (FBF)*, ECLI:EU:C:2021:599.

rests unapplied. The Austrian rules on the FMA's obligations with respect to pertinent EU soft law can still be criticised for limiting the FMA's independence beyond what EU law requires. At the same time, it could be argued that § 1 para 1 FMABG, interpreted in accordance with Union law (which, as was addressed above, itself requires the independence of the Member States' authorities), only aims at preventing undue interference from politically dominated authorities, such as the BMF, but does not prohibit instructions from supervisory and resolution authorities which are independent themselves, such as the EBA, the ECB and the SRB.[119] This seems to be in accordance with the international standards by which the legislator's choice to establish an independent financial market supervisory authority was inspired. The concept of independence pursuant to No. 2 of the BCBS's Core Principles for Effective Banking Supervision, for example, does not seem to reflect upon the peculiar constellation of different supervisory authorities on different levels of public administration interacting with each other with a view to supervising the same entities. The dedication to 'cooperation and collaboration' according to Principle No. 3 only relates to interaction between supervisors of different states, i.e. on the same level of public administration. In their original version, these principles were adopted in 1999 – when no EU bodies entitled to give instructions to national banking supervisors existed –, so the BCBS, unless it had clairvoyant abilities, could not possibly take this scenario into account. This holds true also for the Austrian legislator when it adopted § 1 para 1 FMABG in 2002.

Elaborating on this thought, an instruction by an independent body (active in the same administrative field) would not reduce the overall degree of independence. This is to say that, in a holistic perspective encompassing both the named EU bodies and the FMA, banking supervision in Austria is still independent as required by international bodies such as the BCBS, and thereby the Austrian legislator's objective when adopting § 1 para 1 FMABG is still met. This 'teleological reduction' of the wording of § 1 para 1 FMABG would avoid an instance of unconstitutionality. The argument that Austria has agreed to the SSM Regulation – after all, its legal basis, Article 127 para 6 TFEU, requires unanimity in the Council – may also serve as an argument supporting this approach.[120] When the competent Federal Minister in the Council agrees to a project affecting the Federal Constitution, the *Nationalrat*, according to Article 23e para 3 B-VG, may give its opinion on the matter and, if the Federal Minister deviates from this opinion when voting in the Council, may object within adequate time. The fact that the majority of the MPs supported the Commission's proposal on the creation of the SSM and that the question of

[119] See also F.A. Dechent, *Bundesanstalt für Finanzdienstleistungsaufsicht und Bundesanstalt für Finanzmarktstabilisierung – Unabhängige Behörden in der Bankenaufsicht?*, (2015) Neue Zeitschrift für Verwaltungsrecht, 767, 770.

[120] Also the SRM Regulation (the adoption of which would have required only a qualified majority) was adopted by a unanimous vote in the Council.

constitutionality was not discussed at all in parliamentary debates[121] suggests the implicit agreement of the *Nationalrat*.[122]

If one were to refuse the teleological reduction, the unconstitutionality would have to be affirmed, but the supremacy of EU law would prevent the application of § 1 para 1 FMABG to the extent it conflicts with the EBA's, the ECB's and the SRB's instruction powers. In terms of the application of the relevant provisions of the FMABG in practice, the result would be the same in both cases.

3.1.2. The personal dimension

The FMA's independence – or, *vis-à-vis* the EBA, the ECB and the SRB, rather: lack of independence – also has a personal dimension.[123] The most important decision-making bodies of the three EU authorities comprise representatives of the national banking authorities.[124] In the case of the EBA this is the Board of Supervisors, in the case of the ECB it is the Supervisory Board, the ECB's *quasi*-decision-making body in the field of banking supervision, and in the case of the SRB it is its plenary session.[125] In these three bodies[126] the FMA is represented by one of its two chairpersons. But also on lower decision-making levels the involvement of representatives of the national authorities is the rule. This concerns e.g. the JST which are of pivotal importance in day-to-day banking supervision.[127] They are established for each significant supervised entity or significant supervised group in the participating Member States,[128] composed of representatives of

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121 With regard to the SSM see here (report of the BMF); and here (stenographic protocol of the pertinent debate in the *Nationalrat*); with regard to the SRM see here (stenographic protocol of the pertinent debate in the *Nationalrat*).

122 It is to be noted that this implicit agreement in legal terms does not have the same rank as an (explicit) constitutional amendment. Nevertheless, it is to be taken into account in the interpretation of § 1 para 1 FMABG; for the interpretation of constitutional provisions in Austria see the recent publication of M. Potacs, *Die Auslegung der Verfassung*, in P. Bussjäger, A. Gamper, A. Kahl (eds), *100 Jahre Bundes-Verfassungsgesetz. Verfassung und Verfassungswandel im nationalen und internationalen Kontext* (Verlag Österreich, Schulthess, Nomos 2020), 109.

123 On this issue see also P. Weismann, *Zur ebenenübergreifenden Verflechtung des Einheitlichen Aufsichtsmechanismus (SSM) aus Sicht des Unions- sowie des österreichischen Rechts*, (2021) 76 Zeitschrift für Öffentliches Recht / Journal of Public Law, 799, 817 f.

124 See also M. Busuioc, *Rule-Making by the European Financial Supervisory Authorities*, cit., 111, 120-122, who argues that the representation of national supervisory authorities poses a risk to the ESAs' independence (to follow solely the interest of the EU).

125 Critical with regard to the representation of national authorities in the Supervisory Board: E. Wymeersch, *The Single Supervisory Mechanism: Institutional Aspects*, in D. Busch, G. Ferrarini, *European Banking Union* (Oxford University Press, 2015), 113.

126 Periodically also in the Supervisory Board's steering committee; see Article 26 para 10 SSM Regulation.

127 See ECB, *SSM Supervisory Manual* (2018), 11 f.

128 In Austria there are currently seven significant groups and three subsidiaries from significant credit institutions established in the Euro area. They are directly supervised by the ECB. On the other hand, about 350 (less significant) credit institutions are directly supervised by the FMA and the OeNB; see Annual Report of the Financial Market Authority (2022), 44.

the ECB and the national supervisors[129] concerned and chaired by an ECB staff member ('JST coordinator').[130] The members of the JST work on draft decisions and then vote on them.[131] Eventually, these draft decisions are sent to the Supervisory Board as a basis for its discussion on the decision-making proposal the Board will forward to the ECB Governing Council for adoption (non-objection). With regard to bank resolution, the internal resolution teams and the resolution colleges ensure the involvement of national authorities in everyday decision-making.

To summarise, it is apparent that representatives of the FMA are involved in various procedures aimed at (the preparation of) decision-making, be it in the EBA, the ECB, the SRB, or in subordinate bodies. The fact that all decisions taken by these bodies in the field of the supervision and resolution of banks are, or at least: may be, influenced by the respective representative of the FMA, slightly relativises the risk for the FMA's independence emanating from these decisions. Where consensus or, if a vote is taken, a large majority is aimed at in decision-making procedures of EU bodies,[132] each member – and hence also the FMA's representative – plays a significant role in the decision-making process. In this regime the groups of instructors (i.e. actors giving instructions) on the EU level (mainly) comprise representatives of the authorities which are (potentially) instructed. The personal intertwinement underpins the above image of a consolidated supervisory/resolution regime which is – overall – independent. Thus, instructions by one entity to another within this regime may appear hardly problematic, more like internal orders given in accordance with an internal hierarchy without which no (independent) administrative authority could work.

However, this conceptualisation, in the current stage of EU integration, appears to be overly simplistic. It envisages administrative cooperation under the SSM/SRM as part of a federalist organisation – a qualification which the EU, for the time being, does not meet. We still have different actors – two on the EU level and at least one per (participating) Member State on the national

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129 According to the FMA-OeNB-MoU, the Austrian representatives in the JST stem from both the FMA and the OeNB in accordance with the general distribution of tasks between these two bodies.

130 Article 3 para 1 and Articles 4-6 Regulation 468/2014 (SSM-Framework Regulation).

131 See here.

132 This holds true for the EBA (mostly involved in rule-making) and the SRB's executive session, i.e. the SRB's management organ; see Article 44 para 1 subpara 4 EBA-Regulation or Article 55 SRM Regulation. Consensus may be less easy to achieve (and in fact also less desirable) in the context of individual-concrete supervisory/resolution decisions. That may be the reason that for the Supervisory Board and the SRB's plenary session no aiming at consensus is provided for in the respective founding regulations (see e.g. Article 26 para 6 SSM Regulation); for the practice of administrative boards of European agencies more generally see N. Font, *Informal Rules and Institutional Balances on the Boards of EU Agencies*, (2018) 50 Administration & Society, 269, in particular 279 f.; M. Busuioc, M. Groenleer, *Wielders of supranational power? The administrative behaviour of the heads of European Union agencies*, in M. Busuioc, M. Groenleer, J. Trondal (eds), The agency phenomenon in the European Union: Emergence, institutionalisation and everyday decision-making (Manchester University Press, 2012), 128, in particular 131 f.

level. While the names of the relevant EU regimes may indicate uniformity ('European *System* of Financial Supervisors,' '*Single* Supervisory/Resolution Mechanism,' 'Banking *Union*'), there are still 27 or (in case of the SSM/SRM) 21 legal and administrative traditions in place, demanding consideration of their respective particularities.[133] The FMA's constitutionally guaranteed freedom from instructions is one of these particularities which, however, upon closer inspection (see 3.1.1. above) does not stand in the way of the instruction powers laid down in EU law or national regular provisions taking account of these instruction powers.

3.2. The FMA's power to sanction banks

3.2.1. The VfGH's settled case law

Another example for EU banking law touching upon Austrian constitutional law is the national supervisors' sanctioning power, as laid down in Article 66 para 2 lit c and 67 para 2 lit e of Directive 2013/36/EU (CRD).[134] According to these provisions, Member States are required to vest their respective national supervisors with the power to impose administrative pecuniary penalties of up to 10 % of the total annual net turnover of legal persons in the preceding business year in case of certain violations of requirements laid down in the CRR or the CRD.[135] The obvious purpose of these provisions is to cater for a minimum harmonisation of the pertinent sanctioning regimes in the Member States.[136] Member States are expressly allowed to provide for additional penalties or higher administrative pecuniary penalties.[137] Austria has implemented these provisions in § 99d BWG, thereby providing – in addition to what the CRD prescribes – an alternative penalty of up to twice the amount of the financial benefit resulting from the violation (as far as it can be quantified).[138]

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133 See also M. Almhofer, *Die Haftung der Europäischen Zentralbank für rechtswidrige Bankenaufsicht* (Mohr Siebeck, 2018), 281.

134 The financial sanctions imposed on banks have increased significantly over the past 20 years. In the US, sanctions still tend to be much higher than in the EU; see *Amerikas Banken zahlen am meisten*, FAZ No. 192 (20 August 2021), 23; for sanctions imposed under the SSM (at EU and at national level) see the ECB's Annual Report on Sanctioning Activities in the SSM in 2022; for a reinforced competence of the FMA to impose sanctions see already Federal Law Gazette I No. 48/2006; see N. Raschauer, A. Schramm, *Neue Enforcementregelungen im Finanzmarktaufsichtsrecht*, (2006) Zeitschrift für Finanzmarktrecht, 8.

135 For the sanctions national resolution authorities may impose see Article 111 para 2 BRRD.

136 See N. Raschauer, *§ 99d*, in R. Laurer *et al.* (eds), *BWG* (status 01.06.2020, 4th edn, rdb.at) para 2, with a further reference; for bank resolution see Recital 126 BRRD: 'similar treatment across the Union', 'essential requirements'.

137 Recital 41 of the CRD; for the imposition of 'absorption' interest on credit institutions see case C-52/17 *VTB Bank (Austria) AG*, ECLI:EU:C:2018:648; for bank resolution see Article 111 paras 1 and 2 BRRD: 'at least'.

138 For more specific penalties see § 99d para 3 BWG (second alternative), referring to penalties for violations pursuant to § 98 para 5d BWG; for bank resolution see §§ 152 f. BaSAG.

A constitutional complaint relating to a sanction which was imposed by the FMA on the basis of § 99d FMA led the VfGH to overthrow its earlier case law on administrative sanctions. But let us start from the beginning. While the VfGH had originally granted the legislator a large measure of leeway as regards the assignment of tasks to courts, on the one hand, and administrative authorities, on the other hand,[139] in 1989 the VfGH made a remarkable volte.[140] The regional authority of Vienna had imposed a significant financial sanction on an entrepreneur which he complained against. Eventually, the VwGH requested the VfGH to examine the statutory basis of the sanction with a view to its constitutionality. From Article 91 B-VG – a norm requiring different penal law procedures (i.a. jury trials) for different criminal offences – the Court deduced that, a considerable leeway of the legislator notwithstanding, a distinction is to be drawn between sanctions imposed by criminal courts, on the one hand, and sanctions imposed by administrative authorities, on the other hand. According to the VfGH, the Federal Constitution required that the 'core of punishable offences'[141] be dealt with by criminal courts, not by administrative authorities. Where, due to high social harmfulness, particularly severe sanctions may be imposed, the incriminated offences fell within this core of punishable offences. While the Court did not deem it necessary to specify this threshold, it had no doubt that it was met in the given case. Consequently, the legislator was constitutionally bound to assign the competence to impose such sanctions to criminal courts. Since it was assigned to the regional authority of Vienna, an administrative authority, the legal basis for this competence was declared unconstitutional.

Even though the judgment was subject to heavy criticism in scholarly literature,[142] the 'VfGH [stuck] to this case law.'[143] While the Court has mentioned that criminal courts are, due to their independence, specifically qualified to impose sanctions,[144] it clarified in a judgement from 1995 – in view of the fact that meanwhile the legal protection by independent tribunals against decisions of administrative authorities had been significantly improved – that this was only a subordinated argument, but that its decision of 1989 was mainly

139 VfSlg 2153/1951; B. Wieser, *Zur materiellen Gewaltentrennung zwischen Justiz und Verwaltung – im Besonderen: Zum Funktionsvorbehalt zugunsten der Verwaltung*, (2009) Juristische Blätter, 351, 354; B. Puck, J. Breitenlechner, *Verwaltungsstrafverfahren – Verfahrensrechtlicher Reformbedarf aus Sicht der FMA*, in F. Rüffler, N. Raschauer (eds), *Reform der Finanzmarktaufsicht*, cit., 66 f., with further references.

140 VfSlg 12.151/1989; for an earlier judgment weakly indicating a distinction between sanctions imposed by criminal courts and sanctions imposed by administrative authorities see VfSlg 8.077/1977.

141 Translation by author of the VfGH's expression: 'Kernbereich strafbarer Handlungen'.

142 See references in T. Ganglbauer, *Die Verhängung hoher Geldstrafen durch Verwaltungsbehörden ist verfassungskonform. Anmerkungen zu VfGH 13.12.2017, G 408/2016 ua*, (2018) Österreichische Zeitschrift für Wirtschaftsrecht, 101, 103.

143 Translation by author of the VfGH's expression: 'Der Verfassungsgerichtshof bleibt bei dieser Rechtsprechung'; VfSlg 14.361/1995 with references to preceding cases; see also VfSlg 13.790/1994.

144 VfSlg 12.151/1989.

driven by constitutional considerations. After the ruling adopted in 1995, the Court confirmed its approach in 1997,[145] in 2000[146] and again in 2015.[147]

3.2.2. 2017: The reversal

Two years after the latest confirmation, in 2017, the Court revoked its case law. The federal administrative court had requested the VfGH to declare the above-mentioned § 99d BWG unconstitutional on the basis that it allowed an administrative authority, the FMA, to impose severe financial sanctions against legal persons for violations of the BWG. On this occasion, the Court turned its back on the above case law, stating that the case at issue shows that it 'does not (any more) do justice to the multiplicity of possible cases.'[148] More concretely, the VfGH argued – thereby taking account of the sceptical voices in the literature, as referred to above – that: 1. the distinction between the competences of criminal courts and administrative authorities solely on the basis of the (maximum) punishment the law provides for an offence is not convincing;[149] 2. referring solely to the possible maximum financial sanction when assigning a competence to courts or administrative authorities acknowledges neither the different purposes of financial sanctions in criminal law applied by courts, on the one hand, and criminal law applied by administrative authorities, on the other hand, nor the respective consequences; 3. relying on the mentioned maximum sanction does not allow to encompass differences between legal and natural persons or between wealthy and less wealthy persons which, consequently, allows an only insufficient assessment of the 'severity' of the punishment;[150] 4. the VfGH's case law so far has not sufficiently considered the different purposes the legislator pursues when assigning a competence to punish either to courts or to administrative authorities (in particular stigmatisation or decriminalisation).[151] What is more, the regime of administrative courts of first instance, as introduced in 2014,[152] has strongly improved legal protection against acts of administrative authorities. Hence adequate legal protection in case of severe sanctions – which the Court tried to

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145 VfSlg 14.973/1997.

146 VfSlg 15.772/2000.

147 VfSlg 19.960/2015.

148 Translation by author of the VfGH's expression: 'wird […] der Vielfalt an möglichen Sachverhalten nicht (mehr) gerecht'.

149 For the still relevant conceptual distinctions between 'supervisory decisions', 'administrative measures', 'administrative penalties' and 'penalties having a coloration pénale' under the SSM see R. D'Ambrosio, *Due process and safeguards of the persons subject to SSM supervisory and sanctioning proceedings*, Quaderni di Ricerca Giuridica della Consulenza Legale della Banca d'Italia No. 74, December 2013, 1, 11 ff.

150 This arguably refers to the fact that when measuring the amount of a fine, regularly the financial situation of the person accused is to be taken into account; see e.g. § 19 StGB; § 19 para 2 VStG; § 4 para 4 VbVG.

151 VfSlg 20.231/2017, para IV.2.5.

152 Prior to 2014 administrative decisions could regularly be reviewed by independent administrative tribunals which did not fully qualify as courts. The decisions of these tribunals could then be complained against before the VwGH/VfGH.

ensure with its preceding case law – nowadays is also provided for in case of administrative acts.[153] Thus, § 99d BWG was not declared unconstitutional.[154]

What follows with regard to the FMA is that it is competent to impose significant financial penalties on financial institutions in case of infringements against the BWG.[155] While the arguments brought forward by the VfGH to justify its judicial twist are in themselves convincing, we also need to look beyond the Federal Constitution of Austria. It is not least the EU legislator which increasingly promotes the imposition of financial sanctions by (national) administrative authorities.[156] While the EU, in accordance with the principle of procedural and institutional autonomy, must not generally prescribe whether these sanctions are to be imposed by courts or administrative authorities, in the case of banking supervision EU law requires the sanctions to be imposed by the competent authority according to Article 4 para 1 No. 40 CRR (which may hardly be a court).[157]

In conclusion, it appears that the developments in EU legislation have at least contributed to the abolishment of a particularity of Austrian administrative law which had been retained by the VfGH for nearly 30 years. While from an EU law perspective this may be criticised as an interference with parts of the Member States' regulatory autonomy, from a constitutional perspective the loss of this particularity need not be deplored. Its foundation in the Federal Constitution had not been as apparent as the (now revoked) case law of the VfGH seemed to suggest, and the original concerns regarding insufficient judicial protection against exceedingly high administrative sanctions seem to be met by the introduction of a comprehensive system of judicial review by fully-fledged administrative courts in 2014.

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153 VfSlg 20.231/2017, para IV.2.6.

154 The Court has already had the opportunity to confirm its new case law; see VfGH, 25 February 2019, G325/2018, in particular paras IV.2.7.1. f.

155 Given the new approach of the VfGH, also the FMA's remarkable sanctioning powers pursuant to the BaSAG seem unproblematic from a constitutional law perspective.

156 See e.g. the sanctions laid down in Article 83 of Regulation 2016/679 (General Data Protection Regulation) to be imposed by the supervisory authority (pursuant to Article 51 leg. cit.) in the respective Member State.

157 Articles 64-66 CRD. That the CRD 'should be without prejudice to any provisions in the law of Member States relating to criminal penalties' (see Recital 42 and Article 64 para 2) and that it grants the Member States some leeway to apply criminal sanctions instead does not help here because in the given context Austria has not provided for a regime of sanctions to be imposed by criminal courts (nor does it dispose of such tradition in financial market law). In VfGH, 16 December 2021, G224/2021 and others, the Federal Government of Austria as a party to the proceedings and eventually also the VfGH itself argue that in the regime of the CRD the EU legislator indicates a clear preference for administrative sanctions. As regards bank resolution, the BRRD explicitly speaks of 'administrative sanctions' (Recital 126), of 'penalties and other administrative measures' (Article 111 para 1) and even of 'administrative penalties imposed by [the resolution authorities]' (Article 112 para 1); for the generally different perspectives on sanctions by (banking) supervisory authorities on the one hand and courts on the other hand see R. D'Ambrosio, *The Legal Review of SSM Administrative Sanctions*, in C. Zilioli, K.-P. Wojcik (eds), *Judicial Review in the European Banking Union* (Edward Elgar, 2021) 316.

3.3. Liability for unlawfully caused damages

3.3.1. Constitutional requirements and new developments in banking law

To begin with, let us take a look at the requirements laid down in Austrian constitutional law. Article 23 para 1 B-VG stipulates: 'The Federation, the provinces the municipalities and the other bodies and institutions established under public law are liable for the injury which persons acting on their behalf in execution of the laws have by illegal behaviour culpably inflicted on whomsoever.' The detailed provisions with respect to this provision shall be laid down in (simple) federal law.[158] The main act in this context is the *Amtshaftungsgesetz* (Public Liability Act, AHG) which was adopted in 1948, simultaneously with the current constitutional framework of public liability. Apart from that, in the field of banking supervision law, since 2008 a number of specific provisions have been introduced in various statutes relating to financial market law which reduce the scope of public liability as laid down in the AHG[159] – a reaction to the economic and financial crisis;[160] to the generous case law of the Austrian supreme court in civil and criminal affairs which since the late 70s had confirmed public liability claims of banks' creditors;[161] and to the increasing involvement of EU actors in the various decision-making processes.[162]

According to § 3 para 1 FMABG, public liability of the Federation[163] applies on the basis of the AHG when the FMA enforces the laws laid down in § 2 FMABG, but only for a damage 'directly caused to the legal entity subject

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158 Article 23 para 4 B-VG.

159 That also other acts than the AHG may contain rules on public liability was confirmed in VfSlg 19.684/2012.

160 In 2008, the IMF pointed at the 'very wide interpretation of government institutional liability for financial sector supervision'; VfGH, 16 December 2021, G224/2021 and others, para 6.3.; for further measures taken in Austria in reaction to the Great Financial Crisis see S. Kalss, *Measures by the Austrian Regulatory Authorities in Response to the Financial Market Crisis*, (2010) 11 European Business Organization Law Review, 527.

161 See M. Almhofer, *Die Haftung der Europäischen Zentralbank für rechtswidrige Bankenaufsicht*, cit., 38; S. Schmid, *Die Beschränkung der Amtshaftung gemäß § 3 Abs 1 Satz 2 FMABG. Verfassungs- und unionsrechtliche Fragen, (2021)* Wirtschaftsrechtliche Blätter, 549, 550 f.; F. Braunauer, P. Windischer, *Die Verfassungskonformität des Amtshaftungausschlusses für die Finanzmarktaufsicht*, (2021) Österreichisches Bankarchiv, 857, 858; OGH, 25 April 2023, 1Ob223/22h, paras 23 f., also with references to the numerous sceptics (of the Austrian supreme civil and criminal court's original, more generous approach) in the literature; see also VfGH, 16 December 2021, G224/2021 and others, with a comparison to the (historical) developments in Germany.

162 See M. Oppitz, *Der unions- und verfassungsrechtliche Rahmen aufsichtsbehördlichen Handelns*, cit., 1, 17-20; for the different forms of cooperation in the SSM see R. D'Ambrosio, *The involvement of the NCAs in the ECB's supervisory proceedings*, in R. D'Ambrosio (ed), *Law and Practice of the Banking Union*, cit., 163.

163 According to § 3 para 1 FMABG, it is the Federation which can be held liable for actions of the FMA pursuant to the AHG, not the FMA itself. This was clarified by the legislator in 2005, Federal Law Gazette I No. 33/2005; see also M. Oppitz, *Kapitalmarktaufsicht*, cit., 178 f., with further references.

to supervision in accordance with [the FMABG].'[164] Thus, third party claims for damages seem to be excluded. The theoretical underpinning for this result is the so-called *Schutznormtheorie* ('protective norm theory'), according to which the violated rule must aim specifically and primarily at the protection of a certain legal entity for this entity to be entitled to damages.[165]

Specifications of whom banking law is aimed at protecting can be found e.g. in § 22e FMABG, according to which the FMA's actions against 'unauthorised business activities and violations in conjunction with combatting of money laundering and terrorist financing' on the basis of §§ 22b-22d FMABG shall be taken in the public interest.[166] More generally, § 69 para 1 BWG stipulates that the FMA shall duly consider the economic interest in a functioning banking system and in the stability of the financial market.[167] In para 4 the legislator adds that also potential effects of the FMA's decisions on the stability of the financial market in all other Member States concerned and particularly in crisis situations are to be taken into account.[168] As part of this general purpose, the situation of depositors, investors and other creditors ought to be considered. However, they do not seem to be 'specifically and primarily' protected by banking law.[169]

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164 For the requirement of direct causation and the ensuing negation of third party claims see C. Schöller, *Ausgewählte Fragen der Amtshaftung für mangelhafte Bankenaufsicht*, (2019) Österreichisches Bankarchiv, 886 f. with references to the literature and the case law of the supreme civil and criminal court of Austria.

165 This theory – applied in our context – essentially requires, for there to be a justified claim for damages, the violation of a law the purpose of which is the prevention of the harm caused in the concrete situation. This theory is reflected upon e.g. in § 1311 *Allgemeines Bürgerliches Gesetzbuch* (General Civil Code); for the application to § 3 para 1 FMABG see OGH, 25 April 2023, 1Ob223/22h, para 25, and the case law referred to therein; for an application of the underlying concept in the context of (omitted) criminal proceedings against a bank and damages for the bank's creditors see OGH, 12 October 2022, 1Ob104/22h; for the translation 'protective norm theory' and for further information on the underlying ideas see A. K. Mangold, *The Persistence of National Peculiarities: Translating Representative Environmental Action from Transnational into German Law*, (2014) 21 Indiana Journal of Global Legal Studies, 223, 231 f. and *passim*; see also R. Rebhahn, *Staatshaftung wegen mangelnder Gefahrenabwehr* (Manz, 1997), 279; for related case law of the CJEU see e.g. case C-219/15 *Schmitt*, ECLI:EU:C:2017:128, para 55; case C-735/19 *Euromin Holdings (Cyprus) Limited*, ECLI:EU:C:2020:1014, para 90.

166 At the same time, banks themselves are protected from damages claims in case they delayed or omitted the execution of a transaction, incorrectly suspecting money laundering or terrorist financing (negligent behaviour); § 19 para 1 *Finanzmarkt-Geldwäschegesetz* (Financial Markets Anti-Money Laundering Act); for the role of the FMA and other bodies in the context of preventing money laundering and terrorist financing see here.

167 For a thorough discussion of the underlying concepts see C. Johler, *§ 69*, cit., paras 32 ff; for the OeNB see § 44b para 1 NBG.

168 For the roots in Union law of this duty see C. Johler, *§ 69*, cit., paras 201-203; see also § 3 para 2, second sentence FMABG.

169 Specific protective regimes like the deposit guarantee scheme laid down in the ESAEG, Federal Law Gazette I No. 117/2015, serve as a compensation. Their existence rather supports than opposes the argument that depositors, investors and other creditors *in general* do not have public liability claims under Austrian banking law.

The VfGH recently held that the public liability rules related to the FMA apply also to the OeNB which, in the field of banking supervision, is 'functionally to be assigned to the FMA.'[170] This means that, from a public liability perspective, supervisory actions – but not e.g. monetary policy actions – of the OeNB are treated as actions of the FMA, and hence the regime described here applies.

Also in bank resolution the general public liability regime is subject to restrictions. According to § 3 para 9 BaSAG, the FMA or the OeNB, when performing tasks pursuant to the BaSAG, the SRM Regulation or a delegated act adopted on the basis of the BRRD, may only be held liable for damages when the underlying violation of the law was committed intentionally.[171] When proposing this provision, the Federal Government argued that the restriction was appropriate due to the high complexity of recovery and resolution planning. Against this background, and given the immense time pressure exerted in this context, the government's argument continued, it could not be excluded that the authorities in charge failed to recogise or wrongfully assessed relevant facts or legal questions.[172]

The gradual restriction of public liability in the context of banking supervision in the past years and the restrictive regime applicable in the field of bank resolution have raised an intense scholarly debate as to their constitutionality (in particular: their compliance with Article 23 B-VG, but also e.g. with the fundamental right to property or the principle of equal treatment enshrined in Article 7 B-VG).[173]

In December 2021, the VfGH has confirmed the constitutionality of the second sentence of § 3 para 1 FMABG which limits the liability of the Federation to a damage directly caused to legal entities subject to supervision according to the FMABG. This means that when the FMA, due to unlawful (in)action, directly damages a supervised bank, this bank will regularly have a public liability claim.

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170 VfGH, 16 December 2021, G224/2021 and others: 'der FMA funktionell zuzurechnendes Organ'; see also S. Schmid, *Die Beschränkung der Amtshaftung gemäß § 3 Abs 1 Satz 2 FMABG. Verfassungs- und unionsrechtliche Fragen, (2021)* Wirtschaftsrechtliche Blätter, 549, 557; M. Fister, *Grundfragen des § 3 Abs 1 Satz 2 FMABG und seine Wirkungen für die OeNB, (2021) Österreichisches Bankarchiv, 849,* 855 and *passim.*

171 Article 3 para 12 BRRD only applies to powers laid down in the BRRD itself (see also the more specific provisions in Article 29 para 9, Article 40 para 12 and Article 42 para 13 BRRD). The SRM Regulation does not appear to contain a similar provision applicable to national resolution authorities. The BaSAG regime seems to apply even if the FMA/OeNB act, on the basis of the resolution framework, as supervisory authorities; see 2.2.3. above; for the general trend towards limiting public liability of financial supervisors and resolution authorities and for a comparative overview of the regimes in different Member States see D. Bush, G. Mcmeel, *Liability of Financial Supervisors and Resolution Authorities: Perspectives from Comparative and European Union Law*, (2023) 34 European Business Law Review, 725; see also J. Schürger, *Unionsrechtskonformität nationaler Beschränkungen der Staatshaftung im Bank- und Kapitalmarktrecht*, (2021) Zeitschrift für Bank- und Kapitalmarktrecht, 601, 602 f.; for a reimbursement for unlawful actions of the FMA see § 118 para 5 BaSAG (and Article 85 para 4 BRRD).

172 See ErlRV 361 BlgNR XXV. GP 4.

173 See M. Oppitz, *Kapitalmarktaufsicht*, cit., 179 ff.; F. Braunauer, P. Windischer, *Die Verfassungskonformität des Amtshaftungausschlusses für die Finanzmarktaufsicht*, cit., 857, both with many further references.

However, for the bank's depositors, investors and other creditors who may be negatively affected by the FMA's wrongdoing, as well, a public liability claim is excluded. According to the VfGH, this provision merely explicates at whose protection the rules on financial market supervision in general aim.[174] Also from an EU law perspective this part of Austria's public liability regime appears to be lawful. The judgments of the Court of Justice of the European Union (CJEU) in the cases *Paul and others* and, more recently, *Kantarev* and *Balgarska Narodna Banka*, against the background of existing deposit guarantee schemes in the Member States, do not oppose a public interest thrust of (national) banking supervision and thus the exclusion of public liability for banks' depositors.[175]

The limitation to intentionally committed violations in § 3 para 9 BaSAG goes against the wording of Article 23 B-VG which, given the other criteria are met, provides for public liability also in case of negligent behaviour. While this provision grants some leeway to the legislator to provide for further restrictions,[176] the limitation of liability to intentional infringements seems to be excessive.[177] Article 3 para 12 BRRD allows the Member States, without further specification, to restrict the public liability of its authorities to the extent they exercise functions laid down in the BRRD. Whether this also includes a limitation to intentionally caused damages is questionable.[178] Given the recent case law of the Court of Justice in which, in relation to national deposit guarantee schemes, it has declared such limitations unlawful,[179] Article 3 para 12 BRRD is to be interpreted rather restrictively in that respect.

Given the clear wording and purpose of § 3 para 9 BaSAG on the exclusion of negligently caused damages, it is not possible to interpret this provision in accordance with higher-ranking law – neither with Article 23 B-VG nor with Article 3 para 12 BRRD (as interpreted in consideration of the Court of Justice's case law). Thus, the provision appears to conflict both with the Constitution and with Union law.

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174 VfGH, 16 December 2021, G224/2021 and others. In its decision of 30 September 2002, B891/02 and others, the VfGH still held that financial market supervision comprises the prevention of specific risks for the general public and for the creditors; critical: J. Schürger, *Unionsrechtskonformität nationaler Beschränkungen der Staatshaftung im Bank- und Kapitalmarktrecht*, cit., 601, 605.

175 Case C-222/02 *Paul and others*, para 32; case C-571/16 *Kantarev*, ECLI:EU:C:2018:807, para 90; case C-501/18 *Balgarska Narodna Banka*, ECLI:EU:C:2021:249, paras 51 f. and 57; see also the judgment of the EFTA Court in case E-5/20 *SMA SA and Société Mutuelle d'Assurance du Bâtiment et des Travaux Publics*, paras 42-49.

176 VfSlg 19.684/2012; VfGH, 16 December 2021, G224/2021 and others.

177 Note that – in the field of banking supervision – in 2005 a limitation of public liability to intent and gross negligence was planned (and eventually dropped). In 2008, the legislator adopted a reform resulting in the regime of § 3 para 1 FMABG, as addressed above; see VfGH, 16 December 2021, G224/2021 and others.

178 Sceptical even with regard to a less restrictive national liability regime: R. D'Ambrosio, *The Liability regimes within the SSM and the SRM*, in R. D'Ambrosio (ed), *Law and Practice of the Banking Union*, cit., 503, 524.

179 Case C-571/16 *Kantarev*, ECLI:EU:C:2018:807, paras 121 and 126 to 128; case C-501/18 *Balgarska Narodna Banka*, ECLI:EU:C:2021:249, para 121.

3.3.2. Public liability for actions of the FMA and the OeNB under the SSM/ SRM

When the FMA acts within the framework of the SSM Regulation, public liability is excluded in the following cases: where the FMA acts to execute an instruction issued by or to fulfil a task assigned by the ECB, where it prepares or carries out a decision of the ECB or where it cooperates or exchanges information with the ECB or otherwise supports it (§ 3 para 6 FMABG). These rules are applicable also to the OeNB (§ 79 para 7 BWG). A similar regime applies when FMA or OeNB act within the framework of the SRM (§ 3 para 7 FMABG and § 79 para 8 BWG).

With regard to the FMA and the OeNB when acting under the SSM and the related restrictions of public liability, the FMABG and the BWG distinguish three categories of cases.[180] The first case relates to actions taken to execute an instruction issued by or to fulfil a task assigned by the ECB. If such action is in conformity with the relevant instruction of or task assigned by the ECB, public liability shall be excluded. To the extent the action goes against or at least beyond the instruction or task, public liability applies. This follows from a teleological interpretation of § 3 para 6 FMABG and § 79 para 7 BWG, the purpose of which is to exclude public liability of the Federation only to the extent the underlying action was required by EU law.[181] The ECB as the originator of the action (allegedly) causing the harm – the instruction or assignation of a task – may be held liable according to Article 340 para 3 TFEU, given the requirements of this provision are met.[182] The second alternative of the second category – the carrying out of an ECB decision – is to be similarly assessed.

The somewhat opposite case is the first alternative of the second category – the preparation of ECB action. Whereas in the above-mentioned cases the action of Austrian authorities follows ECB action, here the action of the FMA (or, exceptionally, the OeNB) precedes that of the ECB. Most prominently this is the case in the so-called common procedures pursuant to Article 14 and 15 SSM Regulation. Where the FMA decides on its own – even if within the framework of a common procedure: in particular when rejecting an application for authorisation as referred to in Article 14 para 2 (last sentence) SSM Regulation – the Federation principally can be held liable for a damage thereby caused.

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180 The following elaborations also apply – *mutatis mutandis* – with regard to action taken in one of the forms of relation to the SRB at issue here.

181 This does not prevent the respective action from being reviewed by (Austrian) administrative courts (and, after that, under certain conditions also by the VfGH).

182 For this kind of scenario see already case 175/84 *Krohn*, ECLI:EU:C:1986:85, paras 21 and 23. For the ECB's liability under EU law see M. Almhofer, *Die Haftung der Europäischen Zentralbank für rechtswidrige Bankenaufsicht*, cit.; G. Varentsov, *Staatshaftungsrechtliche Grundlagenprobleme bei der Durchführung von nationalen Vorschriften im Rahmen der Bankenaufsicht durch die Europäische Zentralbank*, (2017) 70 Die öffentliche Verwaltung, 53.

The third category of cases – cooperation, exchange of information with the ECB or other support – is a catchall element to cover any kind of relation to the ECB.

3.3.3. Public liability for FMA/OeNB actions, state liability of Austria and non-contractual liability of the relevant EU authorities

With the above reservations the legislator intended to limit the scope of the Federation's public liability under the regime of Article 23 B-VG and the AHG. A Member State cannot, however, limit its obligations on the basis of state liability, a general principle of Union law.[183] This principle, as fleshed out by the case law of the CJEU, regulates the liability of Member States for violations of EU law. Its scope is partly wider than the Austrian (general) public liability regime (e.g. as it includes unlawful acts of the legislator or of highest courts, and does not require fault), partly narrower, in particular due to its limitation to 'sufficiently serious breaches'[184] of EU law.[185] This means that – where a violation of EU law is at issue – there may be cases where actions of an Austrian public body result in state liability but not in public liability under the AHG, and *vice versa*. The former case is particularly relevant in our context, i.e. with regard to the supervision and resolution of banks, since, as we have seen, here the specific rules on public liability are rather restrictive. Thus, in situations where a damage was caused by the FMA/OeNB, the restrictiveness of the FMABG, the BWG and the BaSAG may be compensated for by the broader scope of the principle of state liability.[186]

The duty of the SRB to compensate national resolution authorities for damages they are required to pay due to a national court decision or due to an amicable settlement (concluded with the agreement of the SRB) applies only where the national authority at issue did not commit the underlying violation of EU law 'intentionally or with manifest and serious error of judgement' (Article 87 para 4 SRM Regulation). The Court of Justice is in charge of deciding on the respective claims. This regime seems to allow for compensation where the relevant national law (or the amicable settlement) is stricter than the rules of state liability. The SSM Regulation does not contain a comparable provision.

Another important layer of liability is the non-contractual liability of the ECB, the SRB and potentially also the EBA according to Article 340 para 3 TFEU, Article 87 SRM Regulation and Article 69 EBA Regulation, respectively.

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183 See e.g. joined cases C-46/93 and C-48/93 *Brasserie du Pêcheur*, ECLI:EU:C:1996:79, para 33; case C-429/09 *Fuß*, ECLI:EU:C:2010:717, para 66.

184 See case C-168/15 *Tomášová*, ECLI:EU:C:2016:602, paras 22 and 24; more explicit on the severe gravity of the breach which is required: case T-415/21 *Banca Popolare di Bari*, ECLI:EU:T:2023:833, para 112, both with further references to the Court's case law.

185 See T. Öhlinger, H. Eberhard, M. Potacs, *EU-Recht und staatliches Recht. Die Anwendung des Europarechts im innerstaatlichen Bereich* (LexisNexis, 8th edn, 2023), 212-218, also for the consideration of fault in the context of the 'sufficiently serious breach' criterion.

186 See M. Almhofer, *Die Haftung der Europäischen Zentralbank für rechtswidrige Bankenaufsicht*, cit., 288 f., with further references.

The non-contractual liability of EU bodies shall be 'without prejudice to the liability of national competent authorities to make good any damage caused by them or by their servants in the performance of their duties in accordance with national legislation.'[187] Due to the manifold forms of interaction between these EU bodies and their respective national counterparts, in the case of a damage the allocation of causality can be a challenging task. In the context of the SSM, the CJEU has decided that preparatory acts of the national supervisor cannot affect the allocation to the ECB of the subsequent (final) decision.[188] This assessment was made with regard to the question whether an action for annulment would be admissible. It is unclear whether this approach can be applied also in the context of the liability for damages of the EU and the Member States. After all, it is the causality which matters here, and while there may not be an act adopted by the FMA/OeNB together with an EU body, these actors may very well cause a damage together (double causality).[189] In this case proceedings may have to be brought both before national courts and before the CJEU. Before the CJEU determines the damage for which the EU or one of its actors is liable, 'it is necessary for the national court [of the Member State concerned] to have the opportunity to give judgment on any liability on the part of [that Member State].'[190] Applied to our context, that means that in a case where the causality of a damage can be clearly allocated to banking supervision or bank resolution as such, but not to either of the two levels involved, the damaged party needs to sue the Federation before Austrian courts (on the basis of the Austrian public liability regime and/or the EU principle of state liability) first – with the possibility to ask for a preliminary reference from the Court of Justice. To the extent its lawsuit was (materially) unsuccessful, it may then claim non-contractual liability of the ECB/SRB/EBA before the CJEU.

4. Conclusion

The EU institutional framework concerning the supervision, regulation and resolution of banks is essentially a product of the past 15-20 years. Only some years earlier banking supervision in Austria was essentially delegated to a newly established authority, the FMA. After some years, the involvement of the OeNB in banking supervision was reinforced. While the EU could create new bodies at the EU level, it had to accept – not least as a consequence of the principle of procedural and institutional autonomy – the authorities already in place in

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187 Recital 61 SSM Regulation.

188 Case C-219/17 *Berlusconi*, ECLI:EU:C:2018:1023, paras 43 f; case T-72/20 *Satabank*, ECLI:EU:T:2023:149, paras 71 f.

189 As explained above, for these cases Austrian law excludes public liability, but a damages claim may still be based on the principle of state liability.

190 Cases 5, 7 and 13-24/66 *Kampffmeyer*, ECLI:EU:C:1967:31, 266. The Court referred to this (temporal) order – the CJEU's judgment having to follow the judgment of the national court – in a specific case in which national proceedings were pending. It is not entirely clear whether a general rule can be deduced to that effect; in the affirmative: Opinion of AG *Rantos* in case C-755/21P *Kočner*, ECLI:EU:C:2023:481, para 52.

the Member States, the knowledge and experience of which have been highly important also for the functioning of a more and more integrated supervisory system. In respect of the bank resolution regime, the SRM, the situation was different. In this case it was EU legislation which requested the Member States – most of which, like Austria, did not have bank resolution authorities before – to make the institutional arrangements accordingly. The federal legislator of Austria decided against the creation of a new authority, but created an independent department within the FMA which should henceforth deal with matters of bank resolution, again being supported by the OeNB.

EU legislation on banking law and in particular the creation of the SSM and the SRM with their respective incorporation of national supervisory/resolution authorities has had a strong influence on the FMA (and the OeNB). Participation in the SSM/SRM in particular for the FMA has come together with a subordination to the ECB/SRB. While this subordination challenges the independence the FMA could act out prior to the establishment of the Banking Union, legally it is to be accepted on the basis of federal constitutional law and/or EU law. From a political perspective, this aspect of the transformation brought about by the Banking Union was hardly discussed in the relevant legislative proceedings in Austria. In general, the project has received broad support from both government and legislator. Conceptually speaking, the hierarchical structure of the SSM and the SRM seems to be without alternative. The introduction of EU actors in charge of the supervision and resolution of banks – in addition to the respective national authorities – could not possibly work without a form of binding coordination, of which instruction rights of the EU actors *vis-à-vis* the national actors are a prominent expression.

The second example addressed here relates to the FMA's sanctioning power. It has been EU law in particular which has provided – in different policy fields – for the power of national administrative authorities to impose significant sanctions on market participants. Arguably paying tribute, among other things, to this development, the VfGH has revoked its long-lasting earlier case law which has reserved the imposition of high financial charges to criminal courts so as to allow also administrative authorities – in our case the FMA – to determine such fines.

Less independence also means less responsibility. While it is true that public liability in relation to the FMA's and the OeNB's actions was reduced by the legislator long before the establishment of the Banking Union, with the appearance of powerful new actors at the EU level this development was reinforced. It seems that the legislator has drawn the limits of public liability too narrowly. In part, this goes against the Federal Constitution, in part it (also) contradicts the EU principle of state liability. Apart from that, also the non-contractual liability of the ECB/SRB/EBA may apply in case a damage occurs. In the highly integrated administrative system of the Banking Union, the allocation of a damage to these different layers of liability may turn out to be a challenging task. In procedural terms, the CJEU seems to require the prior examination of public/state liability at the national level. If the underlying claim turns out to be unsuccessful, the relevant EU actor may be sued for non-contractual liability before the CJEU.

Summing up, our examples have shown (at least) three ways in which EU law is influencing national (constitutional) law in the context of the supervision and resolution of banks: by requiring an interpretation of national constitutional law which is in accordance with EU law or simply by ousting conflicting national constitutional law *qua* supremacy; by facilitating an administrative law culture which contributes to having a national constitutional court (the VfGH) change its mind; by enshrining principles, essentially determined by the CJEU, which may allow for closing a gap caused by overly restrictive national legislation.

Financial supervision in larger Member States: France, Germany and Italy between domestic and European influence

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[*] I am grateful to Jonathan Bauerschmidt for his very useful feedback.

1. Introduction

European financial integration only gathered pace over the past two decades after it had remained limited and had thus lagged behind other areas of European integration.[1] However, several reforms conducted in response to the euro area crisis, and primarily the creation of the European System of Financial Supervision (ESFS) in 2010 as well as the European Banking Union (EBU) launched in 2012, led to a significant overhaul of the system in place. In particular, competences in the areas of bank supervision and resolution started to be exercised at the EU level, thereby provoking significant changes in the relationship between the EU and its Member States. That is to say that EBU Member States (national) institutions that had been in charge of banking supervision and bank resolution until then started to operate under the ultimate responsibility of an EU institution and an EU agency, the European Central Bank (ECB) and the Single Resolution Board (SRB), respectively.[2]

This article focuses on the impact of those reforms performed at the EU level on the institutional frameworks of three Member States: France, Germany and Italy. In particular, it considers to what extent the systems in place were designed in response to the developments observable at the EU level or whether, on the contrary, they responded to national institutional and legal dynamics and constraints. This question is pertinent considering the fact that the applicable EU norms leave ample margin of manoeuvre to the Member States as recalled in the introduction to this edited collection. Indeed, Article 4 of the Capital Requirements Directive (CRD) most prominently limits itself to specifying, with regard to National Competent Authorities (NCAs) in charge of banking supervision, that 'Member States shall designate competent authorities that carry out the functions and duties provided for in this Directive and in Regulation (EU) No. 575/2013. [… Furthermore,] Member States shall ensure that the competent authorities monitor the activities of institutions, and where applicable, of financial holding companies and mixed financial holding companies, so as to assess compliance with the requirements of this Directive and Regulation (EU) No. 575/2013. […] Member States shall ensure that appropriate measures are in place to enable the competent authorities to obtain the information needed to assess the compliance of institutions and, where applicable, of financial holding companies and mixed financial holding companies […] and to investigate possible breaches of those requirements. […] Member States shall ensure that the competent authorities have the expertise, resources, operational capacity, powers and independence necessary to carry out the functions relating to prudential supervision, investigations and penalties set out in this Directive and in Regulation (EU) No. 575/2013. […] Member States shall require that institutions provide the competent authorities of their home Member States with all the information necessary for the assessment of their compliance with the rules adopted in accordance with this Directive and

[1] See further on this: the introduction to this edited collection.

[2] Admittedly, the approval of the Banking Recovery and Resolution Directive (BRRD) also demanded from some of the Member States that they establish an NRA.

Regulation (EU) No. 575/2013. Member States shall also ensure that internal control mechanisms and administrative and accounting procedures of the institutions permit the checking of their compliance with such rules at all times.' As regards National Resolution Authorities (NRAs), the Banking Recovery and Resolution Regulation (BRRD) foresees in its Article 3 that '[e]ach Member State shall designate one or, exceptionally, more resolution authorities that are empowered to apply the resolution tools and exercise the resolution powers. […] The resolution authority shall be a public administrative authority or authorities entrusted with public administrative powers. […] Resolution authorities may be national central banks, competent ministries or other public administrative authorities or authorities entrusted with public administrative powers. Member States may exceptionally provide for the resolution authority to be the competent authorities for supervision for the purposes of Regulation (EU) No. 575/2013 and Directive 2013/36/EU. Adequate structural arrangements shall be in place to ensure operational independence and avoid conflicts of interest between the functions of supervision pursuant to Regulation (EU) No. 575/2013 and Directive 2013/36/EU or the other functions of the relevant authority and the functions of resolution authorities pursuant to this Directive, without prejudice to the exchange of information and cooperation obligations as required by paragraph […] In particular, Member States shall ensure that, within the competent authorities, national central banks, competent ministries or other authorities there is operational independence between the resolution function and the supervisory or other functions of the relevant authority.' Hence, Member States enjoy great discretion in defining the institutional features of their NCAs and their NRAs.[3]

The analysis of the impact of the creation of the EBU on France's, Germany's, and Italy's institutional systems is relevant and necessary for a number of reasons. First, Germany's banking sector is both important in the EU, and structurally distinct from other large national banking sectors such as the French one.[4] Its *Bundesanstalt für Finanzdienstleistungsaufsicht* (BaFin), which was established in 2002 on national initiative, follows a 'single supervision system' (or integrated model) and assumes functions, which are divided among several entities at the EU level (as well as in some of the other Member States). It has a peculiar institutional standing if compared to the other BU Member States: It belongs to the 8 of the 20 NCAs which are not integrated in the national central bank as it is hierarchically submitted to the Federal Ministry of Finance. Germany's central bank, the Bundesbank (BuBa), is, however, also involved in banking prudential supervision. In fact, as discussed further below, the possibility for the BuBa to

[3] This might soon change as a reform of Article 4 CRD (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 L 176/338) is under discussion at the time of submitting this edited collection. This reform proposal is discussed more in depth in the introduction to this edited collection.

[4] See on the historical evolution of the German banking system: A. Busch, *Banking regulation and globalization* (OUP, 2009), ch. 4.

become Germany's banking supervisor has been envisaged in the past. Finally, the Wirecard scandal put BaFin and the suitability of its institutional features under scrutiny, and a reform was recently enacted.

The Italian case is also worth analysing for the following reasons. First, Italy has one of the largest and the oldest banking systems. Second, it has been facing severe difficulties over the past decade, and public funds had to be mobilised. Resolution was resorted to pre-SRM and considered post-SRM, but the public interest requirement was eventually deemed not to be met and the SRM was thus not activated. It remains the case however that banking supervision and resolution are particularly relevant for Italya. Third, Italy's system of financial supervision is organised following a functional divide, whereby Italy's central bank, the Bank of Italy, acts as its NCA and its NRA and CONSOB – a separate authority – has responsibilities with regard to financial markets. Notwithstanding this, at least until the creation of the EBU, the Italian government was involved in banking supervision as detailed further below.

Finally, the French system of financial supervision exhibits some features that make it different still from the German and the Italian system. A functionally independent authority, the ACPR, is in charge of both prudential supervision and resolution, but it is placed within Bank of France. The historical evolution of the French banking system presents some similarities with that of the Italian one, as the both of them had been quite strongly regulated and closed until the 1980s before they opened up, among other reasons because of the efforts of integration conducted within the European Community. The French banking sector is also one of the largest ones in the EU. Mechanisms for its supervision and regulation have undergone numerous reforms since the 1980s and it is thus relevant to determine what domestic or European factors triggered and determined the changes to the institutional framework in place.

This article starts with an analysis of the German case (2) and continues with the Italian case (3); the French one follows (4). A comparison of the administrative and democratic accountability mechanisms in place in these systems following the creation of the EBU concludes (5).

2. Germany: a frontrunner in need for reform?

Contrary to what is true of a number of countries and of the EU, the reform of the German system of financial supervision pre-dates the Great Financial Crisis as BaFin was established in 2002 already. The following paragraphs first recall what the pre-existing structure had been prior to its establishment (a) before BaFin's features, their evolution over time as well as its relationship to other national institutions are depicted (b).[5]

[5] It should be noted that the *Sparkassen* and their supervision are not considered here.

2.1. Historical evolution prior to the establishment of BaFin

Banking supervision is relatively recent in Germany. Despite the fact that this issue arose in the framework of the discussions regarding the creation of a *Reichsbank* in 1875, it is only in 1931 that a mechanism was formally established for that purpose.[6] The first version of the Banking Act in force today (*Kreditwesengesetz*) was however adopted in 1961.

Prior to the creation of BaFin in 2002, Germany's financial supervision operated under a functional model composed of the Federal Banking Supervisory Office (*Bundesaufsichtsamt für das Kreditwesen*, BAKred), the Federal Insurance Supervisory Office (*Bundesaufsichtsamt für das Versicherungswesen*), and the Federal Securities Supervisory Office (*Bundesaufsichtsamt für den Wertpapierhandel*);[7] the currently existing division between the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Pensiones Authority (EIOPA) at the EU level resembles the institutional structure that used to exist in Germany.

The BAKred, established in 1961 after the *Länder* had been in charge of banking supervision since the Second World War, was meant 'to counteract irregularities in the areas of banking and financial services, which threaten the security of the assets of those institutions in its area of responsibility, hamper the orderly conduct of banking transactions and create difficulties for the wider economy.[8] It was established as an independent federal level agency (*selbständige Bundesoberbehörde*), and cooperated with the BuBa in the performance of its supervisory tasks. The BuBa was involved in the process of adopting certain laws or regulations.[9] Ties between the BuBa and the BAKred were, in fact, relatively tight as the President of the BuBa had 'considerable influence' over the selection of the President of the BAKred, and as the latter could take part in the meetings of the BuBa's council that affected its area of responsibility (with no voting rights however).[10] The BuBa provided BAKred with information thanks to its network of regional branches, and had thus been deemed to have taken over 'most of the day-to-day supervision and

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6 E. Gören, *Der einheitliche Aufsichtsmechanismus bei der Europäischen Zentralbank (Single Supervisory Mechanism)* (Nomos, 2019), 21.

7 The other functions fulfilled by BaFin are not examined in depth here in view of the focus on the banking sector. As a consequence of this as well, neither are the supervisory activities performed by the *Länder*. For a discussion on the division of competences between *Bund* and *Länder* see: A. Thiele, *Finanzaufsicht* (Mohr Siebeck, 2014), 368 f. and for a general historical account of banking supervision in Germany: L. Frach, *Finanzaufsicht in Deutschland und Großbritannien. Die BaFin und die FSA im Spannungsfeld der Politik* (VS Verlag, 2008), 61. For a historical account, see also D. Detzer, H. Herr, *Financial regulation in Germany*, in R. Kattel, J. Kregel, M. Tonveronachi (eds), *Financial regulation in the European Union* (Routledge, 2016), 47 f.

8 Kreditwesengesetz, KWG (Banking Act of the Federal Republic of Germany) para 6 (2) as translated by A. Busch, *Banking regulation and globalization*, cit., 95.

9 D. Detzer, H. Herr, *Financial regulation in Germany*, cit., 47.

10 A. Busch, *Banking regulation and globalization*, cit., 97.

reporting'.[11] After 1972, the Ministry of Finance also became involved in financial regulation, but its role was largely limited to the development and amendment of the applicable laws.[12]

Independent federal level agencies like BAKred (and like BaFin today, as further detailed below) do not benefit from full independence from a ministry. German administrative law distinguishes between the supervision of substantive aspects (*Fachaufsicht*) and the supervision of legal compliance only (*Rechtsaufsicht*). The Ministry of Finance exercised both kinds of supervision vis-à-vis BAKred and still exercises it vis-à-vis BaFin (while respecting its full operational independence), hence why it is not fully independent.[13] Any other construction would not be lawful under German law as room of manoeuvre without ministerial supervision (*ministerialfreier Raum*) is only allowed for the BuBa because it is anchored in the Basic Law (Article 88).

2.2. BaFin and its main features

The BaFin was established in 2002 when it replaced the three entities that had existed until then and united their tasks in one agency. Henceforth, Germany moved from a functional model of financial supervision, to a single supervisory one, although BaFin's internal structure still mirrors a functional divide.[14] This reform was motivated by a change in the structure of the financial system,[15] that is the progressive disappearance of the distinction between the insurance, the banking and the securities markets,[16] and by the authorities' insufficient market-orientation deriving from their poor financial and personal resources.[17] Furthermore, the three authorities did not sufficiently exchange information among themselves; as a consequence, they failed to sufficiently consider evolutions that affected several areas of the financial sector.[18] Additionally, the BuBa sought to gain competences in the area of banking supervision after it had lost power to the benefit of the ECB because of the introduction of the euro, and at some point, it seemed that a change in that direction would occur.

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11 H.-J. Krupp, *Umorganisation der Bankenaufsicht, Mittelstand und Bundesbankstruktur*, (2001) 2 Wirtschaftsdienst. Zeitschrift für Wirtschaftspolitik, 81, as cited by D. Detzer, H. Herr, *Financial regulation in Germany*, cit., 47.

12 A. Busch, *Banking regulation and globalization*, cit., 97.

13 See further on this: Bundesanstalt für Finanzdienstleistungsaufsicht, Grundsätze der Zusammenarbeit zwischen Bundesministerium der Finanzen (BMF) und Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin).

14 A. Thiele, *Finanzaufsicht*, cit., 174 f.

15 Bundestag, Entwurf eines Gesetzes zur Modernisierung der Aufsichtsstruktur der Bundesanstalt für Finanzdienstleistungsaufsicht (Aufsichtsstrukturmodernisierungsgesetz) 2007 (Drucksache 16/7078) (Draft Act on the Modernisation of the Supervisory Structure of the Federal Financial Supervisory Authority – Supervisory Structure Modernisation Act), 7.

16 M. Han, *Die Unabhängigkeit der Bundesanstalt für Finanzdienstleistungsaufsicht* (Peter Lang, 2015), 13.

17 L. Frach, *Finanzaufsicht in Deutschland und Großbritannien*, cit., 64.

18 *Ibidem*.

To avoid being placed under the BuBa's control though, the BAKred supported the creation of a single supervisory entity.[19] The creation of BaFin was thus both motivated by failures inherent to the structure that previously existed, and by the strategical (or political) motivations of the actors involved.

This concentration of tasks in the area of financial supervision was further enhanced in 2018 when BaFin also became Germany's NRA after this task had been fulfilled by the Authority for Market Stabilisation (*Bundesanstalt für Finanzmarktstabilisierung*, FMSA); the FMSA assumed this function between 2015 and 2017, that is it was originally designated as Germany's NRA following the creation of the SRM. The FMSA was established in 2008 in response to the Great Financial Crisis. Following a reform implemented in 2018, it became part of the Finance Agency, and BaFin became Germany's NRA. This reform aimed, inter alia, at increasing the efficiency of the FMSA by integrating it in a larger, permanently established entity and at enhancing the synergies between supervision and resolution.[20] However, although some of the services are shared, independence between the supervisory and the resolution functions of the BaFin is guaranteed by the existence of the position of Executive director specifically in charge of resolution.[21]

In its quality as a federal institution established under public law (*Anstalt des öffentlichen Rechts*), BaFin belongs to the ministerial hierarchy being placed under the Ministry of Finance.[22] It enjoys a degree of independence (note here the difference between the *Anstalt* and other administrative entities (*Behörden*)). Entities like *BaFin* (*Anstalt*) fulfil their duties independently and thus have their own identities. This is visible in the fact that specific structures for their internal organisation exist, as opposed to the hierarchical organisation, which is common within *Behörde*.[23] However, as mentioned, BaFin is still submitted to the Ministry's legal and substantiveoversight, which includes a

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19 *Ibidem*, 65.

20 It appears that the FMSA was never meant to exist for a long time; rather, it was established as an immediate, temporary, solution to the difficulties caused by the Great Financial Crisis. See on the background of the merger of the FMSA into BaFin: Referententwurf des Bundesministeriums der Finanzen, Entwurf eines Gesetzes zur Neuordnung der Aufgaben der Bundesanstalt für Finanzmarktstabilisierung (FMSA-Neuordnungsgesetz, FMSANeuOG), 1-3.

21 See also on this: C. Böhm, A. Thiele, *Germany*, in R. D'Ambrosio, D. Fromage (eds), *Member States' institutional arrangements for banking resolution compared*, Quaderni di Ricerca Giuridica della Consulenza Legale della Banca d'Italia, forthcoming.

22 It is established 'as *part of the portfolio* of the Ministry of Finance', Finanzdienstleistungsaufsichtsgesetz – FinDAG (Act Establishing the Federal Financial Supervisory Authority), section 1 (1). F.A. Dechent, *Bundesanstalt für Finanzdienstleistungsaufsicht und Bundesanstalt für Finanzmarktstabilisierung: unabhängige Behörden in der Bankenaufsicht?*, (2015) 34 Neue Zeitschrift für Verwaltungsrecht, 767. See further for a comparison between BaFin's status with that of the three entities it replaced: M. Han, *Die Unabhängigkeit der Bundesanstalt für Finanzdienstleistungsaufsicht*, cit.

23 Bohn as cited by M. Han, *Die Unabhängigkeit der Bundesanstalt für Finanzdienstleistungsaufsicht*, cit., 55. This notwithstanding, it has been argued that BaFin does not totally square well with the common definition of an *Anstalt* under German administrative law because of the type of functions it fulfils. M. Han, *Die Unabhängigkeit der Bundesanstalt für Finanzdienstleistungsaufsicht*, cit., 88-89.

right of information and a right to give instruction.[24] The Ministry is, though, to respect its operative independence and refrain from checking BaFin's supervisory decisions ex ante unless the law provides for the Ministry's involvement.[25] This is to guarantee the respect of democratic principles: as a result of this construction, the minister of finance may be held accountable for BaFin's actions.[26] This, however, questions BaFin's sufficient independence, which constitutional constraints may have prevented in any event.[27]

In the separation of tasks between BaFin and BuBa, it must be noted that, even if BaFin is the main organ in charge of banking supervision, it performs this task in cooperation with the BuBa, which is in charge of the daily supervision (*laufende Überwachung*).[28] This means for instance that the BuBa evaluates whether credit institutions hold sufficient capital, and BaFin eventually adopts the necessary decisions addressed to the credit institutions.[29] Interestingly, in this framework, the BuBa is bound by the guidelines adopted by the BaFin, or by the Ministry of Finance in case of disagreement (after 'intensive hearings' of the BuBa).[30] Their competences are clearly defined, and cooperation efforts as well as exchanges of information are foreseen.[31] In fact, BaFin depends on the information provided to it by the BuBa. Owing to its status, BaFin may not set up any local or regional entity, whilst the BuBa is in a position to do so, and may thus collect the information, which the BaFin needs to perform its supervisory tasks.[32] Accordingly, the BuBa collects the relevant information including for instance monthly reports and balances – which it in any case has to collect to fulfil its own tasks. Should it find through its analysis of the data that a credit institution is in a crisis situation, it is to inform the BaFin accordingly. This administrative cooperation and bundling of expertise and services has been found to be to BaFin's advantage since it allows it to focus on the most vulnerable

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[24] FinDAG, section 2.

[25] Bundesanstalt für Finanzdienstleistungsaufsicht, Grundsätze der Zusammenarbeit zwischen Bundesministerium der Finanzen (BMF) und Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), cit.

[26] See also on the Bundestag's view: Bundestag, Entwurf eines Gesetzes zur Modernisierung der Aufsichtsstruktur der Bundesanstalt für Finanzdienstleistungsaufsicht, cit., 7. Nonetheless, BaFin's independence from the Federal government is larger than that of the three agencies it replaced. On the question of accountability, see E.-W. Böckenförde, *§ 34 Demokratische Willensbildung und Repräsentation*, in J. Isensee, P. Kirchhof (ed), *Handbuch des Staatsrechts der Bundesrepublik Deutschland*, Band III, *Demokratie – Bundesorgane* (C.F. Müller Verlag, 2001), 31-42.

[27] A. Thiele, *Finanzaufsicht*, cit., 415 f.

[28] Kreditwesengesetz, KWG, cit., Article 7 (1) (this article generally regulates the relationship between BaFin and BuBa). See also T. Roth, *Die indirekte Bankenaufsicht durch die Europäische Zentralbank* (Nomos, 2017), 134-135.

[29] See for a critical discussion on the attribution of these competences to an independent central bank: E. Gören, *Der einheitliche Aufsichtsmechanismus bei der Europäischen Zentralbank*, cit., 53-54.

[30] Kreditwesengesetz, KWG, cit., para 7. The BuBa assumes these tasks based on Article 73 (1) para 4 in conjunction with Article 88 para 1 GG.

[31] See further on this: A. Thiele, *Finanzaufsicht*, cit., 390 f.

[32] E. Gören, *Der einheitliche Aufsichtsmechanismus bei der Europäischen Zentralbank*, cit., 52 f.

institutions,[33] as it benefits from the selection previously operated by the BuBa.[34] On the other hand, this organisational structure also demands that the information exchange between both entities be efficient and timely. The existing formal and informal exchanges as well as the existing joint committees thus play a crucial role. However, potential for improvement by means of an increasing resort to technology appears to exist, even if constitutional constraints may impose limitations in this regard.

A Forum for financial market supervision composed of BaFin and the BuBa, in which the Ministry of Finance may participate, is set to coordinate the cooperation between BaFin and BuBa in supervisory matters.[35] This Forum exists in parallel to the Financial Stability Committee (*Auschuss für Finanzstabilität*), which brings these three entities together with a view to exercising macroprudential supervision.[36]

This relationship – and arguably BaFin's dependence on the BuBa – is in some way similar to the relationship that exists between the ECB-SSM and NCAs where the ECB-SSM, too, depends on the provision of information and the expertise of the NCAs. On the other hand, it also raises the question of the independence (or 'Chinese wall') between central banks and supervisors. This issue could be particularly problematic in Germany considering that the BuBa had wanted to become Germany's banking supervisor after it had lost powers to the ECB's benefit following the introduction of the euro. There is thus potential for competition between the two authorities, which both sit on the ECB's Supervisory Board. This actually raises the question of over-representation of some of the Member States within the Supervisory Board, whereby those Member States whose central bank is not the NCA are in a more favourable position than those which central bank is also the NCA. However, such dual representation is perhaps necessary for the effective coordination between the two entities, especially seeing as the BuBa and not the BaFin is part of the Governing Council. In any event, they share a single vote.

2.3. The (limited) impact of EU financial integration on Germany's institutional framework

The creation of the SSM has hence not affected the pre-existing division of tasks and competence between the BaFin and the BuBa, which continue to

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33 J.H. Lindemann, *Zusammenarbeit mit der Deutschen Bundesbank*, in K.-H. Boos, R. Fischer, H. Schulter-Mattler (eds), *KWG. CRR-VO* (C.H. Beck, 2016), para 7, sub-para 5.

34 L. Gramlich, *Die rechtswissenschaftliche Sicht einer neuen Bankenaufsichtsstruktur in Deutschland*, in R. Pitschas (ed), *Integrierte Finanzdienstleistungsaufsicht: Bankensystem und Bankenaufsicht vor den Herausforderungen der Europäischen Wirtschafts- und Währungsunion; Vorträge und Berichte beim Speyerer Wirtschaftsforum an der Deutschen Hochschule für Verwaltungswissenschaften* (Duncker & Humblot, 2001).

35 FinDAG, section 3.

36 Gesetz zur Überwachung der Finanzstabilität (Finanzstabilitätsgesetz – FinStabG) (Financial Stability Act), section 3 (Act on Monitoring Financial Stability).

operate as they did previously with respect to Less Significant Institutions (whose supervision is still primarily exercised at the national level).[37] Both entities support the ECB in its role as banking supervisor, and they must keep each other updated about any information (request) they receive from the ECB to ensure that they always have the same amount of information.

The same may be said of the SRM as the creation and later merger of the FSMA with the BaFin were the results of national dynamics. It is worth noting that this merger clearly contravenes the recommendation contained in Article 3(3) BRRD whereby competences in the area of resolution should only exceptionally be conferred upon the NCA.

However, the efforts of integration at the supranational level that triggered the creation of the ESRB did lead to the introduction of the Committee of Financial Stability mentioned previously, in 2013. This Committee, in charge of macro-prudential supervision, was also established to 'serve as a link to the European Systemic Risk Board'.[38]

Furthermore, as EU integration deepens in the financial domains and as requirements of independence are established at the supranational level, the pressure in favour of BaFin's independence from the Ministry of Finance increases, as illustrated by the fact that the Ministry respects BaFin's operative independence and refrains from ex ante interferences.

Overall, the impact of the creation of the EBU (and the efforts at the EU level towards more integration in this domain) on the German institutional arrangements in the area of financial supervision has, nonetheless, remained limited.

3. Italy's stable institutional design… and de facto evolution

3.1. Historical evolution[39]

The Bank of Italy has a long tradition in banking supervision, a function it started to exercise as early as 1926. Nonetheless, it is the Banking Law of 1936 – which remained in force until 1993 – that established a single and consistent banking system. In 1936, banking supervision was formally entrusted to a State organ, the *Ispettorato per la difesa del risparmio e l'esercizio del credito* (Inspectorate for the defense of savings and the exercise of credit), nonetheless

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37 T. Roth, *Die indirekte Bankenaufsicht durch die Europäische Zentralbank*, cit., 137.

38 D. Detzer, H. Herr, *Financial regulation in Germany*, cit., 48.

39 Much of this historical summary is based on M. Clarich, *Regulation of the Italian Banking Sector: From the 1936 Banking Law to the European Banking Union*, in D. Sorace, L. Ferrara, I. Piazza (eds), *The changing administrative law of an EU Member State: The Italian case* (Springer-Giappichelli, 2021), 223-242, esp. 225 f. See also F. Capriglione, *The Bank of Italy*, in D. Siclari (ed), *Italian Banking and Financial Law* (Palgrave, 2015) and R. D'Ambrosio, *La Banca d'Italia*, in G.P. Cirillo, R. Chieppa (eds), *Le autorità amministrative indipendenti* (CEDAM, 2010).

chaired by the Governor of the Bank of Italy, which was *de facto* in charge of banking supervision.[40] This *de facto* situation was formalised with the dissolution of the Inspectorate in 1944.[41] Some supervisory responsibilities were then (and a few still are) shared between an interministerial committee (which is today the interministerial Committee for Credit and Savings CICR)[42] in charge of credit oversight, the Ministry of the Treasury, and the Bank of Italy.

This system supervised a wide variety of institutions (ordinary banks, cooperative banks, savings banks, public-law credit institutions, rural and specialised sectoral banks) and subjected them to a common regime under firm public control. The custodianship of public savings and credit activity were defined as "duties of public interest" and as such justified heavy restrictions on the freedom of business and even saw banking categorised as a public service.[43] The Bank of Italy was in charge of the authorisation procedure, whereas the interministerial committee was conferred some supervisory and regulatory tasks. The Bank of Italy could also issue special rules. Its involvement was justified for a variety of reasons, among which was also the fact that (contrary to the Treasury) it had (and still has) local branches.[44] In this sense, a parallel between the situation in Italy and that in Germany may be observed. Interestingly, affected entities could – and still can under certain circumstance – request the Bank of Italy's supervisory decisions be reviewed by the interministerial committee (today's CICR),[45] which raises the issue of its compatibility with the SSM.[46] In practice, this procedure is, however, not used.[47]

The Bank of Italy's powers remained very far-reaching for a long time (that is, it held a hegemonic position in the system of supervision and its Governor had

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40 M.E. Salerno, *Art. 4*, in S. Bonfatti (ed), *Commentario al Testo unico bancario. D. Lgs. N. 385/1993* (Pacini Giuridica, 2021), 15.

41 Royal decree law 226/1944, confirmed by the Decree by the provisional Head of State 691/1947. See on this historical evolution: D. Siclari, *Costituzione e autorità di vigilanza bancaria* (CEDAM, 2007), 217 f.

42 Nowadays, the CICR is composed of the Minister of Economy and Finance, who presides over it, the Minister of Agriculture policy, the Minister of Economic development, the Minister of Infrastructures and transport, the Minister of European policy. The Governor of the Bank of Italy is member *ex officio*, but with no voting right. Furthermore, the Director general of the Treasury has been in charge of the secretariat in practice. Other ministers as well as the presidents of the authorities in charge of the supervision of other financial sectors may be invited too.

43 M. Clarich, *Regulation of the Italian Banking Sector*, cit., 227.

44 D. Siclari, *Costituzione e autorità di vigilanza bancaria*, cit, 225.

45 Testo Unico Bancario (Decreto legislativo, 1 settembre 1993, No. 385) (Banking Act), Article 9. See on this Committee: S. Amorosino, *The Interministerial Committee for Credit and Savings (ICCS) and the Minsitry for the Economy and Finance. 20 years after the Consolidated Law on Banking*, in D. Siclari (ed), *Italian Banking and Financial Law. Vol. I, Supervisory Authorities and Supervision* (Palgrave, 2015), 133-144 and M.E. Salerno, *Art. 2*, cit., 9.

46 R. D'Ambrosio, *Unione bancaria e requisiti di indipendenza, accountability e organizzativi della Banca d'Italia*, in M.P. Chiti, V. Santoro (eds), *Il diritto bancario europeo. Problemi e prospettive* (Pacini Giuridica, 2022).

47 International Monetary Fund, *Italy: Financial sector assessment program. Technical note Banking regulation and supervision and bank governance*, IMF country report No. 236, 2020, 17.

strong powers, compared to those attributed to the CICR, especially following the adoption of the Consolidated Banking Act (*Testo Unico Bancario* (TUB)) in 1993.[48] In particular, its exclusive, national prerogatives in this domain were reaffirmed on several occasions vis-à-vis the regional administrative level.[49] In 2001, the Title V of the Italian Constitution was reformed, leading to the further regionalisation of the Italian institutional order.[50] The regulation of the banking activity remains within the realm of the competences of the State nonetheless.[51]

The overall framework in place was, though, significantly reformed in 1993 when the TUB was adopted in response to the changes induced in the 1970s and 1980s by the European integration process.[52] For instance, the Second Banking Directive[53] provoked significant changes in Italy during that period, as it led to conclusive qualification of banking as a business activity, in a moment where Italy had already started the privatization of public credit institutions.[54] At the same time, the Bank of Italy was conferred some powers in controlling the competition in the banking sector, which it exercizes jointly with the national Competition and Market Authority (*Autorità garante della concorrenza e del mercato*).[55] The Banking Law of 1936 showed a great capacity of adaptation to changes in the economic reality and it constituted the basis on which changes were implemented.[56] Notwithstanding this, following the adoption of the Second Banking Directive, the need for a reorganisation of the national legal framework on banking emerged, and the Government was delegated not only the power to transpose that Directive, but also the power to adopt a single consolidated legislative act.[57] Accordingly, a Legislative decree transposing the Directive, and the TUB were adopted in 1992 and 1993, respectively.[58]

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48 D. Siclari, *Costituzione e autorità di vigilanza bancaria*, cit., 239-240. See on this reinforcement of the Bank of Italy's powers and the background to it: M.E. Salerno, *Art. 2*, cit., 10.

49 D. Siclari, *Costituzione e autorità di vigilanza bancaria*, cit., 242 f. See also on the regions' competences: R. D'Ambrosio, *Unione bancaria e requisiti di indipendenza, accountability e organizzativi della Banca d'Italia*, cit.

50 See on this reform: R. Bin, G. Pitruzzella, *Diritto costituzionale* (Giappichelli, 2020), 294.

51 D. Siclari, *Costituzione e autorità di vigilanza bancaria*, cit., 244. Some regions with a special status and the autonomous provinces of Trento and Bolzano disagreed with the loss of their competences to the benefit of the central State, ie to the Bank of Italy, that followed from the approval of the TUB. They launched a procedure before the Constitutional Court which, however, found that their legislative competences were not unduly reduced. See Decision No. 224 of 8 June 1994. See further on this point: R. D'Ambrosio, *Credito (ordinamento amministrativo)*, *Digesto on line*, available at Pluris and Leggi d'Italia websites, Wolters Kluver Italia s.r.l., 2011.

52 See also M. Pellegrino, *La Banca d'Italia e il problema della sua autonomia (dalla traslazione della sovranità monetaria alla Perdita della supervision bancaria?)*, (2018) 4 Rivista Trimestrale di Diritto dell'Economia 466, 470 (on the evolution of Bank of Italy as an NCB).

53 Directive 89/646/EEC.

54 Legge 218/1990, 'Law Amato'.

55 Article 20, Legge 287/1990.

56 R. D'Ambrosio, *Credito (ordinamento amministrativo)*, cit.

57 Article 25, Legge 142/1992.

58 Decreto legislativo 481/1992 and Decreto legislativo 383/1993 (TUB).

The changes at the EU level that materialized with the entry into force of the Maastricht Treaty demanded that the pre-existing Italian supervisory framework be amended with a view to its 'neutralization'.[59] In other words, the margin left to political decision-making was reduced to the benefit of technical expert decision-making, and the Bank of Italy's independence was enhanced. As a consequence of this, its predominance over the executive organs (formally) also involved in banking supervision (the Treasury and the CICR) was further reinforced. The Italian banking sector could also become more open to foreign credit institutions as a result of the reforms conducted.

In view of the Bank of Italy's quality as a National Central Bank (NCB) and part of the European System of Central Banks (ESCB), it was naturally affected as well by the reforms demanded by the entry into force of the Maastricht Treaty, for example as regards its independence.[60] Put differently, the impact of the European integration process on the institutional framework for banking supervision in Italy must be assessed taking due account of the consequences already triggered by the creation of the ESCB.

The system of supervision in place has been very stable over time, although this was also associated to some inefficiencies. For instance, the claim has been made that the Bank of Italy's neutrality in the exercise of its role as banking supervisor remained illusory. A new law (No. 262 of 2005 – *Disposizioni per la tutela del risparmio e la disciplina dei mercati finanziari*) was adopted in 2005 after a parliamentary inquiry had considered the necessary reforms.[61] Accordingly, the Governor's powers were reduced following the conferral of all powers related to the institutional matters – with the exception of some monetary policy prerogatives still conferred to the Governor – to a collegial body (*Direttorio*, Directorate or Governing Board) composed of the Governor, the Senior Deputy Governor and three Deputy Governors.[62] A duration of six years was also defined for the Governor's mandate (which may only be renewed once), whereas it had previously been indefinite.

Before turning to the organisation of financial supervision today in the next sub-part, it should be noted that originally the Bank of Italy was also in charge of the supervision of financial markets (issuance of securities to be listed or placed through banks), a prerogative it lost when the CONSOB (the Italian Securities and Markets Authority) was created in 1974;[63] a further definition of their respective tasks was later required. The Italian system is thus closer to the French institutional design of financial supervision than to the German (unitary) one, as responsibilities are shared among the Bank of Italy, the CICR,

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59 D. Siclari, *Costituzione e autorità di vigilanza bancaria*, cit., 268.

60 See on this evolution: R. D'Ambrosio, *Credito (ordinamento amministrativo)*, cit.

61 See on the system that existed previously: D. Masciandaro, G. Tabellini, *La governance della Banca d'Italia*, (2005) 6 Il Mulino 1019, 1024 f.

62 Article 22, Statute of the Bank of Italy.

63 Legge 7 June 1974, No. 216.

the Minister for Economy and Finance, the CONSOB, the Committee for the supervision of pension funds (COVIP), and the Institute for the Supervision of Insurance (IVASS), whereby the involvement of the Minister of Economy and Finance is justified in view of the domain affected, ie the freedom to conduct business (*libertà d'impresa*).[64] Its role is limited though and should not entail technical assessments.[65] It may, for instance, 'adopt decrees on the suitability requirements of major shareholders and managers (fit and proper requirements) [… and may] put banks and companies belonging to banking groups into compulsory administrative liquidation' on a proposal by the Bank of Italy.[66] It also plays a crucial role in resolution, as it is to approve the Bank of Italy's decision to launch resolution of a banking group.[67] Actually, the International Monetary Fund has recommended that the Ministry lose its power to place a credit institution under compulsory liquidation and that the Bank of Italy be vested with this power instead, after consultation between the supervisor (the ECB and the Bank of Italy) and the Ministry.[68]

3.2. Financial supervision today

Whereas the Maastricht Treaty had provoked important changes in the Italian institutional system, like it happened in Germany and other Member States as well, the creation of the EBU has not led to significant institutional changes within the Italian system. No new institution was created, and responsibilities in banking supervision were not attributed to another (or a new) institution. As such, supervision of credit institutions and financial intermediaries is still the responsibility of the Bank of Italy, whereas the CONSOB continues to supervise financial markets.[69]

With the entry into force of the Single Supervisory Mechanism (SSM), the Bank of Italy's Directorate General for Financial Supervision and Regulation, which is in charge of banking and financial supervision, was reformed to 'make the controls on banks and financial intermediaries more effective'.[70]

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64 R. D'Ambrosio, *Credito (ordinamento amministrativo)*, cit.

65 *Ibidem*.

66 Article 80(1) TUB and International Monetary Fund, *Italy: Financial sector assessment program*, cit., 17. This dependence of the Bank of Italy on a political organ to define those criteria, which it may not update or upgrade as necessary has been criticized by the International Monetary Fund (*ibidem*, 18).

67 Article 4 d.lgs. 180/2015.

68 International Monetary Fund, *Italy: Financial sector assessment program*, cit., 23.

69 The division of competences between Bank of Italy and CONSOB is organized as follows: for investment firms and collective asset managers, the Bank of Italy is responsible for prudential aspects and CONSOB for transparency and correctness; with respect to markets, the Bank of Italy is responsible for wholesale markets in sovereing bonds and CONSOB for other markets. With regard to listed companies and public offers, CONSOB is the only competent authority. See further on their respective spheres of competence: R. D'Ambrosio, *La vigilanza europea e nazionale*, in S. Amorosino (ed), *Manuale di diritto del mercato finanziario* (Giuffré, 2014).

70 Bank of Italy, Organization of the Bank of Italy's supervisory activities.

In banking supervision, powers are generally shared between the Bank of Italy and the ECB following the SSM Regulation. Although the TUB establishes that the CICR is the authority responsible for 'high-level supervision',[71] since the entry into force of the SSM Regulation it is no longer involved in the regulation of prudential matters; only the Bank of Italy is. The CICR may now only issue some regulatory acts – on a proposal by the Bank of Italy – on matters including for instance transparency of contractual clauses and customers (not only consumers) protection, which are tasks that have not been conferred upon an EU Institution or agency vested, for these purposes, with supervisory powers.[72] Prior to the reform of the TUB enacted in 2015,[73] in some cases the CICR still had to deliberate on certain regulatory proposals made by the Bank of Italy in the matter of prudential requirements. Against this background and the now limited role of the CICR, some researchers have even envisaged its suppression, also because national and European legislators have now clearly opted for a model of banking supervision exercised by independent *administrative* organs as opposed to one placed in the hands of political organs.[74] Also the International Monetary Fund has recommended that the CICR's role be clarified and that any residual interference with the Bank of Italy's prudential mandate be removed.[75]

Despite this absence of changes to the institutional framework following the creation of the Banking Union, it is noteworthy that the creation of the SSM has provoked a re-balancing of powers between government and central bank in favour of the latter, thereby further enhancing the pre-existing tendencies already outlined above.[76] This is due among other reasons to the fact that, with respect to the adoption of supervisory decisions, it is the Bank of Italy that is part of the decision-making procedures at the EU level, and not the Italian government.[77] In contrast to this, the Italian government continues to play a key role alongside the Bank of Italy in banking resolution. Besides, even if the right to complain to the CICR for an action of the Bank of Italy in its quality as banking supervisor formally remains,[78] this possibility cannot be used against decisions of the ECB, whilst the ECB is now in charge of the direct supervision of Significant Institutions. However, the impact of this loss of power should not be overestimated seeing as, in practice, this procedure has not been used over

71 Article 2(1) TUB.

72 International Monetary Fund, *Italy: Financial sector assessment program*, cit., 16.

73 Decree law 72/2015.

74 This raises the question of the – political or administrative – nature of the CICR, which has also been object to debates among scholars. M.E. Salerno, *Art. 2*, cit., 10 and R. D'Ambrosio, *Credito (ordinamento amministrativo)*, cit.

75 International Monetary Fund, *Italy: Financial sector assessment program*, cit., 23.

76 R. Ibrido, *L'Unione Bancaria Europea* (Giappichelli, 2017), 263.

77 S. Amorosino, *The Interministerial Committee for Credit and Savings (ICCS) and the Minsitry for the Economy and Finance*, cit., 137.

78 M. Sepe, *EBU and the National Credit Authorities' structure: the Italian case. The role of CICR in the new institutional context*, (2015) 4 Law and Economics Yearly Review, 161, 172.

the past fifty years.[79] The creation of the SSM did lead to a further loss of power for the CICR in that it lost its regulatory powers although only in the area of banking prudential supervision and not in the area of transparency (see, for instance, Article 117 TUB). Another interesting feature of the Italian system lies in the fact that supervisory information and figures held by the Bank of Italy may not be denied to the Minister of Economy and Finance (acting in its quality as President of the CICR) on the ground of secrecy, contrary to what is the case for all other public administrations.[80]

Following the transposition of the BRRD, the Bank of Italy was also attributed powers as national resolution authority.[81] To this end, a new Resolution and Crisis Management Unit (*Unità di Resoluzione e Gestione delle Crisi*) was instituted within the Bank of Italy (it had previously been in charge of dealing with banking crises already though). It reports directly to the *Direttorio* (collegial organ at the head of the Bank of Italy). Early intervention measures are, though, still within the realm of the DG in charge of Banking and Financial Supervision.

3.3. Conclusion

The analysis of the Italian case thus reveals that, formally, it has remained remarkably stable. Although the EU integration process has provoked an impact on it, it was caused by the creation of the ESCB much more so than by the creation of the ESFS or the EBU. Also, the Italian case is characterised by a *de facto* evolution and indeed re-balancing of powers in favour of its central bank and to the detriment of its executive, which has led some authors to question the need to maintain the CICR.

4. The French case: a mix between the German and the Italian models?

4.1. Historical evolution

The last case examined in this article is the French one. The analysis must begin with a brief overview of the evolution of the banking system and its regulation, as it has undergone numerous and complex changes over time.

After WWII, banks were divided into three categories: deposit banks, investment banks, and medium- and long-term lending banks.[82] It is only in the 1980s that important changes were introduced in the French banking system:

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79 *Ibidem*, 175.

80 Testo Unico Bancario, Article 7. This exception also applies to judicial authorities.

81 Decreto legislativo 16 Novembre 2015, No. 181.

82 The information on this historical background is extracted from: C. Blot *et al.*, *Financial regulation in France*, in R. Kattel, J. Kregel, M. Tonveronachi (eds), *Financial regulation in the European Union*, cit., 12 f.

until then, it 'was relatively closed, highly regulated and compartmentalized'.[83] A wave of nationalizations started in 1982, and they were followed by the approval of the Banking Act on the activity and control of credit organizations of 1984,[84] an act, which anticipated the changes, which the Single European Act of 1986 would bring about.[85] This act, which aimed at enhancing competition and at improving the efficiency of the banking sector, abolished the classification of banks into three categories, and created three collegial authorities in charge of controlling the banking sector's activities: the Banking Regulation Committee (*Comité de la Réglementation Bancaire*, CRB), the Credit Organisations Committee (*Comité des Etablissements de Crédit*, CEC) and the Banking Commission (*Commission Bancaire*, CB). The Banking Commission replaced the *Commission de contrôle des banques* (Committee for the control of banks) created in 1941.[86] It was in charge of controlling the correct application of the existing legislation by the banks, and could sanction them where they did not respect their obligations, thus being France's supervisory authority. The Bank of France would provide the (personal) resources necessary to the Banking Commission in order to conduct its (on site) inspections.[87] The Banking Regulation Committee would outline the general rules applicable to credit, and the Credit Organisations Committee had the power to decide, authorize or give derogations among others in the area of banking activities.

Similarly to what has historically been the case in Italy, in France, too, the government used to play an important role in banking supervision. The law of 1945, which nationalized the Bank of France, also created the *Conseil national du Crédit* (National Council of Credit (CNC)) presided over by the Minister of economy and finance, who could, however, delegate its powers to the governor of the Bank of France, who was *ex officio* the CNC's vice-chair.[88] In addition to the chair and the vice-chair, the CNC was composed of 45 members, of which 13 were nominated by the Minister of economy and finance, 25 upon proposal by various professional cooperatives. Seven were (former) leaders of public or semi-public credit institutions: the director general of the *Caisse des dépôts et des consignations* (Deposits and consignments fund), the governor of *Crédit foncier de France*, the CEO of *Crédit national*, the director general of the national fund of agricultural credit (*caisse nationale de Crédit agricole*), the director general of the Central fund for economic cooperation (*Caisse centrale de coopération économique*), the president of the *Crédit populaire de France* (popular credit of France), and a person designated by the Minister of economy

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83 *Ibidem*, 12.

84 Loi n° 84-46 du 24 janvier 1984 relative à l'activité et au contrôle des établissements de crédit.

85 C. Blot *et al.*, *Financial regulation in France*, cit., 11.

86 See on this Committee H. Fournier, *La Commission de contrôle des banques*, (1951) 2 Revue économique, 591.

87 Article 39 Loi n° 84-46 du 24 janvier 1984, cit.

88 Article 12 Loi n° 45-15 du 2 décembre 1945 relative à la nationalisation de la Banque de France et des grandes banques et à l'organisation du crédit.

and finance.[89] Also, the Director of the Treasury used to attend all meetings of the CNC and of its committees, of which they were five: one on deposits, one on short-term credit, one on medium-term credit, one on external trade and one on financial institutions. Representatives of overseas French *départements* and territories, as well as Monegasque representatives, could be invited to participate where appropriate.

It may be noted that the Bank of France played an important role in the CNC as it used to serve as the secretariat to the CNC and as some of its functions were exercized 'through the intermediation' of Bank of France. As such, it has been claimed that banking supervision was exercised based on a model of cooperation between the Finance Ministry and Bank of France.[90]

The CNC originally had far-reaching consultative, regulatory and jurisdictional powers, but, over time, its role evolved to a consultative one only.[91] Indeed, following the adoption of the Banking Law in 1984,[92] the CNC ceased to have regulatory powers, as these were transfered to the Banking Regulation Committee and the Credit Insitutions Committee. The CNC's role as an advisory authority was however enhanced, and it was to prepare a report on currency, credit and the functioning of the banking and the financial system on a yearly basis.

The intertwinement between institutions was not limited to the relationships between the CNC and the Bank of France already outlined. Indeed, the members of the Banking Regulation Committee and of the Credit Organisations Committee were chosen among the permanent members of the CNC, to whom they would report on an annual basis.[93] A similar overlap did not formally exist with the Banking Committee which, however, was also chaired by the Governor of Bank of France and in which the Director of the Treasury participated alongside a Counsel of State, a Counsel from the Cassation Court and two members designated on the ground of their expertise in the banking and financial domain. The Chair – the Governor of Bank of France – had the capacity to decide in case of a tie.[94]

Numerous reforms and mergers subsequently affected these (and newly created) Committees until the creation of the Prudential Control Authority – France's NCA – in 2010. These reforms are not detailed here in as far as they all

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89 The composition of the CNC evolved in 1984 to mirror the evolution of the banking sector and include territorial and democratic representation. Comité Consultatif du Secteur Financier, *Fiche d'information: Conseil national du crédit et du titre*, 2017, 3.

90 P.H. Cassou, *La réglementation bancaire*, SÉFI, 1982, 454.

91 Comité Consultatif du Secteur Financier, *Fiche d'information: Conseil national du crédit et du titre*, cit.

92 Loi n° 84-46 du 24 janvier 1984, cit.

93 Article 29 Loi n° 84-46 du 24 janvier 1984, cit.

94 Article 38 Loi n° 84-46 du 24 janvier 1984, cit.

preceded the ACP's creation. [95] However, one important reform worth mentioning is the one that took place in 2003 when the new Financial Security Law was approved.[96] It was adopted after it had become apparent that the French financial regulation regime with its numerous responsible entities was unfit for purpose. Among other things, it was deemed insufficiently transparent, too complex, and ill-suited to address technological evolutions in the banking sector.[97] The Financial Secutity Law created for instance the *Autorité des marchés financiers* (AMF), the financial markets authority. Additionally, it may generally be said that in France responsibilities were divided among various entities: some had regulatory powers, others a consultative function, some would check that the supervised entities observed the applicable rules and some were in charge of licensing; one authority/entity could also exersize one or more of these functions.[98]

4.2. Banking supervision in France today

Today, banking supervision is performed in France by the *Autorité de Contrôle Prudentiel et de Résolution* (Prudential and Resolution Control Authority, ACPR). Its predecessor, the ACP (*Autorité de Contrôle Prudentiel*) was created in 2010 following the merger of the Banking Committee, the Insurance Companies Committee (*Comité des entreprises d'assurance*), Committee of the investment and companies and credit instituions (*Comité des établissements de credit et des entreprises d'investissement*) and the Committee in charge of controlling insurance and social insurance companies (*Autorité de contrôle des assurances et des mutuelles*).[99] This reform was part of a general attempt to modernize the French economy by the means of the Act on the modernization of the economy (*Loi sur la modernisation de l'économie*[100]*) adopted in 2008. This Act contains an enabling clause (Article 152) according to which the Government is allowed to adopt an executive act (ordonnance*) in several domains. In particular, the Government may adopt measures – later ratified by Parliament to attribute the same normative power as ordinary laws to them – with respect to the authorities in charge of authorizing and controlling the financial sector to 'guarantee financial stability and reinforce the competitiveness and the attractiveness of the French financial sector'.[101] Accordingly, the Government adopted an administrative act

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95 Their detailed account may be found in J.-P. Valette, *Régulation financière internationale, européenne et française* (Ellipses, 2020), 194 f.

96 Loi n° 2003-706 du 1 août 2003 de sécurité financière.

97 J.-P. Valette, *Régulation financière internationale, européenne et française*, cit., 205.

98 See further on the division of responsibilities among the various entities: E. Bouretz, J.-L. Emery, *Autorité de contrôle prudential* (Revue Banque édition, 2010), 15.

99 See further: E. Bouretz, J.-L. Emery, *Autorité de contrôle prudential*, cit., 11-16 and 17 for the detail of the functions exercised by the single committees. The focus is set here on the authorities in charge of the banking sector and thus the reforms already operated previously (in 2004) in the supervision of operators in the insurance sector are not considered.

100 Loi n° 2008-776 du 4 août 2008 de modernisation de l'économie.

101 *Ibidem*, Article 152 (2).

in January 2010,[102] which entailed the creation of the ACP as an independent administrative authority.[103] As such, the Act adopted in 2008 marked the third wave in the evolution of the French system of financial supervision: the first one was provoked by the adoption of the Banking Act of 1984, the second one took place as a consequence of enhanced integration at the European level, and the third one happened in 2008, when the Act was adopted in response to the financial crisis.[104] Hence, like it has been the case in Italy, financial integration at the European level triggered reforms at the national level. At the same time, the Banking Act preceded numerous reforms, which only took place at a later stage at the European level. This was, for instance, the case of the liberalization of capital movements (which only intervened in 1988 at the European level), the introduction of cross-border competition and the definition of permitted services (enshrined in a directive in 1989), capital requirements (dating back to 1989), the definition of investment services (from 1993), deposit guarantee (from 1994) and crisis management schemes (from 2001).[105]

The merger between supervisors in the banking and insurance sectors was triggered by the similarity of the functions fulfilled by the two kinds of authorities, and by the similarity of their operating procedures, as well as by the necessity to have an overview over the *bancassurance*s, that is those entities that offered both insurance and credit services,[106] which flourished on the French market in the 1980s.[107] Up until today, the supervision of financial markets is entrusted with another authority, the AMF which is why the French system of financial supervision is sometimes qualified as a 'two entity-model'. Coordination mechanisms between the two entities have been duly established, for instance under the auspices of the *pôle commun AMF-ACPR* (common group AMF-ACPR),[108] or in the framework of monthly meetings (*Réunion des autorités financières*).[109]

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[102] Ordonnance n° 2010-76 du 21 janvier 2010 portant fusion des autorités d'agrément et de contrôle de la banque et de l'assurance.

[103] See on this status: E. Bouretz, J.-L. Emery, *Autorité de contrôle prudential*, cit., 21 f. and J.-P. Valette, *Régulation financière internationale, européenne et française*, cit., 177 f. The creation of the ACP followed the recommendation of a report by the Financial inspection directorate, which considered how the supervision of financial activities should be supervised in France in 2009 and of a report on the monitoring of compliance with professional obligations towards customers in the banking sector: B. Deletré, *Rapport de la mission de réflexion et de propositions sur l'organisation et le fonctionnement de la supervision des activités financières en France*, Inspection générale des finances n. 2008-M-069-02, 2009, 28 and B. Deletré, J. Azoulay, P. Dugos, *Rapport de la mission de conseil sur le contrôle du respect des obligations professionelles à l'égard de la clientèle dans le secteur financier*, Inspection générale des finances n. 2008-M-040-03, 2009.

[104] C. Blot *et al.*, *Financial regulation in France*, cit., 11.

[105] *Ibidem*, 14.

[106] J.-P. Valette, *Régulation financière internationale, européenne et française*, cit., 226.

[107] C. Blot *et al.*, *Financial regulation in France*, cit., 15.

[108] This group publishes a yearly report on its acitivites available at Rapport annuel du pôle commun AMF-ACPR.

[109] International Monetary Fund, *France: Financial sector assessment program. Technical note Select topics in financial supervision and oversight*, IMF country report No. 325, 2019, 31.

ACPR is institutionally attached to the French Central Bank, Bank of France (*Banque de France*), a fact which could have been problematic owing to the Bank of responsibility in the area of monetary policy. However, institutional embodiment of ACPR in the BdF has been assessed positively as ACPR can benefit from the BdF's expertise, and they can coordinate their actions.[110] Such type of institutional borrowing is also common in France where, for instance, the *Haut Conseil des Finances Publiques*, France's Independent Fiscal Institution as per the definition contained in Eurocrisis law, is institutionally embedded in the *Cour des comptes* (Court of auditors). Another characterstic of the ACPR, which is shares with other (administrative) authorities lies in the important role played by colleges. Those are organs composed of non-permanent members, which have decisionary powers but rely on the preparatory work and the assistance provided by administrative services. Those services, in turn, implement the colleges' decisions.[111]

ACPR's status is that of an administrative authority, but it does not have legal personality.[112] It lost its status as independent administrative authority following a general reform of this status in 2017.[113] In practice, this has not, however, changed the ACPR's level of independence. Fees paid by the institution it supervises finance its budget although the Bank of France may provide exceptional funding. Its resolution and supervision colleges are chaired by the Governor of Bank of France, employees of ACPR are Bank of France officials and its budget is annexed to the Bank of France's. Shared services are commonly used and, in fact, necessary on numerous occasions for the sake of efficiency and economy of resources. Nevertheless, the chairmanship of both committees by the Governor of Bank of France, whilst allowing the coordination between monetary, supervisory and resolution authorities, could at least potentially raise some issues of independence between the three functions performed by the Bank of France. The Supervision and the Resolution colleges are however composed of several members (19 and 7 members, respectively), a fact that presumably compensates for the chairmanship exercised by the Governor. Furthermore, perhaps the question of the ACPR's independence needs to be asked not only with respect to the Bank of France, but also with respect to the Government, which is always represented by the Director-General of the Treasury (who may not vote however).

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110 C. Blot *et al.*, *Financial regulation in France*, cit., 29.

111 See further on this model and its advantages and disadvantages: B. Deletré, *Rapport de la mission de réflexion et de propositions sur l'organisation et le fonctionnement de la supervision des activités financières en France*, cit., 28. The need to separate sanctioning powers and the College was notably highlighted.

112 Its status is thus different from that of some of the authorities that preceded it. J.-P. Valette, *Régulation financière internationale, européenne et française*, cit., 228. This also distinguishes it from its 'twin' supervisory authority, the AMF. See for a discussion on the consequences of this absence of legal personality: D. Israël, *L'indépendance de l'Autorité de Contrôle Prudentiel*, (2012) 3 Revue française d'administration publique, 759, 761 f.

113 Loi organique n° 2017-54 du 20 janvier 2017 relative aux autorités administratives indépendantes et autorités publiques indépendantes.

The introduction of the Banking Union and the ensuing transfer of supervisory competences to the ECB did not lead to the creation of any new institution as France already had a supervisory authority to which it attributed competences in the area of resolution. But it did demand that it reforms its supervision of smaller banks, for which it is still primarily responsible.[114]

Like in Germany, the reinforcement of the framework for macroprudential supervision at the EU level by means of the creation of the ESRB was also accompanied by reforms at the domestic level in France. In 2010, a Council for Financial Regulation and Systemic Risk (*Conseil de la régulation financière et du risque systémique*, COREFRIS) replaced the College of Supervisory Authorities for Companies in the Financial Sector (*Collège des autorités de contrôle des entreprises du secteur financier*, CACES) which had been established in 1999 with a view to facilitating the cooperation among the various responsible committees. The COREFRIS was replaced in 2013 by the *Haut Conseil de Stabilité Financière* (High Council of Financial Stability, HCSF) chaired by the Minister of Finance.[115]

4.3. Conclusion

While reforms were also performed in both Germany and Italy over the past two decades, the French case clearly stands out, not because the reforms introduced in that Member State were induced by changes that happened at the EU level, but because of their (large) number and their high degree of complexity. As a consequence, it is not always easy to distinguish between domestic and European or global impulses for change. Domestic factors seem though to have played a larger or the largest role, and sometimes pre-dated reforms at the supranatinoal level.

5. Accountability post-EBU

To evaluate the impact of the creation of the EBU on the institutional structure for banking supervision in France, in Germany and in Italy, it is useful as a next step to analyse the mechanisms in place to guarantee administrative and democratic accountability in the multi-level system as it now exists.

It should be noted first that the NCAs' and the NRAs' accountability regimes are not mentioned in any way in the relevant EU legislation,[116] despite the fact that

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114 International Monetary Fund, *France: Financial sector assessment program*, cit., 9.

115 Loi n° 2013-672 du 26 juillet 2013 de séparation et de régulation des activités bancaires.

116 Mention is only made to the possibility left to the Member States to design a procedure to share confidential information with parliamentary committees of inquiry and courts of auditors (CRD, Article 59 (2), and Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No. 1093/2010 and (EU) No. 648/2012, of the European Parliament and of the Council [2014] OJ L 173/190, Article 84 (5) (b)).

these rules do define some of the features that these authorities should have, and despite their independence being set as a requirement. The relevant provisions merely state that the possibility for national parliaments to summon ECB-SSM representatives together with a representative of the NCA (who may, or may not, be the one sitting on the Supervisory Board) does not affect the accountability mechanisms that may exist vis-à-vis the NCA in accordance with national law. A similar provision is included in the Single Resolution Mechanism (SRM) Regulation. However, these provisions do not set a minimum, that is that they only state that national law may provide for accountability mechanisms, but they do not require that those exist. As a consequence, they may or may not be provided.

In contrast to this, global standards do set adequate accountability as a minimum requirement. The Bank for International Settlements Core principles for effective banking supervision foresee that '[t]he supervisor possesses operational independence, transparent processes, sound governance, budgetary processes that do not undermine autonomy and adequate resources, and *is accountable for the discharge of its duties and use of its resources*'.[117] The Financial Stability Board's Key Attributes of effective resolution regime, too, unequivocally establish that '[t]he resolution authority should have operational independence consistent with its statutory responsibilities, transparent processes, sound governance and adequate resources and *be subject to rigorous evaluation and accountability mechanisms to assess the effectiveness of any resolution measures*'.[118]

As regards *administrative accountability* first, following the creation of the SSM, part of the external audit function that had been performed at the national level had to be conferred upon the European Court of Auditors (ECA) to match the transfer of supervisory competences to the ECB. However, some of the national audit offices (or Supreme Audit Institutions, SAIs) have contended that, as a result of these changes, and because of the ECB's independence, an audit gap had emerged on the ground that the ECA has more limited powers vis-à-vis the ECB than they have vis-à-vis their respective NCA.[119] A second audit gap would have also arisen because they would now be barred from accessing information required to control NCAs' performance due to their being ECB documents. Furthermore, a third audit gap – which has not been identified by the SAIs – could also arise because the ECA may need information that the SAIs possess, although it may only request information from EU authorities, i.e. the ECB and the SRB and will depend on their capacity to provide it with the information needed. This question is, however, not examined here as the focus is set on identifying potential formal gaps.

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117 Bank for International Settlements, *Core Principles for Effective Banking Supervision* (Basel Committee on Banking Supervision, 2012), Principle No. 2, emphasis added.

118 Bank for International Settlements, *Key Attributes of Effective Resolution Regimes for Financial Institutions* (Financial Stability Board, 2014), Key Attribute 2.5, emphasis added.

119 Contact Committee of the Supreme Audit Institutions of the European Union, Ensuring fully auditable, accountable and effective banking supervision arrangements following the introduction of the Single Supervisory Mechanism (Luxembourg, 25 September 2015). See for an in-depth analysis of this issue: D. Baez, *Is there an audit gap in EU banking supervision?*, (2022) 23 Journal of Banking Regulation, 66.

To control whether these gaps are indeed new, and especially whether they have arisen in France, in Germany and in Italy, the mechanisms of administrative accountability must be examined.

The audit of BaFin's activities is within the remit of the *Bundesrechnungshof*.[120] Nonetheless, its competences are limited to an audit of its performance,[121] that is it cannot audit the way in which BaFin performs its supervisory tasks. Resultantly, even if the ECA's mandate vis-à-vis the ECB is more limited than it is towards other EU institutions,[122] and even if disagreements on the interpretation on this mandate have emerged on several occasions between the ECB and the ECA,[123] it may not be automatically concluded that, from a German perspective, an audit gap has emerged through the conferral of supervisory functions to the ECB. In Italy, the *Corte dei conti* has no powers over the Bank of Italy, expect for the activities it conducts as the Treasurer of the State. In France, it is the *Cour des comptes*, which is in charge of controlling ACPR. This is the case because ACPR, though being functionally independent, is part of BdF and does not have individual legal personality. In consequence, the prerogatives which the Court of auditors has towards BdF also apply to ACPR. The scope of the Court of auditors' action seems to be particularly broad, although performance audits appear to be excluded.[124] The Court of Auditors may perform an audit upon a request by either of the parliamentary assemblies.[125]

As regards *democratic accountability*, the unusual status of BaFin (if compared to the other NCAs) that results from its being placed within the Ministry of Finance also bears important influence for the democratic accountability control to which it is submitted. As noted above, eventually the minister of finance may be held accountable for BaFin's actions.[126] In Italy, ordinary committees as well as committees of inquiry may summon representatives of the Bank of Italy and question them about their banking

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120 Basic Law for the Federal Republic of Germany, Article 114 and Bundeshaushaltsordnung (Federal Budget Code), section 88.

121 Bundeshaushaltsordnung, sections 90 and 111.

122 See on this question: F. Allemand, *Proceedings of the ECB Legal Conference 2017* (European Central Bank, *ECB Legal Conference 2017. Shaping a new legal order for Europe: a tale of crises and opportunities*) and dedicated section in the proceedings of the ECB Legal Conference 2019 (European Central Bank, *Building bridges: central banking law in an interconnected world*).

123 See European Court of Auditors, Special report 'Single Supervisory Mechanism - Good start but further improvements needed' (2016) and European Court of Auditors, Special report 'The operational efficiency of the ECB's crisis management for banks' (2018).

124 D. Baez, *Is there an audit gap in EU banking supervision?*, cit.

125 In fact, it already conducted an audit on the modalities of the setup of ACPR in 2011 but it did not assess the quality of prudential supervision. Cour des comptes, Communication à la Commission des finances, de l'économie générale et du contrôle budgétaire de l'Assemblée nationale. Les modalités de mise en place de l'Autorité de Contrôle Prudentiel (2011).

126 While this may be positive in terms of democratic accountability standards, it also raises issues in terms of BaFin's independence, despite it being a requirement under 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 (SSM Regulation) [2013] OJ L 287/63, Article 19.

supervision tasks. Additionally, since 2005, the Italian parliament receives the Bank of Italy's (formerly bi-annual and now annual) report,[127] and the Governor shares his Final considerations every year on 31 May, which, too, contributes to transparency in the area of banking supervision. The Bank of Italy also supports the Government in answering questions related to supervision. In the past, the absence or limited accountability in the area of banking supervision had been also attributed to the division of the responsibility in this area between the Central Bank, CONSOB and the Ministry of Economy,[128] but this could have arguably improved since with the reinforcement of the Central Bank's predominance in supervisory matters. The Chair of ACPR may be heard by the Finance Committees of the National Assembly and the Senate upon their or his/her request. He/she may also be heard by parliamentary committees of inquiry. ACPR's annual reports are submitted to Parliament and to the President of the Republic.[129] We thus have three very different democratic accountability regimes in France, Germany and Italy, which are however caused by the different institutional setting in which their NCAs and their NRAs were established.

In contrast to the German and the Italian supervisory authorities, and in some ways similarly to the situation in France, the ECB-SSM is submitted to an original accountability mechanism for which responsibility primarily falls within the European Parliament (EP)'s and the Council's remit,[130] but in whose framework national parliaments may also be involved under certain circumstances. For example, the SSM Regulation foresees the EP's involvement in the designation procedure of the Chair of Supervisory Board,[131] the ECB-SSM's annual report shall be transmitted and presented to the EP, and, most importantly, the SSM Regulation establishes a 'Banking Dialogue' in whose framework the Chair of the Supervisory Board regularly appears before the EP's ECON Committee. Members of the EP may additionally submit questions to the ECB. Next to these obligations towards the EP, the SSM Regulation foresees accountability mechanisms towards the Eurogroup in the form of hearings.[132] National parliaments may, in turn, submit written questions or observations to the ECB, and they may 'invite the Chair or a member of the Supervisory Board to participate in an exchange of views in relation to the supervision of credit institutions in that Member State together with a representative of the national competent authority'.[133] The mechanisms

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127 Legge 28 Dicembre 2005, No. 262, Article 19 (4).

128 D. Masciandaro, G. Tabellini, *La governance della Banca d'Italia*, cit.

129 Code monétaire et financier, Article L612-12.

130 SSM Regulation, Article 20.

131 This is in contrast to the procedure applicable to the designation of the ECB President.

132 This is yet an additional formal recognition of the importance of the Eurogroup despite not being an EU institution (or even within the EU according to the latest decision of the Court of Justice on this matter (Case C-597/18 P *Council v Chrysostomides and others* [2020] ECLI:EU:C:2020:1028 (Chrysostomides judgement)).

133 SSM Regulation, Article 21 (3).

of accountability that apply to the SRB are somewhat different:[134] whereas its relationships to EP, Council and national parliaments is similar to the one applicable to the ECB-SSM, an additional layer of control is exercised by the Commission in view of its quality as EU agency.

In summary, as regards the first pillar of the EBU, independently of the fact that the accountability mechanisms in place to control the ECB's action in its quality as banking supervisor are more detailed and far-reaching than those that exist in the area of monetary policy, it is beyond any doubt that they are less far-reaching than those to which BaFin is submitted, be it simply because of the ECB's strong independence. They are, however, more far-reaching that those to which the Bank of Italy is submitted, and closest to the ones applicable to ACPR, although the EP has more powers than the French parliament.

6. Conclusion

The French, the German and the Italian models of financial supervision – in as far as the institutional aspects are concerned – appear to have been influenced by dynamics and legal constraints inherent to their legal frameworks and political systems, rather than having been defined in response to changes that have happened at the EU level, both in the form of the introduction of the ESFS and the EBU. The existing domestic constitutional frameworks have shaped the institutional designs in place, although in Germany other configurations that would consist in either reverting back to a functional model, or in entrusting the BuBa with larger competences (like it is the case of other national central banks) could be possible. The wide margin of national discretion left by the applicable EU norms (i.e. CRD and BRRD) would not pose any obstacle to this or to other changes to the regimes in place.

Perhaps the finding that the impact of the creation of the EBU has been limited is not surprising, considering that the reforms introduced at the national and the EU level (as well as the global level to some extent) were conducted in parallel, and by the same actors (that is, primarily by national governments).

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134 See for a comparison of the mechanisms in place in the first and the second pillar of the EBU: D. Fromage, R. Ibrido, *Accountability and Democratic Oversight in the European Banking Union*, in G. lo Schiavo (ed), *The European Banking Union and the role of law* (Edward Elgar Publishing, 2019), 66-86.

Regulation and supervision of the Spanish banking sector in the context of EMU: the importance of the Banking Union

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1. Introduction

Since Spain joined the Economic and Monetary Union (EMU) in 1998, its banking sector has undergone a radical transformation marked by various events. First, the adoption of the euro, which required adapting the main regulations affecting the sector, as well as accommodating its business model and development. This stage of intense growth following EMU entry and the macroeconomic implications of the euro – namely the removal of exchange rate risk between EMU partners, the progress in financial integration and the convergence of interest rates – fed a credit bubble that, in turn, led to a real estate bubble lasting until 2007. The second event was the start of the financial crisis in the summer of 2007 and the subsequent recession following the burst of the real estate bubble, which led to the bailout of Spain's banking sector with European funds in 2012. The European Stability Mechanism made available to the Government of Spain a credit line of up to 100,000 million euros.[1] The third event concerns the conditionality in the use of these bailout funds to comply with the obligations of the Memorandum of Understanding (MoU), which led to a period of radical transformation and restructuring of the banking sector, necessary to redress the imbalances accumulated in the past. Finally, with the birth of the European Banking Union (BU), and the implementation of the Single Supervisory Mechanism (SSM) in 2014 and the Single Resolution Mechanism (SRM) in 2015, the sector entered a new phase of adjustments to the BU, which takes us up to the present.

According to the information provided by the Bank of Spain (BoS), the transformations took the form of: a) a 44% reduction in the number of competitors through merger and acquisition processes, from 404 in 1999 to 225 credit institutions (191 deposit institutions, of which 79 are foreign branches) in June 2021; b) capacity adjustment, with a reduction in branch network of almost half, from 39,145 to 20,626, and a 28% reduction in employees from 246,685 in 1999 to 179,511 at the end of 2020; c) significant deleveraging after the beginning of the crisis, which reduced the domestic credit by 35%; and d) increased solvency, mainly explained by the stricter regulatory requirements arising from the Basel III Capital Accord.

The regulatory architecture in Spain follows a sectoral approach with different regulators for banking, capital markets, and pension funds and insurance companies. In this article, we focus on the banking sector, in which supervision underwent radical changes with the launch of the BU. Today, the European Central Bank (ECB) carries out the main supervisory functions over the significant credit institutions, while the BoS supervises the remaining institutions and oversees competition and the proper functioning of the payment system. Under this banking supervision model, the BoS is tasked with overseeing and supervising the financial system in collaboration with other Spanish institutions

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[1] Council Decision 2012/443/EU of 23 July 2012 addressed to Spain on specific measures to reinforce financial stability [2012] OJ L 202/17.

such as the CNMV,[2] which supervises the capital markets, and the DGSFP,[3] in charge of overseeing insurance companies and pensions funds.

In this context, the present article analyses how the creation of the BU has influenced regulation and supervision of the Spanish banking sector and how these tasks are performed. We start by analysing the evolution of the sector since Spain joined EMU, because of the paramount impact the adoption of the euro has had on the sector. Thus, in section 2 we review the impact on the banking sector of Spanish accession to the euro area, focusing on regulation and supervision. In section 3, we describe the imbalances accumulated in the period of intense growth up to 2007, which surfaced once the crisis began. In this section, the main legislative changes introduced to deal with the different phases of the crisis up to 2012 are reviewed. In section 4, we examine the period following the bailout of the Spanish banking sector and the conditions imposed by the MoU in July 2012. Such conditions required the sector to be restructured with a series of important measures, which once again affected the regulation and supervision of the sector. The debt crisis in the euro area called into question the continuity of the single currency, which forced the ECB to intervene and at the same time launch the BU, a crucial milestone that has without doubt shaped the Spanish banking sector. This issue is explored in section 5 and section 6 presents some conclusions.

2. Banking regulation and supervision in the context of EMU

Six years after Spain joined the, at the time, European Economic Community (EEC), the adoption of the Maastricht Treaty marked the launch of EMU. In 1998, the European Council agreed the fixed and irrevocable exchange rates for the currencies of the eleven participating countries, which included Spain. In EMU, the monetary sovereignty of the Member States is transferred to an EU institution, the ECB, which is independently and exclusively in charge of setting and implementing monetary policy according to its mandate to maintain price stability.[4] For Spain, adopting the euro represented the culmination of a series of institutional changes that had secured the compliance with the nominal convergence criteria and other requirements enshrined in the Maastricht Treaty, including the independence of the BoS. Once the Law of Autonomy of the BoS had been passed,[5] the objective of monetary policy of the Spanish central bank was to ensure price stability, while intervention in primary public debt markets

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[2] Comisión Nacional del Mercado de Valores (National Securities Market Commission).

[3] Dirección General de Seguros y Fondos de Pensiones (General Directorate of Insurance and Pension Funds).

[4] Consolidated version of the Treaty on the Functioning of the European Union [2012] OJ C 326/47, Articles 119 and 127-133.

[5] Law 13/1994 of 1 June 1994, on the Autonomy of the Bank of Spain (BOE 131, 2 June 1994). This law transposed to the Spanish legislation the provisions of the Treaty on European Union regarding monetary policy and the relationship between the Treasury and the central bank, which was a legal convergence criterion to adopt the euro and join EMU.

was forbidden, which prepared the ground for the euro adoption. In the euro area the BoS implements the monetary policy set by the ECB.[6]

Although its functions concerning monetary policy and the issuing of paper money were transferred to the ECB, the BoS continued to act as the supervisor of the Spanish banking system.[7] Thus, in areas other than monetary policy, including the supervision of credit institutions, the BoS is subject not only to relevant laws, but also to the regulations drafted by the government to implement such laws, with administrative acts and resolutions being subject to ordinary appeal to the Economy and Finance Minister.

The banking supervision framework is designed to meet a dual objective, which is not free from possible dilemmas and tensions. On the one hand, the purpose of banking supervision is to ensure the stability of the financial system as a whole; on the other hand, banking supervision should ensure as well that banks carry out their function as intermediaries between savers and borrowers. Fulfilling these two objectives is subject to risks and uncertainties, especially those related to the evolution of the economic cycle, as well as to the governance and management of the banks themselves. One of the key aspects of banking supervision is to guarantee that banks are solvent, or, in other words, that they are in a position to deal with defaults on loans they have granted without hampering their capacity to return the deposits entrusted to them.

Since Spain joined what was the EEC in 1986, bank supervision has been carried out in accordance with standards defined at the global level, such as the Basel Capital Accord, as well as through the transposition of directives or direct application of EU finance and banking regulations.

As in the case of other Community policies, Spain had already incorporated the European regulation on solvency into its own legal system in 1985, before officially joining the EU. This legal framework evolved to adapt to the so-called Basel I Accord, published in 1988, which in turn was reflected in a series of Community directives.[8] In the Spanish legal system, this accord and these directives were embodied mainly through Laws 13/1992[9]

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6 Law 12/1998 of 28 April 1998, Amending the Law 13/1994 of 1 June, Autonomy of the Bank of Spain (BOE 102, 29 April 1998).

7 The literature on the regulatory framework of the banking sector in the EMU is vast. Banco de España, *Informe sobre la crisis financiera y bancaria en España, 2008-2014* (Banco de España, 2017) and M. Otero-Iglesias *et al.*, *The Spanish Financial Crisis: Lessons for the European Banking Union* (Informe 20, Real Instituto Elcano, March 2016), for instance, provide a wide selection of references not cited here for reasons of space.

8 The EU implemented Basel I Accord by Capital Requirements Directives (CRDs), which required transposition by Member States into their domestic legislation. Seven Banking Directives and their amending Directives were replaced by one single Banking Directive (Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and the pursuit of the business of credit institutions [2000] OJ L 126/1).

9 Law 13/1992 of 1 June 1992, on Own Funds and Supervision on a Consolidated Basis of Financial Institutions (BOE 132, 2 June 1992).

and 19/2003.[10] The regulation set up minimum capital requirements (8% of risk weighted assets) and established limits to the concentration of risks in individuals, institutions and groups.

As discussed in Banco de España,[11] the system based on the Basel I Accord was not exempt from weaknesses, especially regarding the analysis, assessment and weighing of risks. The Basel II Accord was published in 2004, which paid particular attention to the measuring of credit risk and strengthened the role of the regulator. This accord was reflected in the corresponding directives in 2006, which were transposed in 2007 and 2008, when the subprime crisis had already broken out and Lehman Brothers was just about to collapse.

Basel II had three main elements. First, it endowed credit institutions with the capacity to establish their own internal risk assessment models (internal ratings-based – IRB – approach), which had to be validated by supervisory bodies. Second, banks were obliged to carry out annual capital reviews, based on an assessment of the risks. This exercise could lead to capital requirements above the minimum established in Basel I Capital Accord (known as pillar 2). Finally, it aimed to increase the transparency of credit institutions through public information programmes (pillar 3).

Within this legal framework, in its supervisory capacity, the BoS had a system of preventive and corrective actions at its disposal. Preventive measures consisted of systematic, regular visits and the assessment of continuous flows of reserved information sent by the institutions to the BoS. In addition, permanent teams of inspectors were installed in the headquarters of Spain's two most important banking groups, Santander and BBVA.

Based on the conclusions of this inspection process, the BoS had an array of corrective instruments at its disposal. These ranged from just drawing up recommendations, to directly intervene in the credit institution and substitute its board members. Corrective instruments also included assessments of an institution's viability plans and the imposition of sanctions. It should be noted that in the most serious cases, when a bank's board had to be replaced, the BoS was obliged to inform the Ministry of Economy and Finance (the Treasury), which was acting as the resolution authority.

As in the case of the vast majority of supervisory bodies in the world, the BoS's supervision model was essentially micro prudential, focused on guaranteeing credit institutions' solvency, but with no direct connection to macro prudential supervision or, in other words, without overseeing the sector as a whole in order to prevent or mitigate risks to the financial system. This lack of macro prudential considerations in banking supervision precluded the adequate prevention and

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10 Law 19/2003 of 4 July 2003, on the Legal Framework Governing Capital Movements and Foreign Economic Transactions and on Certain Measures to Prevent Money Laundering (BOE 160, 5 July 2003).

11 Banco de España, *Informe sobre la crisis financiera y bancaria en España, 2008-2014*, cit.

assessment of risks and limited the capacity of supervisors all over the world to anticipate the magnitude of the financial crisis.

The regulatory framework in the Spanish financial sector did not differ greatly from those in other euro area countries, where the same Community directives and regulations were applied. However, in the Spanish case two notable differentiating factors deserve a more detailed analysis. Firstly, the specific nature of the regulation on provisions and on the consolidation perimeter of investment vehicles; and secondly, the special regime for savings banks, which represented a significant part of the Spanish financial sector in both assets (loans) and liabilities (deposits). Whereas the first of these factors would mitigate some of the effects of the financial crisis, the second would amplify them considerably.

Dynamic provisions and the treatment of investment vehicles

One relevant aspect of banking supervision concerns accounting regulations, the responsibility of the BoS since 1989.[12] The relevance of these regulations for banking supervision is closely related to the recording of provisions to cover credit risk. Provisions were traditionally either specific, designed to cover default associated with concrete assets, or generic, associated with the overall risk of an asset portfolio.

In 2000, the BoS introduced dynamic provisions,[13] the aim of which was to compensate for the cyclical nature of credit risk. In general, defaults increase in the recession phases of the cycle and decrease in expansive phases, such that banking provisions have a procyclical profile, decreasing in the expansionary phase and increasing in the contractionary phase. Dynamic provisions attempted to counteract this procyclical nature.

The dynamic provisions system aimed to guarantee that institutions could cover expected losses in their credit portfolio throughout the cycle. Banks had to make more provisions during the expansionary phase of the cycle, which would reduce their profits when debt levels were lower, while provisions would be released when growth slowed down and debt levels increased.

These dynamic provisions were introduced to redress the excessively procyclical behaviour of debt in Spain. The supervisor also wanted to forestall the effects of the credit boom detected since the end of the nineties. The BoS wanted to avoid the experience of previous cycles with a rapid expansion of credit linked to the construction sector. In fact, Spain had a long history of

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12 The Ministerial Order of 31 March 1989 granted the BoS the power to establish and modify the accounting regulation and models of financial statements of credit institutions in accordance with Article 48 of Law 26/1988 of 29 July 1988, on Discipline and Intervention of Credit Institutions (BOE 182, 20 July 1988).

13 For a thorough analysis of this type of provision, see S. Fernández de Lis, A. García-Herrero, *Dynamic provisioning: a buffer rather than a countercyclical tool?*, (2012) BBVA Research Working Paper No. 12/22 or C. Trucharte, J. Saurina, *Las provisiones contracíclicas del Banco de España, 2000-2016* (Banco de España, 2017).

real estate bubbles and banking crises, the last of which had taken place at the end of the nineties and resulted in the nationalisation of Banesto.[14] The dynamic provisions were calibrated in accordance with the economic impact of the 1992-1994 crisis, which was much shorter and less severe than the one on the horizon.

The Spanish accounting framework, which allowed such dynamic provisions, had to be adapted in 2004 to the International Accounting Standards (IAS),[15] which were more flexible than the Spanish regulations and gave corporate managers more leeway to reflect the bank situation in their accounts. Although the dynamic provisions were not fully consistent with the IAS,[16] the supervisor followed a prudent approach when transposing the international standards. Specifically, the BoS retained the dynamic provisions and imposed restrictions preventing banks from keeping structured investment vehicles off their balances. These measures were not welcomed by either the industry or in international forums since they were higher than the expected losses, which, in turn, translated into lower profits for the Spanish credit institutions.[17]

Although insufficient, the dynamic provisions reduced the banking sector's financial needs during the crisis. In 2007, the year the subprime crisis broke out, when the dynamic provisions reached their maximum, the Spanish banks accumulated 26 billion euros.[18] This amount represented a fall in profits of around 15 or 20%, but at the same time strengthened the solvency of the Spanish credit institutions. For example, Banco Santander accumulated 6 billion euros in these provisions[19] and around 7 billion of the financing needs to rescue banks were covered by the fund of dynamic provisions.[20]

Other decisions taken by the supervisor mitigating the impact of the financial crisis in Spain include the introduction of severe restrictions on the exclusion of structured investment vehicles from the banks' consolidation perimeter. As a consequence, and unlike what happened in other euro area members, structured vehicles were taken into account in calculations of own resources and capital requirements, which prevented the subprime crisis from having a significant impact in the summer of 2007 in Spain. Unfortunately, the limited impact of the subprime crisis led to complacency among bank and authority managers rather than alerting them to the looming crisis. This almost blind faith in the solvency of the Spanish banking sector delayed radical decisions to clean up a sector in which, as we will explore in the next section, the risk associated with

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14 M. Otero-Iglesias *et al.*, *The Spanish Financial Crisis*, cit.

15 IAS were issued by the antecedent International Accounting Standards Board (IASB), an independent international standard-setting body based in London.

16 Banco de España, *Informe sobre la crisis financiera y bancaria en España, 2008-2014*, cit.

17 See S. Fernández de Lis, A. García-Herrero, *The Spanish Approach: Dynamic Provisioning and other Tools*, (2009) BBVA Research Working Paper No. 0903.

18 C. Trucharte, J. Saurina, *Las provisiones contracíclicas del Banco de España, 2000-2016*, cit.

19 M. Otero-Iglesias *et al.*, *The Spanish Financial Crisis*, cit.

20 Banco de España, *Informe sobre la crisis financiera y bancaria en España, 2008-2014*, cit.

the construction industry represented around two thirds of the total risk, and rampant unemployment would put a huge strain on mortgage payments. This crucial delay in implementing drastic measures to restructure the sector is also explained by the special regulatory mechanisms for the savings banks, their considerable weight in the sector and their even higher accumulation of real estate risk.

Savings bank regulation

In legal terms, savings banks were social foundations predominantly functioning as credit institutions, which ended up operating in a highly competitive market driven by the intense liberalisation and internationalisation of the Spanish financial system. The savings banks had their own legal framework, in line with a more complex and rigid corporate regime than that of the commercial banks.

The way savings banks usually increased their own funds was through capitalisation of profits. Savings banks had no access to the capital markets to raise good quality capital, since they were not public limited corporations. The only way the savings banks could capture capital in the markets was to issue non-voting equity units (*cuotas participativas*) which were less attractive to national or international private investors because they did not grant voting rights. As long as the savings banks operated in local settings and fairly uncompetitive markets, this corporate model worked reasonably well. However, restrictions on their geographic expansion were lifted in 1988, which led to the rapid growth in the number of branches and employees. The deregulation and internationalisation of the Spanish financial system enhanced competition, while the expansion of savings banks beyond their geographic regions intensified the contradictions between their business model and the structure of the market in which they operated.

The legal structure of the savings banks did not favour the application of common corporate practices, which in turn explained the poor professional skills of their managers, who in most cases came from the political environment and/or were heavily dependent on it, especially local and regional governments.[21] As a matter of fact, regional governments considered the savings banks as instruments for carrying out their policies, and their managerial bodies were elected through complex and far from transparent procedures, ensuring that local politicians held control over them. This situation continued even after the reform of 2002, which limited the quota of public representatives to 50% of the general assembly. Not only was this corporate structure inadequate, but it also delayed, with the connivance of the authorities, the inevitable resolution and restructuring of the majority of savings banks in the middle of the financial crisis. Indeed, the division of supervisory tasks between the BoS and the regional governments led

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[21] V. Cuñat, L. Garicano, *Did good cajas extend bad loans? Governance, human capital and loan portfolios*, (2010) Fundación de Estudios de Economía Aplicada Working Paper No. 2010-08, provide an interesting analysis of this issue.

to weaker monitoring by the national supervisor and opened the way for local political powers to interfere in the management of the savings banks.[22]

3. The financial crisis: measures taken

In the summer of 2007, the subprime mortgage crisis broke out in the US, leading to the financial crisis that culminated in the collapse of Lehman Brothers in September 2008. The Spanish banking sector suffered the consequences not so much directly – as explained in the previous section, the sector had little exposure to the products deriving from these mortgages – but indirectly due to initial liquidity problems that resulted in serious problems of solvency when the Spanish real estate crisis hit.

The banking crisis is explained by the imbalances the Spanish banking sector had accumulated in the previous expansionary phase, which coincided with the adoption of the single currency. In the period between 1999 and 2008, abundant liquidity in the markets and low interest rates incentivised borrowing – the private debt-to-GDP ratio rose from 84.8% to 197% and continued increasing to reach a maximum of 205.5% in June 2010, – a process fed by generously available bank credit. The imbalances were as follows:[23]

a) Excessive growth of credit to the private sector, well above GDP growth and that of the euro area countries. Credit grew four times faster than activity, specifically, at an average annual rate of 18.1% from 2001 to 2007, two and a half times the euro area average, and only exceeded by the rate recorded in Greece.

b) High concentration of risk in the real estate sector. By September 2011, the credit granted to real estate developers, construction and mortgages reached 61% of all credit to the private sector. In particular, the percentage rose to 69% in savings banks, compared to 51% in the case of commercial banks, which largely explains why the crisis hit savings banks much harder.

c) A sharp increase in the installed capacity in terms of branches and employees, which became a burden once banking activity started to plummet in 2008 and required a radical restructuring of the sector. From 2000 to 2008, the bank branch network had grown by 17% and the number of employees had risen by 14%.

d) A large credit-deposit liquidity gap, with a high loan-to-deposit ratio. This gap is explained by the intense growth in bank credit that had to be

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[22] M. Otero-Iglesias *et al.*, *The Spanish Financial Crisis*, cit. It must be borne in mind that the Spanish regions, the Autonomous Communities, had regulatory authority over savings banks, which is why supervision was shared between the BoS and the Autonomous Communities.

[23] See a detailed analysis in J. Maudos, *El sector bancario español en el contexto internacional: el impacto de la crisis* (Fundación de las Cajas de Ahorros, 2011).

financed in the wholesale markets, which led to a problem of liquidity when the interbank markets closed.

e) A problem in the savings banks sector, which had a very large market share (almost 50% of the total loans), while, as explained above, their corporate structure prevented them from accessing financial markets to raise high quality capital (equity). To solve this problem, a change in savings banks legislation took place, which did not solve the problem.[24] A second reform was necessary that practically led to their transformation in commercial banks.[25]

With such high credit growth up to 2007, and a low rate of non-performing loans, profitability was very high. Return on equity (ROE) reached 20% in 2007. But due to the large imbalances accumulated, the crisis severely hit the Spanish banking sector, first with the bursting of the Spanish real estate bubble and later with the sovereign debt crisis in the euro area in 2010. The various facets of the crisis described below help to understand the different legislative measures that were gradually adopted.

Because the crisis was initially felt in terms of liquidity, the first measure adopted in Spain was Royal Decree-Law (henceforth RDL) 6/2008 establishing the Financial Asset Acquisition Fund (FAAF),[26] initially endowed with 30,000 million euros, which had to be increased later on. In order to secure access to liquidity for the sector, guarantees for the issue of bank debt were approved in RDL 7/2008.[27] This temporary measure, in force until the end of 2009, consisted of granting Spanish State guarantees for a maximum amount of 200,000 million euros (100,000 million euros for each financial year, 2008 and 2009).

The crisis intensified and, in 2009, Caja Castilla La Mancha was the first financial institution to be bailed out. This led to the creation of the Fund for Orderly Bank Restructuring (*Fondo de Restructuración Ordenada Bancaria*, FROB) in RDL 9/2009. FROB is a public law institution with its own legal personality and full public and private capacity to discharge its duties. Its purpose is to manage the resolution of institutions in the execution phase. The legal status under which FROB operates is set out in Law 11/2015 of 18 June 2015, on the recovery and resolution of credit institutions and investment firms. FROB is subject to the private legal system, unless it acts in the exercise of administrative powers conferred by the aforementioned Law, European Union law or other regulations with the status of law. The measures for the resolution of institutions adopted by

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24 Royal Decree-Law 11/2010 of 9 July 2010, on Governing Bodies and Other Aspects of the Savings Banks' legal framework (BOE 169, 13 July 2010).

25 Law 26/2013 of 27 December 2013, on Boxes of Savings and Banking Foundations (BOE 311, 28 December 2013).

26 Royal Decree-Law 6/2008 of 10 October 2008, on the Creation for the Fund for the Acquisition of Financial Assets (BOE 248, 14 October 2008). It is administered, managed and directed by the Ministry of Economy and Finance.

27 Royal Decree-Law 7/2008 of 13 October 2008, on Urgent Economic and Financial Measures in relation to the Concerted Action Plan of the Countries in the Euro Zone (BOE 248, 14 October 2008).

FROB will be reported, where appropriate, to the European Commission or the Spanish National Commission on Markets and Competition for the purposes of legislation on State aid and competition.

This public institution steered the restructuring of the sector in subsequent years. Its objective was to strengthen intervention mechanisms and restructure the sector, which mainly took place through mergers with a view to gaining efficiency and facilitating access to international markets. To enhance bank solvency, the FROB granted funding through the acquisition of preference shares. The FROB was created with an allocation of 9,000 million euros (75% from the State and 25% from the Deposit Guarantee Fund, DGF) and financed eight integration processes, including the one that gave rise to BFA-Bankia.

In the second phase of the crisis it became necessary to reform the Law on Savings Banks in order to facilitate market access. As mentioned above, savings banks were not public limited corporations and therefore their own resources mainly took the form of reserves accumulated through profits. Taking into account the problems the savings banks had due to the loss of value of their real estate exposure, the RDL 11/2010[28] was approved to reform their model and safeguard their continuity. The legislative reform aimed to recapitalise the sector, enabling savings banks to raise their own funds in the markets by issuing voting equity units, a product that did not prove successful, and professionalising and depoliticising their governing bodies by reducing the maximum weight of public administration representatives from 50% to 40%. This reform marked the beginning of the savings banks' transformation into fully-fledged banks, as in many cases they created banks where they could continue their business.

By the third phase of the crisis, after the start of the sovereign debt crisis with the bailout of Greece in May 2010 and followed by Ireland in the same year and Portugal in 2011, one of the reasons that would justify the creation of the BU one year later became evident: the sovereign and banking risk loop. The increase in the risk premium on the public debt of some countries was transferred to the risk premium on bank debt, since a large part of public debt was on the banks' balance sheets. In other cases, the loop started with the bank, as the falling quality of its assets forced the recapitalisation of banks with aid packages that increased the public debt. In this context several measures were approved, notably the RDL 2/2011[29] to strengthen the financial system, with a view to enhance solvency by requiring more capital to face the stress tests of July 2011, as well as to comply with the new requirements of the Basel III Capital Accord. This RDL motivated the transformation of savings banks into banks, as it required more capital in the credit institutions that depended more on wholesale markets and recorded less than 20% of capital held by external investors, which was the case of most

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28 Royal Decree-Law 11/2010 of 9 July 2010, on Governing Bodies and Other Aspects of the Savings Banks' legal framework (BOE 169, 13 July 2010).

29 Royal Decree-Law 2/2011 of 18 February 2011, on the Strengthening of the Spanish Financial System (BOE 43, 19 February 2011).

savings banks. If, as in the case of Bankia, they managed to raise this capital in the market, the requirement of a 10% solvency ratio was lowered by two points. In this latter case, the institution would save capital, which explains why Bankia went to the stock markets to raise this 20% of private capital. To help savings banks to meet these minimum capital requirements, the FROB approved aid packages, but this time in the form of stock acquisitions. As a consequence, the institutions that requested aid were obliged to set up banks, and the FROB sat on the boards of these newly created institutions.[30]

Another measure introduced in this third phase of the crisis was RDL 771/2011,[31] which amended RDL 216/2008,[32] on financial institutions' own resources, and RDL 2606/1996[33] on credit institutions' deposit guarantee funds. It approved a new prudential regime for securitisations, introduced improvements in the quality of own resources and new capital requirements to cover risk associated to the portfolio. It also introduced changes in remunerations to directors and managers, giving more weight to fixed remuneration and conditioning variable remuneration to the institution's evolution over several years. In the case of the DGF, the main innovation was that the contribution to the fund would depend on the risk of each bank and would penalise excessive remuneration on deposits, with a view to tackling the 'deposits war' that had begun in that year, damaging institutions' profits. The DGF was again reformed in October 2011[34] to unify the three existing funds, one each for banks, savings banks and credit cooperatives, in a single fund.[35] On 2 December of the same year, a further reform of the DGF[36] increased the contributions from institutions and unified those previously carried out by the three types of deposit institutions (banks, saving banks and cooperative banks). The Deposit Guarantee Fund for Credit Institutions has full legal personality and capacity to fulfil its functions. It operates under private law and its headquarters are in Madrid. In order to perform its role in guaranteeing deposits and protecting depositors with secured deposits, the Fund "may take the necessary steps to support the resolution of a

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[30] While in the first round of actions the FROB (called FROB 1) financed the restructuring processes by providing financing in the form of the acquisition of preferred shares, in the second round (FROB 2) it acquired capital shares, which previously required that the savings banks create banks.

[31] Royal Decree-Law 771/2011 of 3 June 2011, amending Royal Decree 216/2008 of 15 February 2008 on the own funds of financial institutions and Royal Decree 2606/1996 of 20 December 1996 on deposit guarantee funds for credit institutions (BOE 133, 4 June 2011).

[32] Royal Decree-Law 216/2008 of 15 February 2008, on Own Resources of Credit Institutions (BOE 16 February 2008).

[33] Royal Decree-Law 2606/1996 of 20 December 1996, on Deposit Guarantee Funds of Credit Institutions (BOE 307, 21 December 1996).

[34] Royal Decree-Law 16/2011 of 14 October 2011, on The Creation of the Deposit Guarantee Funds of Credit Institutions (BOE 249, 15 October 2011).

[35] Given that the crisis was concentrated above all in the savings bank sector, the value of its DGF entered negative territory, which motivated the reform of the DGF law to unify in 2011 the three existing funds into a single fund.

[36] Royal Decree-Law 19/2011 of 2 December 2011, amending Royal Decree-Law 16/2011, of 14 October, which created the Deposit Guarantee Fund for Credit Institutions (BOE 291, 3 December 2011).

credit institution drawing on the funds in the deposit guarantee compartment. Exceptionally and provided that no resolution process has commenced, the Fund may use its funds to halt the winding-up of a credit institution in the circumstances stipulated in law".[37]

The RDL 2/2012[38] on the cleaning up of the financial sector was approved on 3 February 2012, requiring a substantial increase in banking provisions related to real estate exposure. Provisioning requirements were further increased with the approval of a new RDL 18/2012[39] to cover investment classified as normal risk but actually associated to the real estate sector. Paradoxically, this last measure required provisions totalling millions to cover exposures classified as normal risk, which in the end reflects the government's suspicion that part of the real estate loans classified as normal on the banks' balance sheets were not actually standard risk. Interestingly, a few months before, in the preliminary conclusions of its analysis of the Spanish banking sector, the International Monetary Fund (IMF) stated that the supervisor had shown tolerance in asset risk classification, a criticism to which the government responded with this RDL 18/2012 requiring high provisions for loans classified as standard risk.[40]

On supervisory matters, supervision of the BoS was adapted in parallel to the regulatory changes, to which it contributed in the form of *Circulars*.[41] With the creation of the FROB in 2009, the strategy for restructuring institutions in distress changed in order to allow private solutions. As it is stated by the Banco de España,[42] "*compared with winding-up through insolvency proceedings, the strategy of supporting institutions meant shoring up their*

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37 See more details in Royal Decree-Law 16/2011 of 14 October 2011, on The Creation of the Deposit Guarantee Funds of Credit Institutions (BOE 249, 15 October 2011).

38 Royal Decree-Law 2/2012 of 3 February 2012, on Balance Sheet Clean-up of the Financial Sector (BOE 30, 4 February 2012).

39 Royal Decree-Law 18/2012 of 11 May 2012, on the Consolidation and Sale of Real Estate Assets in the Financial Sector (BOE 114, 12 May 2012).

40 International Monetary Fund, *Spain: Financial Sector Assessment, Preliminary Conclusions by the Staff of the International Monetary Fund* (25 April 2012. According to point 4 "The team's stress tests, which covered more than 90 percent of the domestic banking sector, showed that most banks would be resilient to large further shocks, although there were pockets of vulnerabilities. Lender forbearance – which the supervisory authorities have indicated they are monitoring closely – could not be fully incorporated into the stress tests due to lack of data – and this may have masked the extent of credit risk in some institutions". However, the Spanish Ministry translated the term "mask" by "has prevented appreciating" (in Spanish, *ha impedido apreciar*)". Before such an accusation, it is understood that the Spanish Government will approve the Royal Decree-Law 18/2012 of 11 May 2012 (cit.) that required millions in provisions for real estate assets classified as standard risk.

41 A *Circular* is a rule issued by the BoS that may refer either to monetary policy or payment methods or systems, which take the name of monetary circular, or those issued in the exercise of the rest of the Bank's powers, in which case they are simply named *circular*. These rules were issued to provide precise guidelines in the exercise of its powers as provided for in the law. Their preparation requires prior technical and legal reports, which must be issued by the competent services of the BoS, or by reports and advice prepared by experts as requested by the BoS itself.

42 Banco de España, *Informe sobre la crisis financiera y bancaria en España, 2008-2014*, cit.

viability by strengthening their regulatory capital and ensuring the continuity of their essential functions, so as to protect depositors, while minimising the cost in terms of public resources". It was not until 2012 that regulations on the resolution and restructuring of credit institutions came into effect, which provided an alternative to insolvency proceedings when it was deemed to be in the public interest.[43]

At the international level, and especially within the euro area, several reforms were carried out between 2008 and 2011, to coordinate regulation and supervision. These included the creation of the Financial Stability Board (FSB) in 2009, and the European System of Financial Supervision (ESFS) in 2011, approved following recommendations of the high-level group chaired by Jacques de Larosière. The high-level group recommendations also incorporated three new European supervisory authorities, the European Banking Agency (EBA), in charge of banking supervision (EBA), while the ESMA and the EIOPA were set up to oversee the securities and insurance sectors, respectively. Simultaneously, the European Systemic Risk Board was created to implement macro prudential supervision. Finally, the Basel II and III Capital Accords, which required more and better quality capital, as well as new leverage ratios and liquidity requirements, such as the liquidity coverage ratio. However, these measures came into effect only later, in 2014.

4. Banking resolution and restructuring: the MoU

Despite all these measures and state aid, most of which has not been recovered, the solvency problems were not resolved in much of the sector, especially the savings banks, to a large extent because financial instability increased in the euro area after mid-2011, which led to dramatic increases in risk premia. This deterioration in the macroeconomic context led Spain to seek financial aid from in June 2012, and it received a credit line of up to 100,000 million euros that would entail the acceptance of conditions set out in the MoU. The aim of the MoU was to support the Spanish banking sector to regain access to international financial markets. For this to happen, the capital needs of the institutions had to be estimated, restructuring/recapitalisation strategies needed to be designed, and toxic real estate assets had to be removed from balance sheets. Of these 100,000 million euros, 41,333 million were eventually used,

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43 In the EU, bank resolution processes are carried out within the European State Aid framework. A decision from the Commission is required to approve aid. The banking resolutions undertaken before 2012 were carried out under the banking communications of 2008 and 2010, according to which aid below 2% of the RWAs would only require a viability plan, whereas if it were over 2%, a restructuring plan was needed; see Commission, The application of state aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis (Information) 2008/C 270/02 and Commission, Communication from the Commission on the application, from 1 January 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis 2010/C 329/07, respectively. Most of the aid granted to the (few) savings banks bailed out before 2012 came close to, but below, this 2%; Banco de España, *Informe sobre la crisis financiera y bancaria en España, 2008-2014*, cit., 135.

38,833 million devoted to restructuring certain credit institutions and 2,500 million to capitalise the newly created bad bank (the *Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria*, Spanish asset management company for assets arising from bank restructuring, known by its Spanish acronym SAREB[44]).

It is important to remember that by summer of 2012, the crisis and financial instability had reached such levels that the continuity of the EMU project was called into question. An example of the seriousness of the situation was the joint declaration of the presidents of the ECB, the European Commission, the European Council and the Parliament proposing the Banking Union project as a way to break the banking risk-sovereign risk loop.[45] As we analyse in greater detail in the following section, the project was grounded on three pillars and a single rulebook: the Single Supervisory Mechanism, leaving supervision in the hands of the ECB, the Single Resolution Mechanism, and the European Deposit Insurance Scheme Fund. No less important was the declaration by the then ECB President Draghi to support the euro "whatever it takes". However, despite these announcements and the request for help from the EU, the crisis continued in Spain and it was not until the second half of 2013 that the cycle swung into an incipient recovery.

The MoU contained 32 conditions that necessitated legislative changes which would affect the Spanish financial system. Of note is the strengthening of the framework for the resolution and recovery of institutions, increased transparency on real estate sector exposure and on refinancing and restructuring of loans, and a new reform of the savings banks. As mentioned above, the package of measures also included the creation of a bad bank, the SAREB, to absorb all problematic real estate assets on the books of the institutions that had received state aid amounting 50,782 million euros.

On 31 August 2012, in the context of the MoU, the RDL 24/2012[46] on restructuring and resolution of credit entities was approved, which was subsequently replaced by Law 9/2012.[47] This law allowed the authorities to enact the commitments agreed in the MoU and shored up the mechanisms available to them to reinforce and clean up the financial system. A strengthened bank crisis management framework was designed that enshrined in Spanish legislation many of the measures included in what was then a draft of the

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44 The SAREB was regulated under the additional provision 7ª of Law 9/2012 of 14 November 2012, on Credit Institutions Restructuring and Resolution (BOE 275, 15 November 2012) and in Royal Decree 1559/2012 of 15 November 2012, Establishing the Legal Regime of Asset Management Companies (BOE 276, 16 November 2012).

45 The so-called Four Presidents Report, *Towards a Genuine Economic and Monetary Union* (EUCO 120/12, 26 June 2012) was published in 2012 and signed by the Presidents of the European Council, the Commission, the Eurogroup and the ECB; this report would be supplemented by the Five Presidents Report, to which the signature of the President of the European Parliament would be added.

46 Royal Decree-Law 24/2012 of 31 August 2012, on Restructuring and Resolution of Credit Institutions (BOE 210, 31 August 2012).

47 Law 9/2012 of 14 November 2012, cit.

European Bank Recovery and Resolution Directive. Depending on the seriousness of the situation of the distressed institution, and in order to achieve effective restructuring or orderly resolution, three options were available: early intervention, restructuring (with public support), or resolution (for non-viable banks).[48]

In the case of the savings banks, the MoU required a new reform, brought in through Law 26/2013,[49] on the savings banks and banking foundations, which marked a radical change in their legal regime. Under this law, any savings bank with assets over 10,000 million euros was obliged to create a bank and become a banking foundation. They were also prevented from operating in more than one autonomous region so as to prevent the past excesses discussed in section 2, when they expanded outside their geographic origins under the cover of real estate development. Depending on the percentage of ownership of the foundations in the newly created bank, banking foundations were obliged to fulfil certain commitments such as setting up reserve funds when the percentage of ownership exceeds 50%. With these restrictions, only two small savings banks now remain in Spain (Caixa Ontinyent and Caixa Pollença), and the old savings banks have all been transformed into banks whose ownership is held, in part, by banking foundations.

Another important change was the approval in June 2013 of Regulation (EU) 575/2013 (CRR)[50] and Directive 2013/36/EU (CRD IV),[51] which introduced the Basel III International Accord into European banking law. The CRR, as a regulation, was directly applicable in the Member States from January 2014 and the CRD IV, a directive, had to be transposed into national law, which was done with the publication of RDL 14/2013,[52] on urgent measures for the adaptation of Spanish law to EU rules on the supervision and solvency of financial institutions.

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48 The conditions imposed by the Eurogroup to grant state aid under the MoU were more stringent than the minimum established by the Commission in the Banking Communication (see Commission's Communication 2010/C 329/07, cit.), in particular concerning hybrid capital, which actually anticipated the conditions lately enshrined in the BRRD. The Commission updated the Banking Communication in 2013 to incorporate such more stringent conditions to approve state aid; see Commission, Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') (Information) 2013/C 216/01.

49 Law 26/2013 of 27 December 2013, on Savings Banks and Banking Foundations (BOE 311, 28 December 2013).

50 Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 [2013] OJ L 176/1.

51 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 L 176/338.

52 Royal Decree-Law 14/2013 of 29 November 2013, on Urgent Measures for the Adaptation of Spanish Law to EU Rules on the Supervision and Solvency of Financial Institutions (BOE 287, 30 November 2013).

Figure 1

Financial soundness indicators of the banking sector
(consolidated banking data). Percentage

Source: ECB (Consolidated Banking Database)

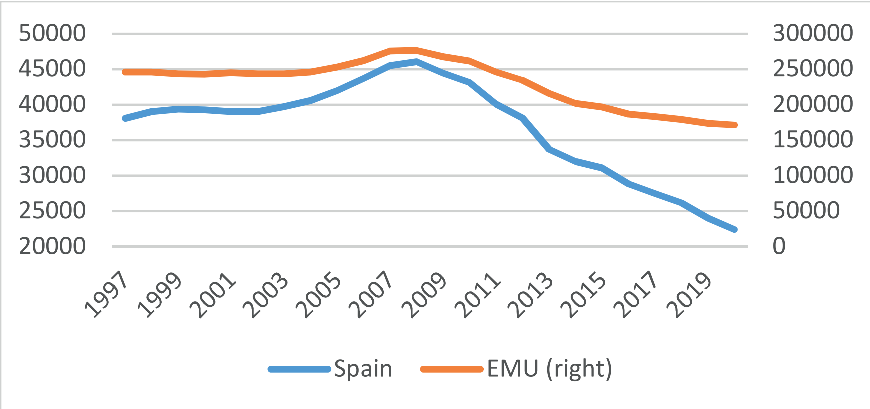
The MoU also had consequences in supervision matters. The BoS[53] carried out a review of its supervisory processes, the conclusions of which were published on 16 October 2012. It included proposals for improvement such as establishing a standardised framework for adopting supervisory measures according to the credit institutions' risk profile, formalising supervisory activity, and linking micro prudential and macro prudential supervision. At the end of September 2013, the BoS approved an internal *circular* on the procedures applied by the Directorate General Banking Supervision which incorporated the above proposals.

53 Banco de España, *Analysis of the supervisory procedures of the Banco de España and recommendations for their reform* (Banco de España, 2012).

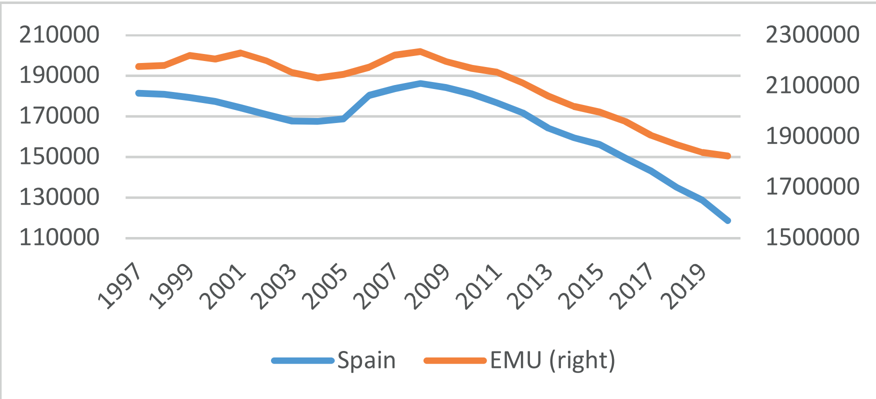
Figure 2

Number of branches and employees in the Spanish banking sector

a) Number of branches



b) Number of employees



Source: ECB

In addition to the measures implemented with the approval of the MoU, the BoS also introduced other changes in 2013, such as recommendations on the limitations of dividends and new criteria on classification of refinancing and restructuring.[54]

With the incipient economic recovery in the second half of 2013 and the restructuring process, the health of the banking sector gradually improved (see Figure 1), as reflected in falling debt ratios and recovering profitability, which had fallen into the red in 2012 as a consequence of the real estate risk provision requirements established in the two RDLs approved in February and May that

[54] The BoS had observed differences in the criteria applied by the different entities that needed to be standardised. After communicating common criteria to the entities, they were urged to carry out an individualised assessment of its refinanced and restructured operations. The BoS inspection teams verified the process.

year. Solvency also began to improve, due to both increasing own funds and containment of risk-weighted assets (denominator of the solvency ratio). The figure also shows the considerable impact of the Covid-19 crisis in 2020,[55] when the provisions undertaken and the extraordinary results, specifically the loss of the goodwill value of Santander and BBVA subsidiaries abroad, caused losses on the income statement. The most recent picture of the Spanish banking sector in the euro context shows it is more profitable, except for 2020, since its ROE was higher than that of the euro area in the first half of 2021, much more efficient as its operating efficiency ratio is lower, which implies higher efficiency because it costs less to reach a given level of net revenues, although it has a higher default rate and, above all, lower solvency. In 2020, the Spanish banking sector was the second least solvent (capital/risk weighted assets) of the EU-27, above only Greece. The position in the ranking improves in terms of the capitalisation ratio (capital/total assets).[56]

As described above, to maintain profitability in the wake of the crisis, the banking sector has had to face a radical transformation by reducing the number of institutions and adjusting its installed capacity. Figure 2 reflects the intensity of this adjustment in terms of branches, to the extent that the network today is less than half its size in 2008. At the same time, the number of banking sector employees fell by 36% between 2008 and 2020, a much higher rate than the 18% fall across the EU banking sector.

This long restructuring phase has required public support, channelled through the FROB. The amount totalled some 64,000 million euros, including one part taken on by the DGF, which despite being a private institution, is included in the total amount because the public sector holds the majority on its board. According to BoS estimates of November 2019, and bearing in mind that some of the aid funds have been recovered, the total net amount of aid was 65,725 million euros (5.5% of the GDP 2018).[57]

5. The Spanish banking sector in the European Banking Union

The financial crisis revealed that neither Spain nor EMU had the appropriate architecture in place to cope with the simultaneous effects of financial deregulation

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55 See J. Maudos, *Spanish banks' preparedness for the COVID-19 crisis: A European comparison*, (2020) 9 Spanish Economic and Financial Outlook 3, 45-53.

56 This difference in the ranking of the two ratios (solvency ratio and capitalisation ratio) is due to the fact that the risk weights of Spanish Institutions are higher, basically as consequence of the more intensive use of the standard method. The advantage in this type of situations is that the standard method is much less sensitive to increases (and reductions) in risk than the internal rating based (IRB) method.

57 The BoS publishes informative notes on state aid granted to the Spanish credit Institutions; see Banco de España, *Nota informativa sobre las ayudas financieras en el proceso de reestructuración del sistema financiero español (2009-2018)* (Banco de España, 2019).

and integration. The EMU did not have the necessary institutions to break the bank-sovereign loop. As the four Presidents stated in their report,[58] decisive steps were needed to set up the BU. The report proposed a BU built on three institutions: the Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM) and the European Deposit Insurance Scheme (EDIS). The BU would also have its own common rulebooks on supervision and resolution. For the moment, only two of these three pillars, the SSM and the SRM, are fully operative. The EDIS is still immersed in a long and complex negotiation process.[59]

The SSM was established in 2013, based on Article 127 (6) TFEU, according to which the Council, acting unanimously, may assign tasks to the ECB concerning the prudential supervision of credit institutions. The SSM is the EU's banking supervision system and includes the ECB and Member States' supervisory authorities, the BoS in the case of Spain. The ECB directly supervises 115 banks in the euro area (as of January 2022), of which ten are Spanish banks.[60] The remaining banks are the direct responsibility of their corresponding national authorities, in close collaboration with the ECB.

Banking supervision in the euro area, regardless of which authority is responsible for it, follows a single supervisory rulebook, based on the Basel III Accord, which is reflected in the Capital Requirements Regulation[61] and the Fourth Capital Requirements Directive.[62] This single rulebook establishes common regulations for banks supervised by the SSM. These regulations are therefore applied in exactly the same way to banks supervised directly by the ECB and those under national supervisory authorities (BoS in the case of Spain). The single rulebook establishes minimum capital ratios and micro prudential capital buffers, sets leverage limits for institutions, establishes minimum liquidity ratios, and introduces guidelines on institutional governance, including policy on remunerations.

In consequence, leaving aside the differences in size and economic weight of the 115 significant banks supervised directly by the ECB and those supervised by national authorities, there should be no differences in compliance with the requirements established in the CRR and the CRD IV. The banks that are directly supervised by national authorities – and indirectly by the ECB – are those with assets below 30 billion euros, so long as they

58 European Parliament resolution of 20 November 2012 with recommendations to the Commission on the report of the Presidents of the European Council, the European Commission, the European Central Bank and the Eurogroup: Towards a genuine Economic and Monetary Union (2012/2151(INI)) [2012] OJ C 419/48.

59 See Commission, A Roadmap towards a Banking Union (Communication), COM(2012) 510 final.

60 Abanca, BBVA, Banco Crédito Social Corporativo, Sabadell, Santander, Bankinter, Caixabank, Ibercaja, Kutxabank and Unicaja.

61 Regulation (EU) No. 575/2013, cit.

62 Directive 2013/36/EU, cit. While the CRR is directly applied in all member states, the CRD IV, like all community directives, must be transposed into national legislation. In the case of Spain, this transposition was completed with the approval of Law 10/2014 of 26 June 2014, on Regulation, Supervision and Solvency of Credit Institutions (BOE 156, 27 June 2014).

do not exceed 20% of national GDP, they do not operate in other countries, and they are not one of the three main banks in the country in question. With these criteria, as of January 2022, the BoS directly supervises 53 deposit institutions operating in Spain.

The SRM, the second pillar of the BU, is another relevant example of the two-way construction of a European Mechanism, representing a sovereignty transfer, while the corresponding national institution actively participates in the EU institution. The SRM was created on the basis of Article 114 TFEU, which establishes the possibility of adopting common legislative regulations in order to align national legislations to ensure the proper functioning of the internal market. The SRM has been fully operative since 2016. It is tasked with ensuring the orderly resolution of banks with insolvency problems by reducing to a minimum the possible impact on financial and microeconomic stability, as well as public finances. The SRM includes the Single Resolution Board (SRB), which is directly responsible for significant banks and cross-border banking groups, and the national resolution authorities, such as the FROB in Spain,[63] which are responsible for other banks. The ECB and the European Commission are observers in the mechanism. The Single Resolution Fund (SRF), which is built up exclusively through payments from the banks and does not receive contributions from public funds, was established to provide the necessary means to finance banking resolution processes. If, at a given moment, funding needs exceed the means available to the SRF, the ESM is the backstop that provides additional money up to the maximum size of the fund of 70 billion euros.[64] The money invested by the ESM would be returned by the banks themselves.

As in the case of supervision, banking resolution processes in the EMU follow a single banking resolution rulebook. The SRM is regulated by Regulation (EU) No. 806/2014,[65] while the resolution processes correspond

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63 The FROB's basic mission is to manage the execution of resolution processes of credit institutions and/or investment firms undertaken in Spain. Thus, in cases where an institution is declared to be unviable, there are no private solutions that might remedy this situation, and there are reasons of public interest that justify it (instead of winding up the institution through normal insolvency proceedings), the FROB will manage the execution of the relevant resolution measures. This it does with full respect for and observation of the resolution objectives (established by Law 11/2015 of 18 June 2015, on Recovery and Resolution of Credit Institutions and Investment Firms (BOE 146, 19 June 2015)), of maintaining the institution's critical functions and preserving economic and financial stability, and at the same time protecting customers' covered deposits and assets. At all times it endeavours to avoid or minimise the use of public resources.
The FROB also has other functions resulting from processes already undertaken in previous stages, such as carrying out the disinvestment of the State' stake in Bankia and managing its stake in SAREB.

64 The banks contribute 1% of the covered deposits, which according to data for 2021 amount to some 70,000 million euros. The ESM makes the same amount available to the single resolution fund, so the SRM has up to 140,000 million euros for banking resolutions.

65 Regulation (EU) No. 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No. 1093/2010 [2014] OJ L 225/1.

to the rules established in the Banking Recovery and Resolution Directive (BRRD),[66] also from 2014. The aim of the banking resolution framework is to guarantee stability in the financial sector of the EMU and reduce to a minimum the cost to the taxpayer of banking resolution processes, while maintaining the institutions' critical functions. The resolution framework includes a preventative phase, establishing that institutions must draft recovery plans and the resolution authorities must prepare resolution plans. In the second early intervention phase, the supervisor assumes functions over distressed but viable institutions. Finally, in the resolution phase the decision is taken about what to do when the institution is likely to fail. This is the crucial phase in the process when, once private solutions have been ruled out, the SRM decides if the institution should go into liquidation or whether in the common interest (too big to fail) the resolution/restructuring of the institution is advisable.

Currently, the Spanish model distinguishes between two types of domestic resolution authorities: the preventive resolution authorities, responsible for the preventative phase of the resolution, and the executive resolution authority, responsible for the execution phase. There are three national resolution authorities: a) two preventive resolution authorities that must carry out their tasks through bodies that are operationally independent from their supervisory functions: the Bank of Spain, with regard to credit institutions, and the CNMV for investment firms; b) and an executive resolution authority, which is also the contact authority at an international level, whose functions are entrusted to the FROB.

At this point it is important to note that the winding up of an institution is carried out according to national bank liquidation frameworks, which in principle are not subject to EU regulations. The winding up of a bank might therefore come at a high cost to the taxpayer. Moreover, today, deposit guarantee funds are national, meaning that the capacity to cover guaranteed deposits still depends in the first place on the solvency of the national banking system, which in principle sustains the guarantee fund, and, secondly, of the solvency of the sovereign that acts as the backstop. As a result, despite the single rulebook on resolution, the restructuring and wind-up of European banks is still, in part, a national responsibility.

Leaving aside the small Veneto banks, which were wound up under Italian laws at a not inconsiderable cost to Italian taxpayers, the only case of banking resolution of a major bank within the SRM framework was that of the Spanish Banco Popular, which was sold in a private arrangement to another major Spanish bank, Santander.

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66 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) 1093/2010 and (EU) 648/2012 of the European Parliament and of the Council [2014] OJ L 173/190.

6. Conclusions

Banking regulation in Spain is strongly influenced by the Basel Committee Accord and the regulatory modifications implemented following the financial crisis of 2008. Until 2008, regulation had four basic components: requirement to carry out the activity, requirement of own funds, regulations governing conduct in the bank-customer relationship, and a deposit guarantee system. This changed radically in 2008 with the Bank of Spain's Circular 3/2008, which incorporated the regulatory framework of Basel II,[67] and since then significant changes have been introduced in wake of the crisis. The crisis in the EU spurred the launch of the BU, which has involved more changes to banking regulation and the creation of European authorities to evaluate regulatory compliance.

The regulatory architecture in Spain follows a sectoral approach with different regulators for banking, capital markets, and pension funds and insurance companies. In the case of the banking sector (the focus of our research), supervision, traditionally entrusted to the BoS, underwent radical changes with the launch of the BU. Today, the ECB carries out the main supervisory functions over the major institutions, while the BoS supervises the remaining institutions and oversees competition and the proper functioning of the payment system.

Under this banking supervision model, therefore, the BoS is tasked with overseeing and supervising the financial system in collaboration with other Spanish institutions such as the CNMV (which supervises the capital markets) and the DGSFP (insurance and pension funds). The model combines micro prudential supervision (to preserve institutions' solvency and their proper functioning, ultimately to safeguard the stability of the financial system, within the SSM framework) with macro prudential supervision (to preserve financial stability) in collaboration with other national and European authorities, such as the ECB and the European Systemic Risk Board. The current model is framed within the SSM and, therefore, the BU.

As regards resolution, the current organisational scheme is also framed within the BU and the SRM. Thus, the organisational scheme for resolution in Spain, Law 11/2015, established a new institutional framework in order to comply with the main provision in the Resolution Directive, namely the separation of supervisory and resolution functions.[68]

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67 Banco de España Circular 3/2008 of 22 May 2008 to Credit Institutions on Determination and Control of Minimum Own Funds (BOE 140, 10 June 2008). With this Circular, the BoS culminated the process of adapting the Spanish legislation on credit institutions to the Directives 2006/48/CE of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) [2006] OJ L 177/1 and Directive 2006/49/CE of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast) [2006] OJ L 177/201.

68 See Law 11/2015 of 18 June 2015, on Recovery and Resolution of Credit Institutions and Investment Firms (BOE 146, 19 June 2015).

Although the two pillars of the BU, the SSM and the SRM, have contributed to breaking the bank-sovereign loop, in reality the banking systems in the euro area are to a large extent national. On the one hand, deposits are guaranteed by national deposit guarantee funds; and on the other, although the resolution rules are applied to systemically important banks in distress but still viable, if a bank is deemed to be failing it is wound up according to national bank insolvency laws, which may foresee or allow the use of public money. The banks in the euro area still die national, even though they have been developed as international institutions. Therefore, the BU needs a common deposit guarantee fund. At the time of writing, the long-running negotiations on the European Deposit Insurance Scheme (EDIS) have still not reached an agreement.

A fully-fledged BU, together with the Capital Markets Union (CMU), will constitute the future Financial Union. The CMU will ensure the diversification of financing sources for European businesses and households, by facilitating access to cheaper and more efficient investment vehicles, and cross-border exchange of stocks and bonds.[69] To this end, European integration must go deeper, especially in areas such as the supervision of capital markets or the harmonisation of national insolvency frameworks, as well as of certain capital and property taxes. The two pillars of the Financial Union, the BU and the CMU, strengthen each other. Capital markets need a common savings market, while efficient capital markets in the euro area shore up the resilience of European banks.

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[69] C. Martínez Mongay *et al.*, *Reforming the governance of the Economic and Monetary Union: the issues*, (2021) Real Instituto Elcano Working Paper 10.

Portugal and the banking union: searching for the spirit of supervision and resolution

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1. Introduction

The purpose of this article is to explain and analyze how the Banking Union (BU) reforms were implemented in Portugal and what impact such reforms had (or not) in the Portuguese system of banking supervision and banking resolution.

The financial crisis of 2008 was the primary catalyst for the EU to pass such comprehensive reforms in financial regulation during the period of 2013-2015.[1] Although the implementation of the BU remains incomplete – the third prong of the BU, a common deposit guarantee scheme, is yet to arrive – its birth marked a significant shift in the regulation of the banking sector, not only in terms of adding new requirements for the exercise of the activity of credit institutions but (notably) in restructuring the system of financial supervision within the EU and inside the Member States.

The Portuguese experience with the BU provides an interesting case-study for three reasons. The first reason concerns the context of the enactment of the reforms. The suitability of powers and effectiveness of the Portuguese system of banking supervision had been publicly questioned shortly before the BU implementation, due to a series of cases involving three Portuguese banks – two of which ended, respectively, in liquidation and in nationalization, with significant losses for individuals and taxpayers. Furthermore, Portugal had to implement BU reforms during an economic crisis, while it was under an external program of financial assistance and having to face the collapse of Banco Espírito Santo ("BES"), one of the country's most significant and historical banks. The BU framework thus came into force in a turbulent period, with a difficult regulatory legacy on its back and what was arguably the greatest banking scandal to deal with in Portuguese history.

The second reason of interest concerns the institutional framework for banking resolution in Portugal and the exercise of its powers. The Portuguese resolution authority is also the banking supervisor, with the support of a separate legal entity that works as a resolution fund, but that depends completely, from a governance and operational perspective, from the banking supervisor. According to the Banking Recovery and Resolution Directive (Directive 2014/59 or "BRRD"), it is necessary that there is an operational independence between the activities of supervision and the activities of resolution.[2] Such independence is essential in order to avoid conflicts of interest and respect market competition and integrity. The aftermath of the BES case, with the latter's resolution and transformation into a new credit institution in which the Portuguese Resolution Fund ("PRF") holds a 25% stake in the share capital, raises problematic questions concerning compliance with the BRRD, generating reputational damages for the Portuguese banking regulator.

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1 For a description and analysis of the BU developments see the introductory article by Diane Fromage in this journal's edition.

2 See Article 3(3) of the BRRD.

The final reason of interest concerns the way in which such problems and questions were identified, discussed and analyzed. Given the impact banking scandals have had on Portuguese society, and because of their complex political ramifications, political parties represented in the Portuguese Parliament agreed to organize Parliamentary Inquiry Commissions ("ICs"). Such Commissions represent a constitutional prerogative of Parliament to assess the action of public powers, where Members of Parliament can call individuals for questioning.[3] The ICs on banking institutions that took place from 2008 to 2021 were high-level affairs, where supervisors, supervisees, government officials, and other relevant personalities discussed their actions regarding events concerning Portuguese banks. The ICs' reports include relevant insights and considerations on the competence and capacity of financial supervision in Portugal.

Therefore, an analysis of the Portuguese case allows to illustrate and discuss financial supervision problems before the BU's implementation and to explore the limits and challenges of financial supervision after the implementation of the BU. In fact, Portugal is still trying to find and implement a supervisory system that is faithful to the BU's purposes of adequate financial supervision.

The first section of the article presents the legal and institutional structure of financial supervision and resolution in Portugal. The section briefly considers the institutional history of banking supervision before describing how BU reforms were implemented. The second section of the article moves from the structural description of the system to a description of the prominent regulatory cases concerning Portuguese banks since the beginning of the financial crisis. Such cases are divided into chronological categories – cases *before* the implementation of the BU and cases *after* the BU implementation. In-between both categories, the article discusses the case of the resolution of BES that occurred chronologically *during* the implementation of the BU. Finally, the third section of the article offers two critical reflections on the way Portugal is trying to abide by "the spirit" of EU financial supervision.

2. Banking supervision and resolution in Portugal

2.1. The Portuguese institutional and legal framework of banking supervision

Portugal adopts the functional model of financial supervision.[4] Therefore, supervision is organized and divided according to the business activity of the supervised entities: banking (credits and deposits), insurance (insurance, reinsurance, and mediation of pension funds), and negotiation of securities and other financial instruments in capital markets. The entity responsible for

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3 See Law No. 5/93 of March 1; for an analysis of the parliamentary powers see N Piçarra, *O Inquérito Parlamentar e os seus Modelos Constitucionais - O Caso Português* (Almedina, 2004).

4 For a more detailed description see Banco de Portugal, White Paper on the Regulation and Supervision of the Financial System (2016), 37-38, 45-50.

supervision of the banking sector is the Bank of Portugal ("Banco de Portugal" or "BdP"), while the responsibility for the other two business areas lays with the Autoridade de Seguros e Fundos de Pensões ("ASF", Insurance and Pension Funds Supervisory Authority) and the Comissão de Mercado dos Valores Mobiliários ("CMVM", Securities Market Commission).

The BdP is the oldest institution of the three: it was established by Royal Decree in 1846, the result of a merger between a private bank and an investment company responsible for financing public debt. It was responsible for issuing currency, and in the end of the 19th century became the lender of last resort of the banking systems and started to play a crucial role in the management of monetary policy, while exercising "informal" powers of supervision vis-à-vis other Portuguese banks, given its size and importance (please note that the bank was a private institution incorporated as a public limited company under Portuguese law; nevertheless, it was highly dependent on the Government). From the end of the 1950s until today, the BdP has been, by law, the sole supervisor of the banking sector, with powers of intervention in the activity of regulated entities.[5]

The rules concerning the institution, competences and powers of the BdP are in its statute (Lei Orgânica do Banco de Portugal: "LOBdP", Organic Law of the Bank of Portugal). As for the legal framework of banking supervision, it is mostly set in the Regime Geral das Instituições de Crédito e Sociedades Financeiras ("RGICSF", General Regime of Credit Institutions and Financial Entities).[6] According to its legal regime, the BdP is a party to the European System of Central Banks ("ESCB") and therefore participates in the definition and execution of monetary policy in the EU.[7] Its main competences are in monetary and exchange policy, in international monetary relations, in advising the Government on economic and financial matters, and in monitoring the Portuguese economic and financial system, serving as the last-resort refinancer.[8]

Monitoring of the financial system includes the competence of banking supervision. The BdP is the entity responsible for authorizing the exercise of banking activity in Portugal (and equivalent activities, according to the law, such as e-money, business with digital assets, and others), and to control the exercise of that activity by authorized institutions under the terms set in the RGICSF.[9] Such control includes the possibility of issuing commands to banks of a preventive or corrective nature, such as to impose orders or sanctions or to make a direct intervention in the bank's structure. The BdP also has powers to approve the composition of the board of directors of a bank and to monitor the board's conduct.

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5 For a history of the BdP see the studies coordinated by N. Valério, *História do Sistema Bancário Português. Volume I* (Banco de Portugal, 2008) and *Volume II* (Banco de Portugal, 2010).

6 Other competences are in separate legislation (for example, competence and powers of anti-money laundering supervision).

7 Article 129 TFEU, Article 3 LOBdP.

8 See Articles 12-14 of LOBdP.

9 Article 17 LOBdP and Articles 1-7 RGICSF.

2.2. Financial supervision in Portugal and the BU reforms

With the implementation of the BU, the BdP became part of the Single Supervisory Mechanism ("SSM"), having to work in the supervision of banks under the direction of the European Central Bank ("ECB"). Furthermore, the BdP received two new competences and functions. The first competence concerns macro-prudential supervision. BdP became the Portuguese macro-prudential authority by the implementation of recommendation CERS/2011/3 issued by the European Systemic Board Risk.[10] Therefore, the BdP is competent to define and execute macro-prudential policy, with powers to identify and prevent systemic risks in the financial sector and protect the latter's resilience.[11] Such powers consist in enacting non-binding acts (determinations, warnings, and recommendations directed to all public and private entities. Moreover, the BdP participates with the other financial regulators (the ASF and the CMVM) in the National Council of Financial Supervisors, a coordination body with competence to provide advice to the BdP regarding macroprudential policy.[12]

In 2011, the BdP enacted a restructuring of its departments, reorganizing supervisory functions among different and separate internal units for efficiency purposes. The reorganization included the setting of a new department responsible for financial stability to support the regulator's activity in the field of macroprudential supervision.[13]

The second competence provided to the BdP in the BU framework concerned the implementation of banking resolution measures. The attribution of competences in the area of bank resolution to the BdP preceded the enactment of EU rules on that subject because of an obligation set in the Memorandum of Understanding ("MoU") signed between Portugal and the European Commission, the ECB and the International Monetary Fund ("IMF"), for provision of financial assistance by the latter, the European Financial Stability Facility and the European Financial Stabilisation Mechanism.[14] The first powers of the BdP in the resolution domain were set in Decreto-lei No. 142/2013. The Portuguese Government and the Portuguese Parliament, respectively, later amended such competences and powers in Decreto-lei No. 114-A/2014 of August 1st and Law n. 23-A/2015 of March 26th, which transposed into Portuguese law the BRRD. According to the new regime, the BdP has powers to adopt resolution measures to ensure the provision of financial services to the economy, safeguard the financial stability of the system, protect the interests of taxpayers and public treasury, and protect funds and assets owned by credit institutions on behalf of their clients.[15]

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10 See Decreto-lei No. 142/2013 of 18 October.

11 Article 16-A of LOBdP.

12 See Article 16-A(3) of LOBdP and Article 2 of Decreto-lei No. 228/2000 of 23 September.

13 As explained by BdP in Banco de Portugal, Parecer do Banco de Portugal sobre o Projeto de Proposta de Lei que cria e regula o Sistema Nacional de Supervisão Financeira (2019), 26-27.

14 See the measures in Portugal "Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding" with the IMF.

15 Article 17-A of LOBdP.

In other words, the BdP is the Portuguese resolution authority for the purpose of the BRRD.

A Resolution Fund was set up to support the application of resolution measures (but not to decide on the resolution measure and to apply it).[16] The Portuguese Resolution Fund ("PRF") is, according to the RGICSF, a public entity with administrative and financial autonomy, within which all Portuguese credit institutions shall participate. It is unclear why the Fund was set out as a separate entity from the BdP; one (purely speculative) explanation might have been to legally isolate (in other words: protect) the BdP from the risk of dealing with financial liabilities concerning the capitalization of resolved banks.

From a practical perspective, the Fund is not autonomous from the BdP. According to the RGICSF, it is up to the BdP to provide all technical and administrative support to the PRF.[17] Furthermore, the chair of the board of directors is a director of the BdP; the two other board members are appointed by the Portuguese Ministry of Finance and by joint agreement of the Ministry of Finance and the BdP.[18] It is also up for the Audit Committee of the BdP to supervise the PRF's activity. In this sense, the FDR is not a resolution authority but an "arm" of the BdP used for intervening in and supporting resolutions.

Rules on early intervention on banks to remove the board also preceded the legislative reform of the BU set out in Directive 2014/59/UE. The Portuguese Government enacted Decreto-lei No. 31-A/2012 following (again) obligations entered into by the State within the MoU of Financial Assistance.[19] It is possible to speculate that the purpose of such reforms was to provide the BdP with enough powers to act in case the situation concerning Portuguese banks deteriorated.

In sum, the BdP is the institution responsible for banking supervision and macro-prudential supervision, as well as resolution planning and application.[20] Three factors might help explain the decision. The first is expertise: the BdP is the oldest financial regulator in Portugal and had been the institution mainly responsible for the supervision of banks and financial institutions until the enactment of the BU. The second factor concerns technical and financial capacity: compared to the other regulators, the BdP is the institution with the most staff (1700 active workers in 2020) and resources (538 million euros of net profits in 2020).[21] The third and final factor has to do with the status of

16 Article 153-C of RGICSF.

17 Article 153-P of RGICSF.

18 Article 153-E of RGICSF.

19 See the preamble of Decreto-lei No. 31-A/2012.

20 The BdP is similar, in this regard, to other 13 national competent authorities in the EU: see European Banking Authority, Report on Supervisory Independence of Competent Authorities (2021), 12.

21 Banco de Portugal, Relatório do Conselho de Administração: Atividade e Contas (2020), 63-65.

the BdP and its influence within economic and political circles (for example, several directors of the BdP have previously served as government officials and worked in banking institutions; many Governors of the Bank were former ministers responsible for financial and economic affairs, such as the current Governor, Mário Centeno).[22]

2.3. Post-BU developments: paths for reform

A legislative overhaul of the banking supervision framework was underway in 2021, after a failed attempt to radically reform the whole system of financial supervision in 2019 with the project of establishing the National System of Financial Supervision.[23] The BdP published a draft project for a new *Código de Atividade Bancária* ("CAB", Code of Banking Activity) in 2020 and put it out for public consultation until January 2021.[24] Due to the dissolution of the Portuguese Parliament and the call for a snap election in January 2022, approval of CAB is currently suspended.

The project of the National System of Financial Supervision was ambitious and would significantly change the structure of banking supervision in Portugal. The major changes concerned the setting of the National Council of Financial Supervisors as the macro-prudential supervisor and the creation of a new and autonomous (both legal and administrative) national resolution authority. The BdP would lose some of its prerogatives in the area of macro-prudential supervision and resolution, with the other two sectorial regulators (ASF and the CMVM) having more powers, through the National Council of Financial Supervisors, in matters concerning financial stability.

It was no surprise that the BdP provided an opinion on the proposal expressing disagreement with the separation of macroprudential supervision from its competences.[25] The BdP saw no problem with the setting of an autonomous resolution authority; however, the BdP criticized the proposed institutional model for the new resolution authority and provided a counter-proposal, according to which the new resolution authority would be working next to the BdP, while receiving technical support from the latter.[26]

The CAB, on the other hand, was but a reform of the RGISCF; its goal was to provide the BdP with more supervisory powers regarding shareholders and directors of credit institutions while establishing new rules regarding business conduct and its assessment and improving administrative procedures of authorization and communication with supervised entities. Overall, the purpose of CAB was to update the procedures and practices of banking supervision and

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22 A list of past BdP Governors and their respective CVs is available in the BdP's website.

23 Law proposal 190/XIII/4.ª.

24 See Banco de Portugal, Anteprojeto de Código de Atividade Bancária (2020).

25 Banco de Portugal, *Parecer do Banco de Portugal sobre o Projeto de Proposta de Lei que cria e regula o Sistema Nacional de Supervisão Financeira*, cit., 92-97.

26 *Ibidem*.

allow the BdP to have more control over the management of banks and equivalent entities.[27]

The rationale for the proposed legislative changes outlined above had to do with the Portuguese banking sector's problems and the series of scandals that occurred in the past 15 years. We shall analyze such cases and critiques below. Suffice to say, for now, that the draft version of the CAB, unlike the project of the National System of Financial Supervision, did not put forward any changes to the institutional system of supervision and resolution: the banking supervisor, macroprudential supervisor and resolution authority continues to be the BdP, with the PRF being the support institution under the administrative dependence of the former. In this sense, the CAB reform was not very ambitious, and while it may have given more supervisory powers to the BdP, it did not seem to address adequately the problems posed by the Portuguese framework of resolution, as we shall see below.

3. Banking sector dynamics and supervisory activity in Portugal

3.1. The financial crisis and its impact in Portugal

The financial crisis (that morphed into a sovereign debt crisis) significantly affected the Portuguese banking sector.[28] After the euro came into force, Portuguese banks accumulated high debt levels from external creditors (e.g. foreign banks and institutions) and provided loans to the local economy, leading to what some authors describe as a lending boom.[29] Basically, banks became overexposed to foreign creditors, and with the rise of interest rates in financial markets due to the lower credit rating of the Portuguese State, banks started to have difficulty obtaining financing from abroad and turned to the ECB and the BdP for liquidity. At the same time, the level of non-performing loans started to rise, which led to difficulties in leveraging commercial portfolios.

Another problem for Portuguese banks was their exposure to Portuguese sovereign debt, particularly after 2007.[30] Given the link between the sovereign State and the financial system, such exposure was problematic from a financial stability perspective. The strength of the banking sector became a matter of concern for national and European political authorities. Stress tests performed

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27 As per the preamble of the preliminary draft of the proposal. Banco de Portugal, *Anteprojeto de Código de Atividade Bancária*, cit.

28 See M. Crosignani, M. Faria-e-Castro, L. Fonseca, *The Portuguese Banking System during the Sovereign Debt Crisis*, (2015) NYU Stern Bulletin, and T. Cardão-Pito, D. Baptista, *Portugal's banking and financial crises: unexpected consequences of monetary integration?*, (2017) 20 Journal of Economic Policy Reform 2, 165-191.

29 T. Cardão-Pito, D. Baptista, *Portugal's banking and financial crises*, cit., 168-170.

30 M.M. Campos, A.R. Mateus, Á Pina, *Sovereign exposures in the Portuguese banking system: evidence from an original dataset*, (2019) Banco de Portugal Occasional Papers 3, 10-14.

by the European Banking Authority on the major Portuguese banks (Caixa Geral de Depósitos or "CGD", Banco Comercial Português or "BCP", Banco Português de Investimento or "BPI", and Banco Espírito Santo or "BES") revealed capital ratios below Core Tier 1 levels of 10, the minimum limit set for the year 2012.[31]

Therefore, Portuguese banks had a strong incentive to influence the Portuguese authorities to ask for a bailout, enable mechanisms of recapitalization, and decrease the pressure on Portuguese sovereign debt.[32] The MoU on financial assistance established several measures concerning the banking sector, the most important being the setup of a public credit line specific for the recapitalization of banks financed by the EU and the IMF.[33] Four credit institutions – CGD, BCP, BPI, and Banco Internacional do Funchal ("BANIF")[34] – made use of the credit line through the subscription of contingent convertible bonds.

3.2. Banking supervision activity before BU implementation

Before it became a sovereign debt crisis, however, the financial crisis did not take too long to affect the stability of the Portuguese banking sector and bring to the fore questions over the effectiveness the BdP's supervision. There were three crises involving Portuguese banks before the enactment of banking reforms and the period of financial assistance. Such cases were the first significant banking scandals to happen in Portugal since the revolution of 1974.

The first situation concerned the "shareholder wars" at BCP in 2006.[35] BCP is the largest private bank in Portugal. After a failed attempt to acquire BPI, there was tension between the shareholders and within the board of directors itself, regarding the bank's bylaws and the powers of the board to appoint the bank's CEO. Such tensions consequently led to the creation of factions among shareholders and directors, with each faction counting their respective shares (i.e., decision-power), and speculation over BCP's capital increased. Participants in the conflict started to buy share capital of the bank to gain more voting power in the general assembly. Some participants borrowed large sums of money from other banks (BES and CGD) to finance such purchases. The fact that CGD was a public bank led to considerations of government interference in the war. BdP had the power to refuse that investors raise their participation in banks, consequently controlling the issuance of credit provided to the shareholders involved in the conflict. However, the regulator did not act, thus tacitly accepting such capital increases. More concerning was the fact that the

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31 T. Cardão-Pito, D. Baptista, *Portugal's banking and financial crises*, cit., 174.

32 See V. Stadheim, *Banks 1 – Portugal 0? Financial player entanglements in the Eurozone crisis*, (2021) 25 Competition and Change 3-4, 401-427.

33 A resumed list of the reforms is in the report by M. Eichenbaum, S. Rebelo, C. de Resende, *The Portuguese Crisis and the IMF*, (2016) IEO Background Paper, 27-28.

34 By decision of the BdP, given that BANIF was not under EBA supervision.

35 See the book by M. Teixeira Alves, *Terramoto BCP* (Booknomics, 2008).

conflict ended with the BdP pressuring the substitution of BCP's CEO and accepting that three CGD directors (who had responsibility for greenlighting the loans) moved to the executive board of the private bank.

In the BCP case, the report from the Parliamentary IC found that BdP failed to effectively control and authorize the buying of BCP's shares by shareholders that did not have sufficient liquidity or sound financial standing and used loans provided by CGD, the public bank. Members of Parliament also considered that the regulator adopted formalistic and "over-literalistic" interpretations of the law to avoid confrontation with the regulated entities.[36] The IC report indicated that members of the Commission were far from satisfied with the answers provided by the Governor of the BdP at the time, which cited the lack of powers to justify its inaction – according to the Governor, he could not have intervened in the bank's management of the situation.[37] However, the answer seemed insufficient: before the arrival of the BU framework BdP already had powers to prevent the issuance of credit by banks and could have acted to mitigate the risk of the situation if it considered that it put at risk the stability of the financial system. Finally, BdP was criticized for failing to admit any shortcomings and wrongdoings and avoid public scrutiny of its actions.[38]

The second situation was the fall of Banco Privado Português (BPP).[39] BPP was a private bank that had liquidity problems, laid bare by the financial crisis. BdP intervened (this time) in the bank in 2008 by appointing a temporary board and negotiating a loan (guaranteed by the Portuguese State) with other banks. The funds provided by the loan were for compensation of the clients' deposits and credits; financial applications and wealth management provisions were outside of the scope of the adopted measures. However, not all clients managed to take their funds out, and a complex situation arose regarding the compensation of people with investments locked in specific applications. Evidence started to mount regarding the existence of fraudulent practices perpetuated by the bank's board of directors, which led to public questions over BdP's supervision of BPP's activities. The regulator withdrew BPP's banking license, and the bank went into liquidation. Not all clients managed to recover their funds. The case did not lead to an IC in Parliament, probably because no public entity (either the public bank or the Government) was involved in the situation. The directors of the bank were prosecuted and convicted in criminal proceedings.

The third situation, and arguably the most dramatic one, was the fall of Banco Português de Negócios ("BPN").[40] BPN was a private bank that grew exponentially during its short life (1993 to 2008) and where there were, like in

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36 Portuguese Parliament, Relatório final da 2ª CPI à Recapitalização da CGD e à Gestão do Banco (2019), 189-190.

37 *Ibidem*, 155-160.

38 *Ibidem*, 373.

39 See the book by L. Henrique, D. Lobo Antunes, *A Face Oculta do BPP* (Primebooks, 2010).

40 Portuguese Parliament, Relatório final da CPI sobre a situação que levou à nacionalização do BPN e sobre a supervisão bancária inerente (2010), 55-75.

BPP, suspicions of fraudulent management practices conducted by the board of directors. Moreover, and again similar to BPP, BPN was affected by the financial crisis and started to suffer from liquidity issues. After failing to answer a high number of communications and warnings issued by the BdP, based on regular inspections made by the latter, the Portuguese Government decided to nationalize BPN to safeguard the stability of the financial system. The Portuguese Government then sold the bank to another private bank, EuroBIC. Nationalization of the bank was controversial, given the effects on taxpayers: according to the Portuguese Audit Court, the costs of nationalization were in the region of 6 billion euros.[41]

In the IC report regarding the BPN case, Members of Parliament considered that the BdP could have acted more diligently and incisively in the situation. However, they also recognized that the regulator did not have at the time, according to the law, enough powers to implement corrective supervisory measures to adequately stop the actions of the non-compliant credit institution. As one director of the BdP put it, the regulator only had powers to "fire small missiles" (like imposing fines) or "to launch the atomic bomb" (to revoke the bank's license and take care of its liquidation), but nothing in between.[42] The report acknowledged the limitations and problems in finding the best financial supervision models and the limits of imposing self-regulation to banks through internal controls without a proper legal framework that allowed for more significant intervention by the BdP in the activity and governance structure of private credit institutions.

3.3. Banking supervision activity after the BU: the BES case

The BES case was a different beast altogether from the situations of BCP, BPP, and BPN discussed above, due to its size (BES was at the time the third largest Portuguese bank), its role as the bank that financed several Portuguese companies, particularly SMEs (67,5% of the total credit of the bank) and, arguably, the position of most of its directors and shareholders, the Espírito Santo family, as power-brokers within Portuguese society.[43] The fall of BES had a substantial economic impact, and strong political and social implications, the effects of which the country is still feeling today.

A short story of the events: BES was part of a larger group called Grupo Espírito Santo ("GES"). The group included financial and non-financial entities, incorporated across different jurisdictions, with the holding being Espírito Santo Financial Group ("ESFG"), a company incorporated in Luxembourg. BES was the only major Portuguese bank that did not use the public credit line for recapitalization provided by the Portuguese State to its banks in the beginning of

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41 The process led to a Second PCI report on BPN, Relatório final da CPI ao Processo de Nacionalização, Gestão e Alienação do BPN (2012).

42 Portuguese Parliament, Relatório final da CPI sobre a situação que levou à nacionalização do BPN e sobre a supervisão bancária inerente, cit., 114.

43 On the BES case and its fall, see A. de Jesus, J. Poças Esteves, *Caso BES – A Realidade dos Números* (Clube do Autor, 2015) and from the same authors *Caso BES – O Impacto da Resolução na Economia Portuguesa* (Clube do Autor, 2018).

the crisis. Instead, BES' shareholders performed a share capital increase to comply with the requested capital ratios. However, the bank's exposure to its non-financial arm raised some questions. The operations of GES (some considered suspicious from a criminal perspective) were heavily financed by or through the bank. Once the financial position of companies around the GES group started to become problematic due to the pressure of creditors, so too did the situation for the bank.

In just twenty days, the board of directors corrected the numbers of estimated losses from 1.500 million euros to more than double that amount. BES did not have enough buffers in place to compensate for the losses. Additionally, BES (like other Portuguese banks) had been extensively borrowing liquidity from the Eurosystem. The day after the bank publicly disclosed its losses, the ECB announced that it would be revoking BES's counterparty status as well as suspending its access to liquidity issuances, requesting the repayment of 10.000 million euros of credit issuance.[44]

The systemic impact of the bank's possible default and eventual liquidation process could have been dramatic for the Portuguese financial system at the time. The BdP decided to act, and, in a weekend, the regulator applied to BES a resolution measure.[45] The measure included the complete dismissal of the board of directors of the bank and the separation of BES in two institutions: BES and a bridge institution called Novo Banco ("NB"). The resolution measure further established the transfer of assets from BES to NB, specifically those considered by the BdP as not being toxic (the division was annexed to the resolution measure and included a provision stating that the BdP could decide at any time on the transfer of assets from BES to NB and vice-versa). The purpose of the resolution measure was to safeguard the banking activity of BES (and its clients) and make the shareholders and creditors of the bank the primary bearers of the cost of the resolution measure. BES became the "bad bank" and NB the "good bank," with the share capital wholly subscribed by the PRF.

It is important to note that the BdP applied a measure based on an incomplete legal framework of resolution than the one prescribed by the BRRD, since the latter only came completely into force in Portugal in 2015. In fact, the Directive was partially transposed by a Decreto-lei (a normative instrument of legislative character enacted by the Government that can be more quickly approved) enacted on July 31, 2014, that entered into force on August 2, 2014 – the day *before* BdP applied the resolution measure to BES (August 3). The Directive was only completely transposed with a Law (normative instrument of legislative character enacted by Parliament and that requires a longer form of deliberation) approved

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44 The events are described in the resolution measure: Banco de Portugal, *Deliberação do Conselho de Administração de 3 de agosto de 2014 sobre a aplicação de uma medida de resolução ao Banco Espírito Santo, S.A.*, 3 August 2014; see also A.R. Garcia, *Banco Espírito Santo, S.A.: Resolution Via A Bridge Bank Including A Re-Transfer*, in *Bank Resolution and "Bail-In" in the EU: Selected Case Studies Pre and Post BRRD*, (2017) World Bank Working Paper, 52-60.

45 Banco de Portugal, *Deliberação do Conselho de Administração de 3 de agosto de 2014 sobre a aplicação de uma medida de resolução ao Banco Espírito Santo, S.A.*, cit.

in 2015.[46] At the time of the resolution measure the Portuguese transposition of BRRD did not include the provisions of the Directive concerning compensation measures for the resolved institution (article 36 of the Directive) and compensation for shareholders (article s 73, 74 and 75 of the BRRD).

The resolution measure already made explicit that the bridge bank solution was temporary and that the purpose was for the PRF to sell the NB. It was a sensitive situation from a legal and political point of view. Although the PRF was a separate entity, and in terms of liability responsible for the capital invested in BES, it was dependent in its decision-making capacity of the BdP. Therefore, in practice, NB *was owned and controlled by* the BdP, the institution responsible for the supervision of the banking sector, which seemed to be at odds with the logic of independence between resolution and supervision established in article 3(3) of the BRRD. Moreover, part of the funds the PRF used to fund NB came from contributions of the other Portuguese banks, which added to the problematic nature of the solution and its effects on banking competition, fairness, and the neutrality of the regulator.

PRF immediately proceeded to try to sell the bank. A first attempt occurred at the beginning of the following year, 2015. After a long process with several interested parties, BdP and the PRF called off the sale to a possible buyer when it was in very advanced stages over discrepancies in the price and conditions. The PRF concluded the sale of 75% of the bank's share capital a year later to an American private equity firm, Lone Star, and remained a shareholder of the bank. The European Commission approved the sale agreement from the point of view of state aid rules, with the caveat that a bank restructuring plan would have to be implemented and include the sale of assets and loan portfolios.[47]

The resolution measure proved controversial for shareholders and creditors of the bank and owners of assets considered by the BdP as toxic, leading to litigation in Portugal, London, and in Luxembourg (with the CJEU) regarding the transfer of funds from the bad bank to the good bank, and the validity of the measure with Portuguese and EU law.[48] The appeal in London was dismissed because the Supreme Court considered that the funds of the claimants were never transferred to Novo Banco, and therefore remained in BES.[49] In Portugal, the case reached the Supreme Administrative Court,[50] that ruled in favor of BdP, with the CJEU participating in the procedure through

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46 See section 2.2 *supra* on the implementation of resolution powers in Portugal.

47 European Commission decision on Case M.8487, 7 July 2017, and European Commission Decision on State aid No. SA.49275 (2017/N) – Portugal, 11 October 2017.

48 There were two other cases connected with BES and decided by the CJEU that did not have to do with the validity of the resolution measure. The first was Case C-504/19, concerning the right to an effective remedy in court when requesting a credit from a resolved institution. The second was Case C-396/19, concerning access to information from the ECB by the insolvency managers of GES in Luxembourg (an appeal from the General Court case).

49 The British case is Goldman Sachs International and others v. Novo Banco SA, UKSC 34, 2018.

50 Procedure 2586/14.3BELSB.

the preliminary ruling mechanism.[51] In this case, the CJEU considered the question of the of the Portuguese legislation on resolution with EU law, more specifically with the BRRD, the right to property established in the Charter of Fundamental Rights (Article 17), and with the CJEU's case-law regarding the temporal requirements for the transposition of directives. The Court did not not see any incompatibility between the Portuguese legal framework for banking resolution, at the time of BES, with both the BRRD and the Charter, and considered the Portuguese transposition of the BRRD conform to EU rules on the transposition of directives.[52]

3.4. Assessment of the BdP's role in the BES saga

BdP had to publicly answer questions over its timing and action regarding BES, especially considering the vulnerability of Portugal's banking sector in the period of financial intervention. Furthermore, it was the fourth time in seven years that the regulator's actions in the exercise of its mandate of supervision fell short of expectations.

The Parliamentary IC on the fall and sale of BES considered, that BdP had been (as in the BCP case) too formalistic and over-legalistic in its interpretation of the law, and not very incisive in its supervision of the activity of GES. According to the Parliamentary Commission, BdP could have acted earlier and swifter to protect the clients of BES and to avoid the situation that happened in 2014.[53] The Commission considered that BdP hesitated, acted too late, and failed to respond when confronted with suspicious actions by BES and its directors. To quote the report: "The attitude of the BdP towards the supervision of BES was, during several months [before the enactment of the resolution measure], somewhat permissive and not very efficient from an objective point of view (…)".[54]

It was not only the Members of Parliament who were critical of the Central Bank's action in the BES case. An internal report of the BdP was, according to the news in Portugal,[55] also critical of the conduct of the supervisor. The only public version available contains recommendations for improving the framework of supervision but falls short of any significant critique.[56] Such recommendations are, basically, proposals for amendments to the legal framework (both national and European). In a recent Parliamentary IC regarding the losses of Novo Banco, the author of the internal report criticized the BdP's failure to act while having all

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51 Case C-83/20 *BPC Lux 2 Sarl and others v. Banco de Portugal, BES and Novo Banco*, ECLI:EU:C:2021:853.

52 See M.L. Pires, *Unforgivable late admissions: the Court of Justice decides on bank resolution in BPC Lux 2 Sàrl (C-83/20)*, in EU Law Live, 12 May 2022.

53 Portuguese Parliament, Relatório final da CPI à Gestão do BES e do GES (2015), 327-332.

54 *Ibidem*, 345.

55 E. Caetano, N. Vinha, A. Suspiro, *Banco de Portugal podia ter feito mais no BES. As críticas violentas do relatório secreto que nunca saiu da gaveta de Carlos Costa*, Observador, 13 April 2021.

56 Banco de Portugal, *Comunicado do Banco de Portugal sobre as recomendações da Comissão de Avaliação às Decisões e à Atuação do Banco de Portugal na Supervisão do Banco Espírito Santo S.A.*

the means at its disposal to swiftly change the board of directors of BES and halt the activity of the bank (something that the bank did not have with the BPN and the BPP case).[57] The director of the supervisory arm of the BdP during 2013/2014 responded, in the same IC, by rejecting any criticism, and said that the supervisor acted in a "particularly assertive and energetic form".[58]

The role of the PRF was also questioned. In the Parliamentary IC devoted to the execution of the sale and purchase agreement of Novo Banco,[59] Vítor Bento (the last CEO of BES, appointed shortly before the application of the resolution measure) also criticized the relationship between BdP and the PRF in dealing with the resolution.[60] Bento told Members of Parliament that he disagreed with the terms of the resolution and the way it was applied, calling the resolution measure the "daughter of a ghost" (to which he meant the unpopular experience with the nationalization of BPN) and "of an illusion" (to which he meant the value of the bridge bank, that was insufficient for the new institution to pursue its activity). He criticized the BdP, saying that the regulator did not distinguish between acting as a resolution authority and as a supervisor, and adding that as a shareholder of BES the PRF was not committed enough nor had a clear plan of action regarding what to do with the bank. Bento seems to have a point when considering the complicated connection between the supervisory and the resolution roles in the BdP's treatment of Novo Banco. At the same time, this was the first resolution measure ever applied in Portugal, and to a very big bank, and while there was a complex external context happening. It was as challenging as it gets, and so perhaps not all criticism of the BdP's action is justifiable.

The activity of the PRF and the BdP regarding Novo Banco was also subject to scrutiny by the Portuguese Court of Auditors in a report, published upon a request by Parliament, on the transfer of funds from PRF to Novo Banco under the sale and purchase agreement signed with Lone Star.[61] The Court found the Portuguese model of banking and resolution has significant technical and legal shortcomings. First, the BES case showed that there are severe risks to the regulator's independence, since the PRF is part of the organic structure of the BdP and not sufficiently autonomous to take its decisions of resolution – it is up to the board of the BdP to take such decisions, not the PRF Second, the PRF does not have enough technical means and personnel to work adequately and to be a proper shareholder of the bridge bank, failing to monitor adequately what Novo Banco was doing. The Court found that the PRF relies too much on the BdP and its resolution department, losing operational independence, and leading to issues of efficiency.

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57 Portuguese Parliament, Relatório final da CPI à Gestão do BES e do GES, cit., 48-57.

58 See the transcription from the audition here, 5.

59 See Portuguese Parliament, Relatório Preliminar da Comissão Eventual de Inquérito Parlamentar às perdas registadas pelo Novo Banco e imputadas ao Fundo de Resolução (2021).

60 See the video of Vítor Bento in the PCI, 23 March 2021, available here.

61 Tribunal de Contas, Prevenção da Resolução Bancária em Portugal, Relatório de Auditoria 12/2020, 2ª secção, 2020, 15-34.

3.5. Banking supervision activity after the implementation of the BU

The Portuguese banking sector has remained stable after the crisis, with only two events to mention, and that had to do more with economic and external events than with supervisory issues *per se*.

In 2015, BdP resolved BANIF (a bank with a strong presence in the archipelagos of Madeira and Azores) for understanding that there were risks concerning the solvability of the bank, and after a long period (involving public capitalization of the bank) without being able to find a viable solution that did not conflict with EU state aid rules.[62] The measure was partially similar to the one applied to BES (i.e. setting up a bridge institution to manage the assets and leave the toxic assets with the original bank entering into liquidation) with the difference that the goal of the resolution was to quickly force a sale of the activity of the bridge institution. Such a sale happened, with Banco Santander Totta being the buyer.[63]

The case of BANIF was far less controversial than the BES case, given the dimension of the bank and the lack of any regulatory problem or suspicions of fraudulent/criminal activity. Still, there was enough concern for Parliament to set up an IC on BANIF regarding the "hard" powers the supervisor should have to control external auditors (responsible for analyzing the balances of financial institutions) and questioning the formal structure of the BdP's competences regarding banking supervision and resolution in terms of independence, for it was "evident" that the activities of supervision and resolution ran in parallel, and could produce conflicts of interest.[64] The report also criticized the implementation of the BU framework due to the discrepancy between the transfer of supervisory powers of intervention and resolution to the EU without a centralized system of funds for financial support of these measures being properly set up. With this supervisory structure in place, Member States ended up (according to the report) with the "worse of both worlds," for they lack the competence to intervene but must bear the costs of the measure.[65] Such assessment by the Members of Parliament is based on a incorrect comprehension of the BU structure: with the SRM in place there is a centralized mechanism for financially supporting the resolution of banks that are supervised by the SSM, thus protecting national authorities (and national funds). The comment seems to have more to do with the limits put forward by the Directorate General of Competition of the European Commission in the (failed) process of trying to make BANIF commercially viable.

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62 As per the resolution measure of Banif in Banco de Portugal, *Deliberação do Conselho de Administração do Banco de Portugal*, 19 December 2015.

63 See Banco de Portugal, *Deliberação do Conselho de Administração do Banco de Portugal*, 20 December 2015.

64 Portuguese Parliament, Relatório final da CPI ao processo que conduziu à venda e resolução do BANIF (2016), 262.

65 *Ibidem*, 267.

Currently, BdP has in its hands the case of EuroBIC. EuroBIC is the bank that bought BPN, and that has as its majority shareholder Isabel dos Santos, an African billionaire that is the daughter of a former president of Angola. The Luanda Leaks' investigative reporting project disclosed a series of money-laundering activities supposedly done by dos Santos and its firms, in which EuroBIC was included.[66] Upon the publication of the revelations, BdP approached dos Santos, requesting her to sell her bank shares. BdP also initiated a sanction procedure on money-laundering charges to the bank.[67] There has been no further intervention, nor notices of any malpractice, and the bank has been recently acquired by Abanca, a Spanish bank. Here, the BdP decided to act swiftly, but without using any powers of corrective intervention.

4. Critical reflections on the framework of banking supervision and resolution in Portugal

There has been no shortage of banking scandals in Portugal in the last fifteen years, which does not amount properly well for the country's system of financial supervision. After analyzing the cases that occurred, one might ask if the problem with the first batch of scandals was in the legal and institutional framework at the time and if the implementation of the BU reforms (with the introduction of a legal framework for resolving banks), which came at the same time that the BES scandal occurred, brought improvements to banking supervision.

It is, unfortunately, too soon to understand the impact of BU reforms in Portugal. The problems with BCP, BPP and BPN occurred before the BU, while the problems of BES also originated before the BU. To understand how supervision changed it would be necessary to have use-cases and datasets (as well as reports) that showed how the BdP currently acts when exercising its supervisory activity, in comparison with how it used to act before EU reforms of banking supervision were implemented. Nevertheless, with the available data, and thanks to the detailed work of the Parliamentary ICs, it is possible to make two general reflections on the state of banking supervision in Portugal.

First, it is possible to speculate whether any of the first batch of scandals – BCP, BPP and BPN – could have been treated differently with the improved set of supervisory "armory" brought by the BU. The BdP could have, in the situations of BPP and BPN, intervened in the bank's activity and asked for directors to be removed, or for the banks' activity to be suspended, or it could have asked for an external audit.[68] Perhaps the existence of those powers could have put some pressure on the banks' directors to refrain from fraudulent

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66 See Transparency International Portugal, FinCEN Files & Luanda Leaks: Suspicious EuroBIC payments further proof of anti-money laundering failures in Portugal, September 2020.

67 L. Rosa, *Banco de Portugal pressiona Isabel dos Santos a sair do Eurobic e admite abrir uma investigação formal ao banco*, Observador, 20 January 2020.

68 According to powers set in article 140 RGICSF.

practices (or not). Or perhaps liquidation and nationalized could have been avoided with the application of a resolution measure that protected deposits and part of the bank's business. What is clear is that the BdP would have had many more options to actively interfere in a supervised bank and its structure if there was a risk for the stability of the financial system or for the interests of the banks' clients.[69] If it would decide to use them or not, that is another question.

The case of BCP would have been different, at least formally, because of the SSM, since BCP is a significant institution following the criteria set out in the SSM Regulation.[70] The same would apply to BES. The latter's collapse came when the SSM was still starting, making the BdP cope with the reputational costs of inefficient supervision and of applying a resolution measure. Although the rules were (at least in part) European, the measure was completely owned and managed by national authorities.

It is unclear, however, whether in practice this form of centralized EU supervision is (and would have been before) more effective than national supervision. A good argument for the greater effectiveness of EU supervision is the isolation that regulators have from national pressures, particularly in countries where the circles of (political, financial, *de facto*) power are concentrated in a handful of institutions. However, there is also some distance that might make supervisory authorities at the center less close and attentive to some situations. Novo Banco continues, unfortunately, to be a case in point: a recent investigation by Portuguese newspaper *Público* argues that the bank's management took decisions that had a negative impact on the bank's activity on purpose, for the sake of using all the public funds that were available to it under a contingency capital mechanism approved in the sale and purchase agreement with the PRF.[71] Allegedly, some of these decisions – that, given the use of public money, could be considered as a violation of public interest – were taken with the complacency of the PRF.[72]

A second point of reflection concerns the structural implementation of the legal framework of banking resolution in Portugal and the degree of operational independence established between the supervisory and the resolution activities. Operational independence refers, technically, to "the duty of the supervisor to operate independently, without external interference, maintaining its objectivity and fairness, and avoiding any deterioration of its integrity".[73] The BES case demonstrates a problematic degree of superimposition between the BdP as a supervisor and the BdP as the resolution authority that do not seem to fit within this logic of independence as integrity. Because of the technical and operational

69 As stated in Article 139(1) of the RGICSF.

70 According to Article 6(4) or Article 6(5)(b) in Council Regulation No. 1024/2013.

71 C. Ferreira, *Novo Banco: a anatomia do negócio que capturou o Estado na teia de Vieira*, Público, 19 April 2022.

72 *Ibidem*.

73 European Banking Authority, Report on the Supervisory Independence of Competent Authorities (2021), 19.

dependence of the PRF, the BdP is a *de facto* shareholder of BES, one of the major banks of the Portuguese financial system that the *BdP has the duty to supervise*. From the point of view of competition, fairness, and objectivity, the current situation is not ideal; a reform making the PRF more autonomous would be welcome. However, it seems that the BdP, given its comment on the proposed legislative reform of the national financial system, does not want to abdicate from having some degree of control, even if only technical, over resolution activities.

5. Conclusions

Portugal entered the BU while facing a challenging financial situation where the solvability and stability of the country and of its banking system were at stake. There was much media attention on the BdP, an institution that suddenly saw its actions politically and socially scrutinized to an impressive extent. Before the SSM and the SRM were set up, the Portuguese regulator already had several complex decisions to make, the hardest being the decision on BES' resolution measure. The Novo Banco issue is now being dealt with under the institutional framework of the BU, but it is not easy to find data (at least currently) that allows for a comprehensive understanding of the impact European reforms on the banking sector supervision have taken apart from the measures on banking resolution.

What seems clear is that the Portuguese model of financial supervision changed, at least formally, during the financial crisis and with the arrival of the BU, and that such change was necessary, even if made by stealth. The enactment of reforms provided the regulatory system with more powers to react to different events. However, the reform of the banking supervision regime, its structures, and powers continues to be discussed in Portugal, because of the legacy of past scandals and the reputational (and financial) "weight" of Novo Banco. The Parliamentary IC reports on the banking scandals shed light on the challenges of banking supervision, and how it is not only dependent on the availability of proper institutional and legal instruments of reaction, but also in being able to navigate the complexity of internal (national) and external (EU) interests at stake.

The BU is part of the discussion of the reform of banking supervision, but because of the BdP's responsibility in the actions of the past years, all conversation and questioning (and criticism) eventually end up focusing on the regulator and forgetting the European perspective of supervision. It is not clear to what extent the new role of the SSM and the SRM play in changing banking supervision in Portugal; the general idea is that the BdP still plays the critical role and should also be the key accountable institution for the situations that are occurring in Portugal (an image that, let it be said, the BdP does not seem to want to let go off, given its position concerning the reform of the national system of financial supervision). Let us see how the situation evolves in the future.

The reform of the institutional framework for financial supervision in Latvia

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1. Introduction

In early 2019, the Prime Minister of Latvia announced a 'capital repair'[1] of the financial sector. He pledged to overhaul the Latvian banking sector by proposing a number of reforms aiming at strengthening the regulatory framework and institutional capacity in the area of anti-money laundering and combating terrorism financing ('AML/CTF'). Nine months later the Parliament of Latvia ('Parliament') mandated a reform of the institutional framework for financial supervision consisting of the integration of the Financial and Capital Market Commission ('FCMC'), the Latvian financial supervisory authority, into the Bank of Latvia. As a result, the central bank of Latvia has assumed the responsibility for the supervision and resolution of financial institutions, while the former was abolished as of 1 January 2023.

Much of Latvia's financial sector's vulnerability to money laundering risks have been associated with the business model of the non-resident banking sector. This was one of the two dominant banking business models that emerged in the early 1990s. At that time, Scandinavian-owned banks emerged as the largest banks in the country, and they still dominate the domestic market for retail and business customers. As such, domestically-owned banks focused on the Commonwealth of Independent States clientele presenting themselves as a gateway between the East and the West.[2] This business model consisted of servicing cross-border transactions often involving opaque non-resident holding companies with accounts in these banks.[3] Non-resident banks also extensively relied on on-demand deposits[4] exposing them to heightened liquidity risk. In case of loss of reputation or another external shock, this risk could manifest itself in sudden withdrawals of non-resident deposits from these banks.[5]

The development of non-resident business in Latvia has been favoured by the combination of several factors – geographical location, EU membership that provides for a safe and regulated environment and developed financial services. An additional boost to the perceived safety of the Latvian banking sector was given in 2014 when Latvia became a Member State of the euro area and the newly established Banking Union. From an institutional perspective,

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[1] Leta/TVNet, *Kariņš piesaka finanšu sektora „kapitālo remontu"*, 20 February 2019.

[2] IMF, Republic of Latvia: Selected Issues, 7 August 2019, para 6.

[3] On the use of shell companies and business introducers see G. Stack, *Shell companies, Latvian-type correspondent banking, money laundering and illicit financial flows from Russia and the former Soviet Union*, (2015) 18 Journal of Money Laundering Control 4, 496-512.

[4] The amount of non-resident deposits reached its peak in 2015 when they constituted 53.1% of overall deposits in Latvian banks, a sum equivalent to 40% of Latvian annual GDP: Delna, *Connections: Money Laundering in Latvia and the Role of Trust and Company Service Providers, Transparency International* (2018), 21.

[5] IMF, *The Republic of Latvia: Financial System Stability Assessment, including Reports on Observance of Standards and Codes on the following topics: Banking Supervision; Payment Systems; Securities Regulation; Insurance Regulation; Corporate Governance; and Monetary and Financial Policy Transparency*, Country Report No. 02/67, March 2002 ('IMF Country Report of 2002'), paras 4, 26, 27; FCMC, *Non-resident banking business in Latvia – benefits and risks*, press release, 26 November 2012.

this meant that the Bank of Latvia and the FCMC were vested with new European mandates of maintaining price stability and promoting financial stability, respectively. The Bank of Latvia became a part of the Eurosystem which assumes the responsibility for the elaboration and implementation of monetary policy. On the other hand, the FCMC assumed its role as a national competent authority and national resolution authority participating in the Single Supervisory Mechanism ('SSM') and the Single Resolution Mechanism ('SRM'), respectively.

The Latvian AML/CTF system was assessed by the European Commission[6] and the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism of the European Council ('Moneyval')[7] to be broadly compliant with the relevant EU and international standards. Nevertheless, recurrent observations were made by international organisations that insufficient enforcement and weak sanctions undermine the effectiveness of the overall regime.[8] As Latvia bid to accede to the European Monetary Union[9] ('EMU') and the Organization for Economic Cooperation and Development ('OECD'), the pressure on the non-resident banking sector continued to rise. The European Commission published in 2014 a report highlighting the risks that this business model needed strong policies to guard against money laundering. The report concluded that financial transactions in non-resident banking may be more complex and opaque which requires specific supervisory actions and adequate response by banks active in this sector.[10] The OECD echoed those concerns in a 2015 report, casting doubt on Latvia's prospects for accession to the organization.[11]

In response to the deficiencies highlighted by the OECD, the FCMC took a more aggressive stance in tackling financial crime which was evidenced by more, and larger, fines for AML violations throughout 2016 and 2017.[12] The FCMC commissioned and coordinated external auditing of non-resident banks with the view to review their compliance with AML/CTF laws and the efficiency of their internal control systems.[13] The financial supervisor also

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6 European Commission, Convergence Report 2013 on Latvia, European Economy No. 3/2013, 42.

7 In 2012, Moneyval concluded that Latvia's legislation and institutional setup are largely compliant with the international AML standards: of the 48 recommendations that apply to Latvia, the country "complies" with 15, "largely complies" with 19 and "partially complies" with the remaining 14: Report on Fourth Assessment Visit – Summary, 5 July 2012, Moneyval (2012)16 Summ.

8 *Ibidem*; A. Bowen, M. Galeotti, *Latvia and Money Laundering: An Examination of Regulatory and Institutional Effectiveness in Combating Money Laundering*, (2014) 8 *Central European Journal of International and Security Studies* 4, 85-86.

9 European Commission, Convergence Report 2013 on Latvia, European Economy No. 3/2013, 9 and 46.

10 G. Eglitis, B. Forgo, R. Krastev, I. Toming, C. Weise, Assessing Business Practices in Latvia's Financial Sector, ECFIN Country Focus, April 2014.

11 OECD, Phase 2 Report on Implementing the OECD Anti-Bribery Convention in Latvia, October 2015.

12 The FCMC also requested the ECB to revoke the license of Trasta Komercbanka on the ground of AML violations, although the bank was already insolvent FCMC, information on Trasta Komercbanka AS, available here.

13 *Annual Report and Activity Report of the Financial and Capital Market Commission for 2016*, 10.

issued regulations[14] under which the banks are required to undertake similar audits every 18 months and to implement remedial plans.[15] This progress was acknowledged by the OECD which completed the accession negotiations with Latvia in May 2016.[16]

All these measures contributed to a considerable de-risking of the bank client portfolios.[17] From 2014 to 2018 non-resident deposits declined from 54 to 20 percent of the total volume of deposits.[18] The US authorities had nevertheless become impatient with the protracted reforms and modest sanctions which seemed not to deter banks from continuing a high-risk business without adequate controls.[19] They claimed that the non-resident business should be decreased to approximately 5 percent of the total business, as this amount would correspond to the capacity of the Latvian authorities to supervise this type of banking business.[20]

In this context, the US Department of the Treasury's Financial Crimes Enforcement Network ('FinCEN') announced in early 2018 a draft measure[21] to name ABLV Bank, the third largest Latvian bank subject to direct supervision of the European Central Bank ('ECB'), 'a financial institution of primary money laundering concern' which would prohibit the bank from opening or maintaining of correspondent accounts in the US.[22] This raised doubts about the soundness of the bank's business model, causing a sudden drop in the bank's credibility and withdrawal of deposits. While the bank was struggling to raise liquidity, the Governor of the Bank of Latvia was detained over the weekend for suspicion of having accepted a bribe from another bank in 2010 and 2012.[23] The market confidence deteriorated quickly and ABLV Bank was neither able to raise the necessary funds on the market nor was given access to central bank emergency

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14 FCMC, Regulations No. 196/2016 of 29 November 2016, Regulations for Cooperation with Third Parties and Requirements for Business Relations with the Customers whose Identification or Due Diligence is Performed Using Third Party's Services (replaced by the FCMC Regulations No. 4 of 5 January 2021).

15 See more detailed information in IMF, *Republic of Latvia*, cit., para 6.

16 OECD, *Accession: Latvia Invited to Join OECD*, 11 May 2016.

17 The de-scaling of non-resident client portfolio was also a result of increasing aversion of US correspondent banks towards a high-risk non-resident business. In 2015 and 2016, eroding confidence in the Latvian financial system's integrity caused US correspondent banks to temporarily sever ties with their Latvian counterparts, effectively shutting them out from direct access to clearing transactions in US dollars: IMF, *Republic of Latvia*, cit., para 7.

18 Annual US dollar transaction flows involving Latvian banks declined during the same period more than 26 times: see *Annual Report and Activity Report of the FCMC for 2018*, 5; Delna, *Connections*, cit., 23 and 34.

19 J. Kirschenbaum, *Latvian Banking: Recent Reforms, Sustainable Solutions*, Brief, The German Marshall Fund of the United States, No. 020, May 2018, 4.

20 L. Čigāne, *The EU: Muddling Through*, in Latvian Institute of International Affairs, *Latvian Foreign and Security Policy Yearbook 2019*, 39.

21 FinCEN, Proposal of Special Measure against ABLV Bank, as a Financial Institution of Primary Money Laundering Concern – 31 CFR Part 1010-RIN – 1506-AB39, 12 February 2018 ('FinCEN Proposal') prepared pursuant to Section 311 of the USA Patriot Act.

22 See further discussion of the events preceding the FinCEN announcement in Section 3.1 (A).

23 ECJ, 30 November 2021, *LR Ģenerālprokuratūra*, C-3/20, EU:C:2021:969, paras 25-30.

liquidity assistance ('ELA'). The ECB determined on 23 February 2018 that the bank, as well as its Luxembourg subsidiary ABLV Bank Luxembourg, were failing or likely to fail[24] ('FOLTF'), and the SRB subsequently found that the resolution of the bank was not in the public interest.[25]

The FinCEN announcement coincided with the heightened tension between Russia and the West in the context of the hybrid war in Ukraine.[26] In this new geopolitical context, the risks associated with high-risk non-resident business were perceived as a threat to national security.[27] In the following month, the Latvian Prime Minister publicly acknowledged that Latvia as a NATO member state with a border with third countries could not continue allowing servicing a sizeable volume of risky money and pledged to reduce the level of non-resident deposits to 5 percent within a couple of months.[28] The allegations about the deficiencies of the Latvian AML/CTF system were also followed by the decision of the Moneyval to enlist the country among the countries subject to enhanced follow-up. A negative Moneyval report could result in a referral to the Financial Action Task Force, an inter-governmental organization that sets global AML standards and has the ability to blacklist noncompliant jurisdictions. The prospect of being singled out as a risk-probe country had a mobilising effect on Latvian authorities which implemented the Moneyval recommendations[29] in less than a year and a half.[30]

The rebuilding of the reputation of the FCMC tainted by the AML/CTF scandals was a solid option as the existing supervisory model was believed to function well.[31] The main shortcomings of the Latvian AML/CTF system were associated with an insufficient capacity in enforcing the AML/CTF laws. In particular, the FCMC's lack of resources[32] did not allow it to carry out sufficient inspections of banks serving non-resident clients and to take enforcement action to prevent repeated violations.[33] Apart from scarce supervision, the sanctions imposed on banks for the violations of AML/CTF

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24 ECB, ECB determined ABLV Bank was failing or likely to fail, press release, 24 February 2018.

25 Decision of the Single Resolution Board of 23 February 2018 concerning the assessment of the conditions for resolution in respect of ABLV Bank Luxembourg S.A, non-confidential version, SRB/EES/2018/10.

26 S. Jemberga, *In the shadows of ABLV: from a regulator to a friend*, Re:Balica, 13 March 2019.

27 N. Buckley, *Latvia: a banking scandal on the Baltic*, Financial Times, 23 February 2018; M. Richard, *Latvia vows to crack down on unscrupulous banking*, Financial Times, 18 March 2018.

28 A. Eglitis, Latvia to Cut Shell-Company Dealings After U.S. Security Warning, Bloomberg, 19 March 2018.

29 Moneyval, *Anti-money laundering and counter-terrorist financing measures*. Latvia, 5th Round Mutual Evaluation Report, July 2018.

30 Moneyval, *Anti-money laundering and counter-terrorist financing measures*. Latvia. 1st Enhanced Follow-up Report, December 2019.

31 A. Lošmanis, *Jautājums bija vispirms risināms konceptuāl*, Jurista Vārds, 24 March 2020, No. 1122, 19-21.

32 Apart from the FCMC, the capacity of the Financial Intelligence Unit was considered to be insufficient.

33 OECD, *Phase 2 Report on Implementing the OECD Anti-Bribery Convention in Latvia*, October 2015, 31-32.

regulations were disproportionately small to have a deterrent effect.[34] For this reason, the reforms initially focused on strengthening the regulatory framework and the institutional capacity without modifying the supervisory architecture.[35] New money laundering scandals continued nevertheless to unfold[36] contributing to the sentiment that incremental improvements of the existing institutional framework would not suffice to rebuild the reputation of the financial supervisor. A lasting solution would require not only increased enforcement resources and sustained political commitment but also institutional changes in order to ensure that the dominance of the non-resident banks is eliminated. With a view to completing the 'capital repair' of the Latvian financial sector,[37] the Parliament mandated the Government to elaborate a new Law on the Bank of Latvia[38] providing for the integration of the FCMC into the Bank of Latvia.[39]

The centralisation of monetary policy and supervisory functions at the level of the Bank of Latvia seems to follow the trend towards greater involvement of euro area central banks in the supervision of the banking sector. This raises the question of the impact of the EU integration process on the decision of Latvian authorities to abandon the institutional separation of monetary and supervisory tasks in favour of the consolidation of these functions within a central bank. How much was the Latvian reform driven by the EU reforms and how much was it a post-crisis reappraisal of the institutional architecture of financial supervision? To what extent did the governance framework of the ECB and national central banks ('NCBs') in charge of financial supervision serve as a point of reference for designing the new governance framework of the Bank of Latvia? These multiple dimensions reveal that the answer to this question is necessarily multi-faceted.

The Latvian institutional reform can be seen as a politically driven post-crisis reaction seeking to rebuild public confidence in robust supervision. It can also be perceived as a completion of a gradual unification process of the Latvian institutional framework for financial supervision which started in 2001 when Latvia switched from a sectoral model to a unified supervisory model (Section 2).

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34 *Ibidem*.

35 For a summary of the main reforms see Delna, *Connections*, cit., 31-32.

36 A report commissioned by Swedbank found that the bank had carried out EUR 34 billion of non-resident transactions via its Estonian and other Baltic subsidiaries with a high risk for money laundering between 2014 and 2019. Swedbank was the largest Scandinavian-owned bank in the Baltics whose name had not been previously associated with high-risk non-resident business. In 2015, following the AML scandal involving its subsidiary in Estonia, Danske Bank decided to exit the Baltic market: R. Milne, *Swedbank failings on €37bn of transactions revealed in the report*, Financial Times, 23 March 2020; J. Ewing, *Why Scandinavian Banks' Clean Reputations Are Threatened by Dirty Money*, The New York Times, 7 April 2019; Danske Bank, *Danske Bank closes down its banking activities in the Baltics and in Russia*, company announcement No. 4/2019, 19 February 2019.

37 *Minister Jānis Reirs: Merging of the FCMC with the Bank of Latvia is a logical completion of the "capital repair" of the financial sector*, press release of the Ministry of Finance, 22 May 2020.

38 Law on the Bank of Latvia, effective as of 1 January 2013.

39 Section 3 of the Transitional Provisions of the new Law on the Bank of Latvia.

The EU institutions were largely absent from the decision of policymakers to proceed with institutional reform. This is consistent with the principle of procedural and institutional autonomy,[40] under which the EU Member States remain free to determine the organisation and functioning of the institutional framework for financial supervision.[41] The national autonomy in designing the new governance framework of the Bank of Latvia was however limited. In accordance with Article 131 of the Treaty on the Functioning of the European Union ('TFEU'), the new supervisory framework had to be compatible with the EU treaties and the Statutes of the European System of Central Banks ('ESCB') and of the ECB ('Statutes of the ESCB and of the ECB'), in particular, to ensure that the supervisory and resolution tasks of the Bank of Latvia do not interfere with its ESCB-related tasks. In that respect, the ECB governance framework served as a point of reference for remodelling the governance structure of the Bank of Latvia with a view to accommodating multiple mandates within a single institution (Section 3). The increase of the powers of the Bank of Latvia also called for a rethinking of the relationship between central bank independence and accountability. Enhanced democratic control was needed in order to avoid that bringing the supervisory and resolution tasks under the shield of the central bank independence could obstruct the accountability for the discharge of these tasks (Section 4).

2. Gradual unification of the financial supervision

Over the last three decades, Latvia has gone through four banking crises: a systemic crisis in 1995, the Russian financial crisis in 1998, the global financial crisis in 2008-2009 and, finally, a confidence crisis in 2018. These crises have been very different, but each of them has led to a consolidation of the banking system and changes to the regulatory framework. The experience of the first two banking crises was the main driver for switching from sectoral supervision to unified supervision within a separate supervisory authority (2.1). On the other hand, the crisis of 2018 was the main catalyst for further consolidation of the supervisory architecture (2.2).

2.1. Switching from a sectoral to unified supervision

In 2001, Latvia introduced the unified (integrated) supervisory model which replaced a vertical (silos) supervisory model. The central role in the sectoral model was attributed to the Bank of Latvia which was in charge of bank supervision (A).

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40 See ECJ, 27 June 2013, *Agrokonsulting-04*, C-93/12, EU:C:2013:432, para 35.

41 See the expression of this principle in Article 2(2) of the Council Regulation (EU) No. 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, OJ L 287, 29.10.2013, 6 ('SSM Regulation') and Article 4(1)(4) of the Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012, OJ L 176, 27.6.2013, 1.

The failure of the central bank to prevent and effectively manage the banking crises of 1995 and 1998 revealed nevertheless the institutional weakness of the bank supervision in Latvia (B).

A. A central bank dominated sectoral approach

After the restoration of its independence in 1991, Latvia carried out in-depth market economic and legal reforms which turned it into an open and entrepreneurial economy with a thriving banking sector. Between 1991 and 1993, more than 60 new banks entered the market as a result of the privatisation of State-owned banks and low market entry requirements. The rapid expansion of the banking market coincided with the macroeconomic stabilization involving the reduction of inflation[42] and stabilisation of the national currency.[43]

The liberalisation of the financial sector was accompanied by regulatory and institutional reforms. In 1991, the operation of the Bank of Latvia was reinstated[44] and it was vested with a large autonomy in carrying out central banking and banking supervisory tasks.[45] The supervision of the insurance and private pension fund sector was entrusted to the Insurance Supervision Inspectorate, while the supervision of the securities markets was vested with the Securities Market Commission. The new supervisory architecture reflected the prevailing trend in many European countries at the beginning of the 1990s which had adopted a vertical (silos) supervisory model.[46]

The three supervisory authorities were not however of equal legal standing. The law recognised the importance of the Bank of Latvia by assigning it the status of a public autonomous institution and guaranteed its independence. The Bank of Latvia was vested with the principal objective of maintaining price stability and subsidiary objectives of promoting competition, efficient allocation and circulation of resources and stability, coordination and stability of the financial system. The Bank of Latvia was vested with limited regulatory power and broad autonomy in managing its personnel and budget. The operational independence[47]

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[42] Inflation dynamics from 1992 to 1997 according to Central Statistical Bureau of Latvia: 1992 (interim currency) – 951.2%, 1993 (introduction of the national currency Lat) – 109.2%; 1994 – 35.9%; 1995 – 25%; 1996 – 17.6%; 1997 – 8.4%.

[43] IMF, *Latvia: Recent Economic Developments*, Country Report No. 1995/125, 19 December 1995, 25.

[44] The Bank of Latvia was established on 19 September 1922 with a decision of Cabinet of Ministers of Latvia. After the restoration of the independence of Latvia, the operation of the Bank of Latvia was reinstated with the decision of the Supreme Council of the Republic of Latvia of 3 September 1991 "Regarding the reorganisation of the banking institutions in the territory of the Republic of Latvia".

[45] Article 10 of the Law on the Bank of Latvia, adopted on 19 May 1992.

[46] ECB, *The Role of National Central Banks in Banking Supervision in Selected Central and Eastern European Countries*, Legal Working Paper Series No. 11, March 2010, 6; D. Masciandaro, *Financial Supervision in the EU: Is There a Convergence in the National Architectures?*, (2009) 17 Journal of Financial Regulation and Compliance 2, 87.

[47] Adequacy of legal powers constitutes an element of the operational independence of financial supervisor: EBA Report on the Supervisory Independence of Competent Authorities, EBA/REP/2021/29, 18 October 2021 ('EBA Report'), Section 2.3, 24-27.

of the Bank of Latvia in supervising the banking sector remained however limited since the range of its supervisory and sanctioning powers remained relatively limited. Furthermore, Latvian financial markets in the early 1990s were dominated by the banking sector[48] which reinforced the role of the Bank of Latvia in the new financial supervisory architecture.

In contrast, the Securities Market Commission and the Insurance Supervision Inspectorate formed a part of hierarchically organised public administration with the Cabinet of Ministers at its apex. The Securities Market Commission was a public body with a distinct legal personality whose functioning was overseen by the Minister of Finance.[49] For the purposes of carrying out its tasks, it was vested with delegated regulatory power and autonomy in organising its work and managing its personnel. The commission's financial autonomy was however limited as it was mainly financed from the State budget allocations. Similarly to the securities market supervisor, the Insurance Supervisory Inspectorate was a public body with a distinct legal personality overseen by the Minister of Finance.[50] Its operational and personal autonomy was however very limited. The director of the Insurance Inspectorate was appointed by the Cabinet of Ministers, whereas the members of its Council, a consultative body, were appointed by the Minister of Finance. The operation of the inspectorate was financed by contributions of the market participants, while its annual budget was approved by the Cabinet of Ministers and the Parliament.[51]

B. The institutional weaknesses of the bank supervision

The robustness of the regulatory framework and the institutional capacity of Latvian supervisory authorities was tested during the banking crisis of 1995. Liberal licensing requirements allowed the establishment of an excessive number of commercial banks without the necessary capital, adequate banking skills, and appropriate accounting and internal control procedures. The lack of effective regulatory mechanisms to enforce discipline, together with the moral hazard associated with the generalized perception of implicit government guarantees, allowed banks to take excessive risks and adopt unsound lending policies. These led to the build-up of weak portfolios[52] and eventually to sizable losses when the risks associated with trade financing, currency and interest rate risks materialised.[53]

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48 IMF Country Report of 2002, paras 13-17.

49 Articles 3 and 4 of the Law on Securities Market Commission, effective from 14 September 1995 until 1 June 2001.

50 Article 2 of the Law on the State Insurance Supervisory Inspectorate, effective from 27 September 1995 until 1 September 1998.

51 Cabinet of Ministers Regulations No. 161 of 29 April 1997 *Financing Regulations of the State Insurance Supervisory Inspectorate*.

52 In 1995, non-performing loans represented 25% of the total loans: IMF, *Latvia*, cit., 28.

53 *Ibidem*, 28 f.; A. Fleming, S. Talley, *The Latvian Banking Crisis: The Lessons Learned*, The World Bank Policy Research Working Paper No. 1590, April 1996, 6.

The bankruptcy of Banka Baltija, the largest bank at the time, exposed the distortions accumulated in the banking sector over the previous years and precipitated the banking crisis. In the course of 1995, 15 banks, accounting for around 40 percent of the banking assets, were closed. The social implications of the crisis were aggravated[54] by the fact that at the time Latvia did not have a deposit guarantee scheme.[55] The banking crisis revealed also the weaknesses of the Latvian institutional framework for banking supervision, in particular the risks arising from the cumulation of the monetary policy and banking supervisory tasks within the Bank of Latvia and its insufficient capacity to supervise the banking sector.

According to its statutory mandate,[56] the Bank of Latvia had adopted a macroeconomic stabilisation policy which privileged price stability over financial stability. The cornerstone of the macroeconomic stabilisation was a very tight monetary policy which was seen as a precondition for long-term growth.[57] This was manifest in the policy of the Bank of Latvia to reduce the refinancing interest rates. Despite the attempt of the Bank of Latvia to lower the interest rates, the market rates remained relatively elevated, reflecting in part the high interest rate strategy pursued by Banka Baltija and other banks. In fact, Banka Baltija had engaged in a very aggressive policy to increase its market share consisting of offering high deposit interest rates[58] and of providing high-risk short-term loans.[59] The efforts of the Bank of Latvia to pursue a macroeconomic stabilisation policy eventually proved to be successful, and the inflation sharply declined in 1994 and the following years leading to an increase in real interest rates. This may well have had a negative effect on the ability of the enterprises to repay their loans and, consequently, contributed to a general deterioration in the bank loan portfolio quality.[60]

It has been also argued that the severity of banking crises could have been mitigated if the liberalisation of financial markets had taken place only after the central bank had managed to reduce inflation and stabilise the national currency. Indeed, the Bank of Latvia was itself a new institution whose reputation in maintaining Lat as a strong currency was not yet established and not reflected in the expectations of the market participants.[61] There is some evidence that Banka Baltija and possibly other banks followed a very high-risk strategy in bidding for

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54 W. Hallagan, *The Evolution of the Latvian Banking Market*, (1997) 28 Journal of Baltic Studies 1, 67 and 70.

55 The Government introduced nevertheless an *ad hoc* scheme compensating a part of the deposits over a three-year period.

56 Article 3 of the Law on the Bank of Latvia.

57 See M. Bitāns, D. Šļakota, I. Tillers, *Price Dynamics in Latvia: Experience and Future Prospects*, Bank of Latvia, 2001, 3-6.

58 In 1995, it offered 90% interest rate for deposits denominated in Lats, whereas other banks were offering interest rates in the range of 12 to 55%.

59 IMF, *Latvia*, cit., 31.

60 A. Fleming, S. Talley, *The Latvian Banking Crisis*, cit., 6.

61 W. Hallagan, *The Evolution of the Latvian Banking Market*, cit., 73-74.

Lat deposits at very high interest rates. Convinced that the Lat would depreciate vis-a-vis the US dollar, Banka Baltija repeatedly converted large volumes of Lats into US dollars and on-lent these dollars, thereby exposing itself to considerable currency risk. It is possible that Bank Baltija believed that by putting itself in a position where it dominated the banking system,[62] any doubts about its solvency would either force the Bank of Latvia to depreciate the national currency against the US dollar or the Government to bail it out.[63] None of this happened. The Bank of Latvia continued to pursue the goal of a fixed exchange rate[64] and the Lat even appreciated against the US dollar over the 1994-1995 period,[65] aggravating the losses incurred by a part of the banks.

Apart from the crystallisation of the risks implicit in the tight monetary policy, the crisis revealed the weaknesses of the regulatory framework and insufficient supervisory capacity. Very liberal banking regulation[66] combined with unscrupulous supervision had allowed the proliferation of unsound banks and encouraged imprudent behaviour. The Bank of Latvia lacked adequate powers to prevent unfit shareholders and managers from accessing the banking business and to ban insider lending.[67] The banking supervisor was also slow to identify the accumulation of the risks in the banking sector in the years leading to the banking crisis. Indeed, the Bank of Latvia had introduced provisioning for bad loans and external auditing requirement only in 1994,[68] and the losses and inadequate capital base of the banks were discovered only in April 1995 when the banks had to submit their financial statements.[69] The banking supervisor also lacked an adequate range of enforcement powers to impose sanctions, remove from office unfit management and intervene in financially unsound banks.[70]

Public opinion associated the multiple banking failures and fraud cases with the supervisor's failure to adequately supervise the banking sector.[71] Despite the orderly consolidation of the banking sector in the following years and the reforms undertaken to strengthen the regulatory framework, the fragility of the banking sector manifested itself again during the Russian financial crisis in 1998. Two banks having heavily invested in assets denominated in Russian rubbles were

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62 In 1995, it held 30% of the total deposit portfolio of Latvian banks.

63 A. Fleming, S. Talley, *The Latvian Banking Crisis*, cit., 6; W. Hallagan, *The Evolution of the Latvian Banking Market*, cit., 67, 70 and 73.

64 In February 1994, Lat was pegged to IMF currency unit, special drawing rights, and, as of 1 January 2005, to euro. The monetary policy of maintaining a fixed exchange rate mechanism of Lat remained unchanged until 2014 when Latvia joined euro area.

65 *Ibidem.*

66 The first banking law was a rudimentary law of 6 pages.

67 A. Fleming, S. Talley, *The Latvian Banking Crisis*, cit., 5.

68 IMF, *Latvia*, cit., 29.

69 *Ibidem*, 30.

70 The Bank of Latvia had the right to issue recommendations or to withdraw the banking license, but it lacked the power to impose "intermediate stage" sanctions and to adopt other early intervention measures: see A. Fleming, S. Talley, *The Latvian Banking Crisis*, cit., 10.

71 *Ibidem*, 11.

declared bankrupt and one was restructured.[72] In an attempt to rebuild public confidence in the banking system, the Bank of Latvia initiated an institutional reform for financial supervision.

2.2. Switching to a unified supervisory model

In 2001, Latvia switched from a vertical supervisory model to a unified supervisory model by conferring financial supervision to a specialised supervisory authority (A). Almost two decades later the confidence crisis triggered by money laundering scandals urged the policymakers to revisit the arguments in favour of the institutional separation of monetary policy and supervisory tasks (B).

A. Consolidation of the financial supervision within a specialised supervisory authority

The new unified financial supervisory authority, the FCMC, assumed the supervisory functions of the Bank of Latvia, the Securities Market Commission and the Insurance Inspectorate as of 2001.[73] It was established in the form of an autonomous public institution and vested with autonomy in managing its personnel and budget. This new legal status was a considerable improvement for the supervision of the insurance sector and the securities markets which were previously supervised by public bodies subject to the oversight of the Minister of Finance.[74]

Although the main driver of the creation of a unified supervisory authority was the reputational failure of the Bank of Latvia during the crisis of 1995 and 1998, several other arguments were invoked in favour of the reform. The Bank of Latvia argued that the centralisation of the supervisory functions in a single authority would create a competency centre that would ensure robust and efficient financial supervision.[75] It was also argued that a sectoral approach to financial supervision was inconsistent with the degree of market integration and the emergence of cross-sectoral financial groups.[76] The Latvian banking sector centred around a universal banking model with banks owning half of the domestic non-bank financial institutions.[77] The inefficiencies of the sectoral approach were associated with overlapping of the supervisory tasks and insufficient cooperation between sectoral supervisors resulting, for instance, in double or even triple

72 V.I. Roldugin, *Principal Causes of Financial Crises in Latvia for Last 20 Years*, (2016) 16 Advances in Systems Science and Application 2, 46.

73 In 2022, the FCMC was in charge of supervising around 300 financial market participants with a total value of assets exceeding EUR 30 million.

74 IMF Country Report of 2002, paras 100 and 138.

75 The institutional reform of 2001 was also positively assessed by international organisations considering it had improved the overall quality of financial supervision: IMF Country Report of 2002, para 42.

76 I. Pommere, *Vienota finanšu un kapitāla tirgus uzraudzība - attīstībai, drošībai un stabilitātei*, interview with Mr. Ilmārs Rimšēvičs, at the time Chairman of the Board of the Bank of Latvia, Averss un Reverss, Bank of Latvia, 1 January 2003; T. Laizāns, *Finanšu un kapitāla tirgus uzraudzības modeļi*, Averss un Reverss, Bank of Latvia, 1 January 2003.

77 IMF Country Report of 2002, para 66.

reporting.[78] It was also considered that centralisation of financial supervision within the FCMC would contribute to the harmonisation of the regulatory standards and supervisory practices applicable to different financial sectors, which was of increasing importance in the light of the forthcoming accession to the EU in 2004.[79]

The potential conflict of interest between monetary policy and financial supervision was also one of the considerations in favour of the institutional separation of these functions.[80] At the time, it was believed that supervisory concern about the fragility of the banking system could lead a central bank to pursue a more accommodating monetary policy than warranted for the maintenance of price stability. The involvement of a central bank in crisis management could also create a moral hazard of excessive risk-taking by banks which would count that the central bank would provide ELA to fragile banks or manipulate interest rates.[81] The banking crisis of 1995 provided in fact some evidence of the risk that serious problems of the banking system could place the Bank of Latvia under a pressure to adopt a more accommodating monetary policy (see Subsection 2.1 (B)).

The decision to create a unified supervisory authority in Latvia was made in the context where a number of countries in the 1990s and early 2000s were consolidating their supervisory architecture.[82] In support of the decision to create a unified supervisory authority, Latvian policymakers invoked the positive experience of the United Kingdom, Denmark, Sweden and Germany in reforming their supervisory architecture.[83] The Bank of Latvia further argued that "the experience of the Scandinavian countries has shown that as a financial market develops and its range of services provided expands, merging several financial supervisory authorities into one provides for more efficient supervision of the transactions in the financial sector, including an opportunity to assess market conditions more objectively and duly identify risk factors that could affect the interests of market participants and clients […]. A unitary system for supervision of the capital market has been successful in the Scandinavian countries, Australia, Canada, Japan, Korea, Singapore and Great Britain. Of the

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78 Explanatory Memorandum (Annotation) to the Law on the Financial Instruments Market Commission.

79 IMF Country Report of 2002, para 43; T. Laizāns, *Finanšu un kapitāla tirgus uzraudzības modeļi*, cit.

80 See S. Gerlach, *Banking and Fiscal Union*, Introductory remarks at a panel session at the EUI conference on *The State of Play in the Euro Area – Fixing the EMU for the Long Term*, Florence, 21 January 2013.

81 I. Pommere, *Vienota finanšu un kapitāla tirgus uzraudzība*, cit.; see also C. Goodhart, D. Schoenmaker, *Should the Functions of Monetary Policy and Banking Supervision Be Separated?*, (1995) 47 Oxford Economic Papers. New Series 4, 539-560; ECB, *The role of central banks in prudential supervision* 2012, 5-6.

82 Financial Stability Institute, *Institutional Arrangements for Financial Sector Supervision*, Bank for International Settlements, Occasional Paper, September 2007, 1, 12-13; on the 'bandwagon' effect as a driver of institutional reforms see D. Masciandaro, D. Romelli, *Central Bankers as Supervisors: Do Crisis Matter?*, BAFFI CAREFIN Centre Research Paper No. 2015-4, 2 and 14.

83 Explanatory Memorandum (Annotation) to the Law on the Financial Instruments Market Commission.

Central and East European countries, it has already been introduced in Hungary, and […] Estonia”.[84]

Two decades later, the advocates of the reform argued that the balance of arguments in favour of the institutional separation of monetary and supervisory tasks had changed. The integration of the Latvian authorities in the EU composite institutional structures – the Eurosystem and the Banking Union – were seen as mitigating factors for risks associated with the cumulated exercise of these tasks.

B. Consolidation of financial supervision within the central bank

The decision to integrate the FCMC into the Bank of Latvia was a politically driven process. In late 2019, the Parliament mandated the Cabinet of Ministers to “submit a proposal on the Law on the Bank of Latvia setting out its functioning and governance structure and providing for the integration of the FCMC into the Bank of Latvia, having due regard to the functional independence of monetary policy, supervisory and resolution functions”.[85] The parliamentary committee in charge of financial policy also instructed the Cabinet of Ministers to submit an assessment of the intended reform. The fact that the Parliament had mandated the integration of the FCMC in the Bank of Latvia before this assessment was made suggested however that a political decision to proceed with the reform had been already taken and that the role of the assessment was to legitimise this decision.[86]

The assessment was favourable to transferring the supervisory and resolution tasks to the Bank of Latvia. The conferral of supervisory tasks on the Bank of Latvia was supported by synergies between monetary policy and supervisory tasks, especially informational advantages and economies of scale derived from bringing all functions under the authority of the central bank. Furthermore, given that macroeconomic and supervisory goals are interdependent, a single institution responsible for both objectives might be better able to consider these interdependencies. It was acknowledged that, due to different cycles of economic development, a uniform monetary policy within the euro area could be for some time less adapted for Latvia. The consolidation of the financial stability function with the Bank of Latvia could nonetheless equip it with additional tools, for instance, macroprudential policy measures to ensure price stability.[87]

The report also identified several risks stemming from the cumulation of potentially conflicting mandates within the Bank of Latvia. It was considered however that they could be managed by additional safeguards intended to ensure

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84 Bank of Latvia, *On Establishing the Financial and Capital Market Commission in Latvia*, press release, 22 May 2001.

85 Point 3 of Transitional Provisions of the Amendments to the Law on the Bank of Latvia of 21 November 2019.

86 See G. Bērziņš, *Neatbildēts jautājums – vai ir skaidri un nepārprotami noteikts likumdevēja mērķis*, Jurista Vārds, 24 March 2020, No. 1122, 18; A. Lošmanis, *Jautājums bija vispirms risināms konceptuāl*, cit.

87 Assessment regarding the Integration of the Financial and Capital Markets Commission in the Bank of Latvia, 20 May 2020 (‘Assessment of the Institutional Reform’), 10.

operational independence of monetary, supervisory and resolution tasks.[88] The main risk was associated with excessive concentration of power within the Bank of Latvia which could be detrimental to institutional 'checks and balances'. Indeed, the centralisation of financial stability functions within the Bank of Latvia might reduce the plurality of opinions and mutual control.[89] The report also highlighted a potential conflict of interest in cumulating monetary policy and supervisory tasks (refer to Subsection 3.1(A)). This exposed the Bank of Latvia to the risk that its reputation could be impaired by potential supervisory failures, which could adversely affect the effective implementation of macroprudential and monetary policy.[90]

3. Multiplication of the mandates of the Bank of Latvia

As a result of the institutional reform, the Bank of Latvia has assumed the responsibility for financial supervision and resolution alongside its monetary policy function (3.1). In order to address potential conflicts of interest arising from the cumulation of competing mandates, the law envisages operational separation of monetary policy, supervisory and resolution functions within the Bank of Latvia (3.2).

3.1. Cumulation of monetary policy, supervisory and resolution tasks

The Bank of Latvia has emerged from the institutional reform as an NCB with one of the broadest mandates in the euro area.[91] It assumes the responsibility for the supervision of all regulated financial market participants, the resolution of credit institutions and investment firms, as well as the management of the deposit guarantee fund, the fund for the protection of the insured and the disbursements under the investor protection scheme ('Compensation Schemes').[92] The consolidation of these tasks at the level of the Bank of Latvia entails the risk of multiple conflicts of interest. The advocates of the reform argued however that the composite nature of the EU institutional structures, in particular, the Eurosystem and the Banking Union mitigates potential conflict of interests between potentially competing mandates. Indeed, the integration of the Bank of Latvia and the FCMC in this institutional framework allows to revisit the arguments against the institutional separation of supervisory and monetary policy tasks[93] (A) and the separation of resolution and supervisory tasks (B).

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88 *Ibidem*, 9.

89 *Ibidem*, 4 and 18.

90 *Ibidem*, 4.

91 Assessment of the Institutional Reform, 8.

92 The Consumer Right Protection Centre will remain responsible for the supervision of non-bank consumer credit service providers and out-of-court debt collection service providers.

93 Initial impact assessment (annotation) of the proposal of the Law on the Bank of Latvia ('Explanatory Memorandum of the Law on the Bank of Latvia'), para 15.3.2, 19.

A. Revisiting the institutional separation of supervisory and monetary policy tasks

The potential conflict of interest between monetary policy and financial supervision was one of the considerations which led to the institutional separation of these functions in 2001 (see Subsection 1.2 (B) above).[94] This argument has nonetheless lost most of its force since 2014 when Latvia joined the EMU. In the new institutional setting, the monetary policy decisions are outside the exclusive control of the NCBs and reside with the Eurosystem.[95] This was also the main argument of the advocates of the institutional reform contending that the involvement of a NCB in the financial supervision would not be a source of a major conflict with its monetary policy functions, since the relevant decision-making bodies for these two functions do not coincide anymore.[96] Due to the limited responsibility for monetary policy, the expected downsides of the involvement of the Bank of Latvia in financial supervision have also become weaker.[97] These arguments also echo the position of the ECB which over the last decades has consistently encouraged a greater involvement of NCBs in prudential supervision.[98]

In contrast, the moral hazard risk associated with the cumulation of supervisory and lender-of-last-resort functions within a central bank has not entirely disappeared within the EMU. The provision of ELA to banks remains mainly the responsibility of the Bank of Latvia,[99] which nevertheless exercises this function within the EU legal framework. In accordance with the EU Agreement on emergency liquidity assistance,[100] the Bank of Latvia may provide ELA to banks unless the Governing Council of the ECB finds that such assistance interferes with the tasks and objectives of the ESCB,[101] in particular the prohibition of monetary financing.[102] The proponents of the reform argued however that the risk that the new institutional framework could incentivise banks to take excessive risks in belief that the central bank would be more inclined to provide ELA to avoid reputational damage from its supervising failings is moderate.[103]

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94 See S. Gerlach, *Banking and Fiscal Union*, cit.

95 Article 127(2) of the TFEU.

96 Explanatory Memorandum of the Law on the Bank of Latvia.

97 On similar trend in other Member States of the EMU see D. Masciandaro, M. Quintyn, *The Evolution of Financial Supervision: the Continuing Search for the Holy Grail*, in M. Balling, E. Gnan, *50 Years of Money and Finance: Lessons and Challenges* (SUERF 2013), 289-190.

98 See, for instance, ECB, The role of central banks in prudential supervision (2012), 5-6.

99 Provision of ELA is not a monetary policy task of NCBs. ELA fall within the residual category set out in Section 14.4 of the ECB and ESCB Statues, under which 'national central banks may perform functions other than those specified in this Statute' and 'such functions shall be performed on the responsibility and liability of national central banks and shall not be regarded as being part of the functions of the ESCB'.

100 Section 2.1 of the Agreement on emergency liquidity assistance of 9 November 2020.

101 Subsections 5.1 and 5.2 of the Agreement on emergency liquidity assistance.

102 Article 123 TFEU.

103 P. Tucker, *The lender of last resort and modern central banking: principles and reconstruction*, Re-thinking the lender of last resort, BIS Papers No. 79, September 2014, 19-20.

It was considered that the moral hazard risk could be further mitigated, first, by structural separation of monetary and supervisory functions within the Bank of Latvia[104] and, second, by limiting recourse to ELA to exceptional cases. In that respect, the new law stipulates that the Bank of Latvia may provide ELA only to solvent financial institutions with short-term liquidity problems against adequate collateral to avoid contagion effect or material disruption of the functioning of financial markets.[105]

The Latvian institutional reform could be also seen as a reflection of a reversal of the trend to institutionally separate monetary policy and supervisory tasks since the global financial crisis.[106] The reputational failures of many supervisory institutions during the crisis have reinforced the idea that banking supervisors need the market expertise and macroeconomic forecasting of central banks and could be more efficient as a built-in function of central banking.[107] A shift in the general perception of monetary policy institutions also occurred, with central banks being nowadays perceived as public policy institutions with the mandate to promote both monetary and financial stability.[108] A telling example of this reversal is the evolution of supervisory architecture in the United Kingdom between 1997 and 2013. In 1997, when the UK decided to separate monetary policy and financial supervision by transferring the latter task from the Bank of England to the Financial Services Authority. However, the supervisory failure of the Financial Services Authority during the financial crisis led in 2013 to the transfer of prudential supervisory tasks to the newly established Prudential Regulation Authority, a subsidiary of the Bank of England.[109] Also, a number of euro area Member States – Belgium, Germany, Greece, Ireland, Lithuania and Portugal – following the global financial crisis have either conferred prudential banking supervision or financial supervision on the NCB or enhanced the role of the NCB in supervisory activities.[110]

B. Path-dependent choice of cumulation of resolution and supervisory tasks

The decision to confer the bank resolution task on the Bank of Latvia was a path-dependent choice reflecting the earlier policy preference of assigning

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104 Assessment of the Institutional Reform, 15.

105 Article 34 of the Law on the Bank of Latvia.

106 D. Calvo *et al.*, *Financial supervisory architecture: what has changed after the crisis*, FSI insights on policy implementation No. 8, April 2018, paras 26 and 29; D. Masciandaro, M. Quintyn, *The Evolution of Financial Supervision*, cit., 298-299; L.D. Pellegrina, D. Masciandaro, R. Pansini, *The central banker as prudential supervisor: Does independence matter?*, (2013) 9 Journal of Financial Stability 3, 415-427; D. Masciandaro, D. Romelli, *Central Bankers as Supervisors*, cit., 2.

107 C. Goodhart, *The regulatory response to the financial crisis*, (2008) 4 Journal of Financial Stability 4, 351-358.

108 D. Masciandaro, D. Romelli, *Central Bankers as Supervisors*, cit., 4.

109 E. Ferran, *The Break-up of the Financial Services Authority*, (2011) 31 Oxford Journal Legal Studies 3, 455-480.

110 ECB, Recent developments in supervisory architectures in the EU Member States (2007-10), October 2010.

this task to the financial supervisory authority. Although some of the functions related to the bank recovery and early intervention were exercised by the FCMC, Latvia did not have a comprehensive regulatory and institutional framework for bank resolution. At the time of the institution of the SRM, it was considered that resolution and financial supervision are complementary tasks that would be more efficiently exercised by a single institution. Latvian law acknowledges however that these functions need to be exercised independently in order to avoid that supervisory and resolution teams might have different views on when to open resolution proceedings.[111] This is also the underlying rationale of Article 3(3) of the Bank Recovery and Resolution Directive,[112] which allows designating banking supervisors as resolution authorities only exceptionally and only subject to adequate structural arrangements being in place to ensure operational independence of competing mandates.[113]

In the same vein, the ECB has accepted that resolution tasks may be conferred on an NCB provided that they do not undermine its independence in accordance with Article 130 TFEU.[114] In the context of the Latvian reform, the ECB opined that administrative resolution tasks are related to supervisory tasks within the meaning of Article 127(5) TFEU as they complement each other. It has generally accepted the conferral of resolution tasks on an NCB on a condition that they 'do not interfere financially and operationally with the performance of its ESCB-related tasks'.[115] This implies that using of monetary reserves in order to finance a resolution fund or other financing assistance to banks in resolution is incompatible with the prohibition of monetary financing set out in Article 123 TFEU.[116]

These requirements are already respected by the Latvian resolution financing arrangements and the institutional reform will require only the substitution of the FCMC with the Bank of Latvia as a resolution authority. The Bank of Latvia accordingly assumes the responsibility for ensuring the accumulation and management of funds in the national resolution fund from entities subject to resolution. It is also entitled to use alternative sources of financing and enter

[111] Explanatory Memorandum to the Law on the Recovery and Resolution of Credit Institutions and Investment Brokerage Companies, Section 2.

[112] See also Recital 19 of the Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 82/891/EEC, and Directives 2001/234/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No. 1309/2010 and (EU) No. 648/2012, of the European Parliament and of the Council ('BRRD'), OJ L 173, 12.6.2014, 190.

[113] See also Key Attribute 2 of FSB Key Attributes Assessment Methodology for the Banking Sector, 19 October 2016; EBA, Interpretation of the requirement of structural separation of the competent (supervisory) and resolution, Q&As, 24 July 2015.

[114] Para 2.3 of Opinion of the European Central Bank of 30 May 2011 on financial market supervisory reform in Lithuania (CON/2011/46).

[115] Opinion CON/2021/9, para 5.2.3.

[116] ECB Convergence Report, June 2020, 36; on the limits arising from the prohibition of monetary financing see also ECJ, 13 September 2022, *Banka Slovenije*, C-45/21, EU:C:2022:670.

into a loan or other support agreements with investment brokerage companies, financial institutions or other third parties if the funds in the resolution fund are not immediately available or insufficient to cover losses, costs or other expenses.[117] In full respect of the prohibition of monetary financing, it is not entitled to assume or finance any obligation of either a bridge institution or an asset management vehicle (see Section 3.1(A) on the financial independence of the Bank of Latvia).

Assigning the supervisory and resolution tasks to the Bank of Latvia raises the question about the relationship between its primary mandate and newly attributed mandates. The Bank of Latvia will have to act under different ‘hats’ which may result in conflicting decisions. To address this risk, the governance structure of the Bank of Latvia has been redesigned in order to ensure independent exercise of its competing mandates.

3.2. Operational independence of competing mandates

The operational independence of financial supervisory authority requires not only its protection against external interference but also adequate safeguards against conflicts of interest arising from the exercise of competing mandates.[118] In that regard, the principles underlying the ECB governance framework provided useful guidance to the Latvian legislator for designing such institutional framework of the Bank of Latvia that would accommodate the exercise of multiple functions.[119] In order to provide legal certainty about its core mandate, the new law reaffirms the priority of the price stability objective over other objectives to be pursued by the Bank of Latvia (A). Furthermore, the internal organisation of the Bank of Latvia is remodelled with a view to ensure that its competing mandates are exercised independently (B).

A. Prioritisation of price stability over other central bank objectives

The new law seeks to manage potential conflicts of interest between monetary policy, supervisory and resolution tasks by prioritising the mandates vested on the Bank of Latvia.[120] In line with Article 127(1) TFEU, the law affirms that the primary objective of the Bank of Latvia is to maintain price stability. Without prejudice to this objective, it has to support the general economic policies in the EU and promote financial stability at large.[121] Financial stability is understood to refer not only to existing tasks of the Bank of Latvia (e.g. macroprudential

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117 Article 121.[3] of the Law on the Recovery and Resolution of Credit Institutions and Investment Brokerage Companies (‘Resolution Law’).

118 See EBA Report, Section 2.3, 20-24; Article 4(4) of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176, 27.6.2013, 338.

119 Explanatory memorandum of the Law on the Bank of Latvia, para 15.3.2, 20-21.

120 On the obligation of the EU Member States to guarantee functional independence of national central banks see ECB Convergence Report, June 2020, 20.

121 Article 4 of the Law on the Bank of Latvia.

supervision, promotion of smooth operation of payment and securities settlement systems and ELA) but also to its new tasks (supervision, resolution and administration of Compensation Schemes).[122] The new law hence affirms that the conferral of supervisory and resolution tasks on the Bank of Latvia should not prejudice the pursuit of its core mandate of maintaining price stability.

The financial sector has expressed some concern that the institutional subordination of the financial stability mandate to the price stability mandate could relegate financial supervision to a secondary task.[123] There are however reasons to believe that this will not happen. It is expected that two thirds of all the decisions of the Bank of Latvia will be taken in the area of financial supervision. The changes to its workload and the allocation of its resources may balance out the relative importance of the mandates of the Bank of Latvia. Furthermore, financial supervision has so far attracted more controversies and, hence, has been subject to greater public scrutiny than the implementation of the monetary policy. Indeed, the role of the Bank of Latvia as NCB is limited to participation in the definition and implementation of monetary policy within the ESCB. In contrast, prudential supervision of credit institutions within the SSM largely remains decentralised.[124] The ECB directly supervises only the largest three Latvian banks in terms of their assets,[125] whereas the Bank of Latvia will be responsible for the direct supervision of all the remaining banks.

A related risk consists of overburdening of the Bank of Latvia with new tasks which could impede the latter from giving equal attention to all of them. Indeed, the tasks of central banks and financial supervisors are constantly expanding covering such domains as financial innovation and integration of climate change into the financial stability framework. The policymakers considered however that this risk could be effectively managed by setting up an appropriate organisational structure of the Bank of Latvia with adequate powers, resources and communication channels.[126]

B. Structural separation of competing functions

Further parallels can be drawn between the institutional arrangements introduced by the ECB and other euro area NCBs and the Bank of Latvia in order to ensure that monetary policy decisions are not influenced by concerns about financial stability and vice versa. Article 25(2) of the SSM Regulation[127] provides for the meticulous separation of the monetary policy and the supervisory functions. The supervision function is entrusted to the Supervisory Board which

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122 Explanatory memorandum of the Law on the Bank of Latvia, para 14, 16-17.

123 M. Ķirsons, *Notikuma izklāsts*, Dienas Bizness, 28 January 2020.

124 Article 6(1) and (4) of the SSM Regulation.

125 ECB, List of supervised entities, 1 November 2023.

126 Assessment of the Institutional Reform, 11.

127 See also the decision of the ECB of 17 September 2014 on the implementation of separation between the monetary policy and supervision functions of the European Central Bank (ECB/2014/39), OJ L 300, 18.10.2014, 57.

is in charge of preparing proposals of supervisory decisions for the approval of the Governing Council under the so-called 'no objection procedure'.[128] The operational independence of the supervisory function is further guaranteed through a structural separation of personnel and reporting lines. The new organisational structure of the Bank of Latvia draws on similar principles in order to ensure that the monetary policy, the supervisory and the resolution functions are carried out by separate internal units with separate reporting lines and delimitation of the powers of the decision-making bodies and their members.[129]

The policymakers considered that the transfer of supervisory and resolution tasks to the Bank of Latvia would require a more efficient and streamlined organisational and decision-making structure. Previously, the Bank of Latvia had a two-tier governance structure. The Council, composed of six members appointed by the Parliament, was the highest decision-making body, while the Board was an executive body vested with the task of ensuring efficient management of the central bank.[130] The two-tier governance structure was however considered to be overly complex in order to implement a meaningful operational separation of monetary policy, supervisory and resolution functions. Drawing on the model of the Bank of Lithuania,[131] it has been replaced by a single tier governance structure in which the Council is the sole decision-making body for ESCB-related tasks.[132]

The Council is composed of seven members. It is chaired by the Governor, who has two deputies.[133] Apart from participating in collegial decision-making, each member of the Council is vested with an individual sphere of responsibility. The Governor is in charge of monetary policy issues and sits on the Governing Council of the ECB.[134] One of his Deputies is in charge of other central bank functions, whereas the other Deputy is responsible for the supervision of financial institutions and sits on the Supervisory Board of the ECB. He shares the responsibility for the supervision of financial institutions with another Council member and they both represent the Bank of Latvia at the level of the three European Supervisory Authorities. Furthermore, another Council member is in charge of the banking resolution and administration of Compensation Schemes and acts as a member of the Single Resolution Board.[135]

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128 Article 26(8) of the SSM Regulation.

129 Article 5(2) of the Law on the Bank of Latvia; see more generally on the arrangements used to ensure structural separation of supervisory mandates: S. Kirakul, J. Yong, R. Zamil, *The universe of supervisory mandates – total eclipse of the core?*, FSI Insights on policy implementation No. 30, March 2021, 20 f.

130 Article 23 of the Law on the Bank of Latvia.

131 In the light of historic and geographic similarities, it was considered that the Lithuanian example was particularly pertinent for designing the new institutional framework: see Explanatory Memorandum of the Law on the Bank of Latvia, para 4, 3.

132 Explanatory Memorandum of the Law on the Bank of Latvia, para 22, 28.

133 Article 11 of the Law on the Bank of Latvia.

134 Article 283(1) TFEU and Article 10.1 of the Statute of the ESCB and of the ECB.

135 Explanatory Memorandum of the Law on the Bank of Latvia, para 22, 29.

Two separate committees have been established for supervisory and resolution matters which operate according to the regulations adopted by the Bank of Latvia.[136] Each of these committees is chaired by a different Council member. Structural separation of the personnel is ensured so that the members of the Supervisory Committee may not act as members of the Resolution Committee and *vice versa*. Furthermore, personnel responsible for the monetary policy task may not be members of either of these two committees.

The Supervisory Committee and the Resolution Committee do not constitute decision-making bodies within the meaning of Article 130 of the TFEU and Article 7 of the Statute of the ESCB and of the ECB. They are responsible for preparing proposals for decisions that are submitted to the Council for approval. The Council has nevertheless delegated the power to the Supervisory Committee and the Resolution Committee to adopt most of the supervisory decisions and decisions relating to the application of resolution tools and to the implementation of the Compensation Schemes, respectively.

Despite the institutional arrangements to separate supervisory and resolution from monetary decision-making, it is hardly possible to make these functions completely independent from each other.[137] The most important supervisory and resolutions decisions are taken by the Council which has to eventually arbitrate between different central bank objectives. Indeed, the constitutional constraints posed by the principle of democracy may prevent the Council from delegating substantial decision-making powers to the supervisory and resolution committees which do not enjoy the same democratic legitimacy as the Council (see 4.2 below). Furthermore, the Governor of the Bank of Latvia is responsible for the organisation of the administrative work and several business areas (e.g. legal) which provide support to all of its functions as shared services. Finally, the separation of monetary, supervisory and resolution functions does not preclude the exchange of information (subject to confidentiality arrangements) between the internal units of the Bank of Latvia. These linkages between internal units of the Bank of Latvia seem to relativise a strict separation of these functions. This might be all the more true because the organisational structure of the Bank of Latvia is relatively flat and its personnel has developed a culture of cooperation. As a result, the operational separation of monetary, supervisory and resolution functions envisaged by the new law is likely to be less pronounced in practice.

The conferral of supervisory and resolution functions to the Bank of Latvia results in the concentration of extensive powers within a single institution,

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136 Regulations of the Bank of Latvia No. 228 of 14 November 2022, The Regulations of the Supervisory Committee of the Bank of Latvia, and Regulations of the Bank of Latvia No. 229 of 14 November 2022, The Regulations of the Resolution Committee of the Bank of Latvia.

137 See more generally on the intertwinement of the functions: M. Goldmann, *United in Diversity? The Relationship between Monetary Policy and Prudential Supervision in the Banking Union*, SAFE Working Paper No. 178, December 2017, 14-15; S. Eijffinger, R. Nijskens, *Monetary policy and banking supervision*, Vox, CEPR Policy Portal, 19 December 2012.

which may be detrimental to the 'checks and balances' on which the functional separation relies. This consolidation calls for the accommodation of the governance arrangements of the Bank of Latvia to its new tasks.

4. Remodelling of the governance framework of the Bank of Latvia

The relationship between independence and accountability is at the core of central bank governance. The extension of the mandate of the Bank of Latvia to financial supervision and banking resolution brings these functions under the shield of central bank independence (4.1). The principle of democracy requires, however, that strengthened independence in the discharge of these functions is counterbalanced with enhanced accountability (4.2).

4.1. Extension of central bank independence guarantee to the new tasks

The Eurosystem has been designed as a composite institutional structure which brings together the ECB and NCBs in a system of central banks of euro area Member States.[138] In the same vein, the SSM is modelled as a vertically integrated institutional framework composed of the ECB and national competent authorities which form together a system of financial supervision.[139] In these highly integrated systems,[140] the national authorities are vested not only with a European mandate[141] but also with additional independence guarantees in the execution of this mandate. Article 130 TFEU, reproduced in Article 7 of the Protocol on the Statute of the ESCB and of the ECB, guarantees the independence of the ECB and the NCBs in order to shield them from political influence in performing their monetary policy tasks. The central bank independence standard[142] is not however applicable to financial supervision and resolution per se. The independence of national supervisory and resolution authorities in the performance of the tasks that are carried out within the framework of the SSM and the SRM is guaranteed by secondary law.[143] Apart from this difference, the degree of independence afforded by the EU law to these authorities is considered to be lower than that of NCBs.[144]

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138 Article 282(1) TFEU.

139 Articles 2(9) and 6(1) of the SSM Regulation.

140 On the particularly integrated nature of the ESCB see ECJ, 26 February 2019, *Rimšēvičs and ECB v Latvia*, joined cases C-202/18 and C 238/18, EU:C:2019:139, para 69.

141 In the context of the applicability of the Protocol (No 7) on the privileges and immunities of the European Union, ECJ has estimated that in the performance of his duties as a member of the Governing Council of the ECB, the governor of a national central bank acts as a representative of an EU institution: ECJ, 30 November 2021, *LR Ģenerālprokuratūra*, C-3/20, EU:C:2021:969, paras 43 and 45; ECJ, 17 December 2020, *Commission v Slovenia (Archives of the ECB)*, C-316/19, EU:C:2020:1030, para 84.

142 ECB Convergence Report, June 2020, 20.

143 Article 19(1) of the SSM Regulation and Article 47(1) of the SRM Regulation.

144 Y. Mersch, *Central bank independence revisited*, keynote speech at the Symposium on *Building the Financial System of the 21st Century: An Agenda for Europe and United States*, 30 March 2017.

As a result of the cumulation of multiple tasks within an NCB, the central bank independence guarantee may nevertheless spill over to the discharge of its supervisory and resolution tasks. Indeed, following the integration of the FCMC in the Bank of Latvia, the members of its managing body responsible for the discharge of the supervisory and resolution tasks benefit from enhanced personal independence guarantees (B). At the same time, the conferral of new tasks on the NCB may weaken its independence in performing its monetary policy tasks. In order to mitigate this risk, the new law provides for additional safeguards against diluting of the financial independence of the Bank of Latvia (B).

A. Enhanced personal independence

Freeing financial supervision from political influence is likely to be one of the main advantages of the reform.[145] In the new institutional setting, all the members of the Council of the Bank of Latvia will benefit from equivalent security of tenure as the Governor of the Bank of Latvia. This change is particularly important in the light of the tensions surrounding the appointment and dismissal of the Council members of the FCMC in the past. In fact, the last four chairmen of the FCMC have resigned before the expiry of the tenure of their office. Although the reasons for resigning have differed from one case to another, this reoccurring pattern raises the question of whether the institutional capacity and independence guarantees of the FCMC were adequate in order to effectively fulfil its mandate.

The FinCEN announcement regarding the ABLV Bank came six months after the FCMC had fined five Latvian banks for effecting transfers from bank accounts of off-shore companies involved in the circumvention of international sanctions against North Korea between 2009 and 2015. The US authority had provided the FCMC with information about the potential involvement of certain Latvian banks in circumventing the North Korean sanctions and was waiting for enforcement action.[146] The FCMC imposed fines on five Latvian banks for the violation of AML/CTF laws,[147] while ABLV Bank was fined for an inadequate internal control system.[148] The fine on ABLV was set out in a non-public administrative agreement which provided, among others, the commitment of the bank to invest in its internal control system. Although the FCMC considered that there were insufficient legal grounds for fining ABLV for the violation of AML/CTF law,[149] this differentiation might have contributed to an impression

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145 Assessment of the Institutional Reform, 15.

146 S. Jemberga, *In the shadows of ABLV*, cit.

147 FCMC, *FCMC in collaboration with U.S. law enforcement authorities identifies weaknesses and imposes monetary fines on JSC "Norvik Banka" and JSC "Rietumu Banka"*, press release, 21 June 2017; FCMC, *FCMC in collaboration with U.S. law enforcement authorities identifies weaknesses and imposes monetary fines on three banks*, press release, 27 June 2017.

148 S. Jemberga, *In the shadows of ABLV*, cit.

149 S. Jemberga, *How Americans Took Down a Latvian Laundromat*, Re:Baltica, 7 March 2018.

that the supervisor was complacent towards this bank. Indeed, the language of the proposal of FinCEN concerning the special measure proposed against ABLV Bank was particularly harsh. The US authority alleged, among others, that it 'has reasonable grounds' to believe that ABLV Bank has 'institutionalized money laundering as a pillar of the bank's business practices'[150] and that 'ABLV executives and management have used bribery to influence Latvian officials when challenging enforcement actions and perceived threats to their high-risk business'.[151] In light of these allegations, the FCMC's decision to approve a voluntary liquidation of ABLV Bank and not to pursue its management after the SRB decision that the resolution was not in public interest might have further corroborated doubts about its integrity.[152]

Latvian law did not however provide for a forced liquidation of a solvent credit institution in the state of FOLTF. In that respect, the ABLV Bank case highlighted the misalignment between triggers for FOLTF under the EU law and the triggers for liquidation proceedings under national insolvency law.[153] In applying the FOLTF test, the ECB had attached importance to the deterioration of the liquidity situation of ABLV Bank considering that it would, in the near future, be unable to pay debts as they fall due.[154] On the other hand, under Latvian law, a bank can be declared insolvent only if its liquidity problems are actual.[155] This condition was not fulfilled since the liquidity outflow from the bank was imminent only upon the lifting of the moratorium imposed by the supervisor on the bank's payment obligations (which did not happen due to the SRB decision). Furthermore, the bank was solvent under the so-called balance sheet test. As none of the two insolvency tests provided by Latvian law was fulfilled, forced liquidation of ABLV Bank was not warranted. In order to overcome legal uncertainty about the bank's legal status after the SRB

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150 FinCEN Proposal, 6.

151 *Ibidem*, 9-10.

152 In parallel, Mr Ilmārs Rimšēvičs, at the time the Governor of the Bank of Latvia, was suspected of having accepted a bribe in exchange of exerting influence on the FCMC in favour of another Latvian bank. See ECtHR, 10 November 2022, *Rimšēvičs and the ECB v Latvia*, app. No. 56425/18, paras 7 and 8.

153 See more generally on this issue J. Deslandes, M. Magnus, *Further harmonising EU insolvency law from a banking resolution perspective?*, Economic Governance Support Unit – Directorate General for Internal Policies, No. 2, April 2018; F. Restoy, R. Vrbaski, R. Walters, *Bank failure management in the European banking union: What's wrong and how to fix it*, BIS Financial Stability Institute, Occasional paper No. 15, July 2020; European Commission, Summary report of the Public and Targeted consultations on the review of the Crisis Management and Deposit Insurance (CMDI) framework, Q1-2021; E. König, *European Parliament ECON Committee Hearing*, Speech, 30 July 2018; ECB annual report on supervisory activities 2019, foreword by C. Lagarde; see also new Article 32a which was inserted in the BRRD in order to address the misalignment of EU law and national insolvency law: Article 1(10) of the Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019 amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC, OJ L 150, 7.6.2019, 296.

154 GC, 6 July 2022, *ABLV Bank v SRB*, T-280/18, EU:T:2022:429, para 10.

155 Article 140(2) of the Credit Institutions Law.

decision, the shareholders initiated a voluntary liquidation of ABLV Bank,[156] and this course of action was subsequently approved by the FCMC.[157]

Latvian law was however amended in the course of the liquidation proceedings of the ABLV Bank in order to empower the FCMC to oversee the liquidation of the bank. The distribution of any assets to the bank's clients was also made subject to an AML/CTF audit that was carried out in accordance with a methodology elaborated by the bank and approved by the FCMC.[158] The elaboration of the methodology proved however to be a lengthy process involving multiple stakeholders and controversies.[159] At some point, the mistrust of the US authorities in the integrity of the FCMC in overseeing the liquidation of ABLV Bank was such that it could undermine continued cooperation in the field of AML/CTF.[160] This however could put at risk the attempts of Latvian authorities to obtain a positive Moneyval assessment of the Latvian AML/CTF system.[161] In these circumstances, the replacement of the members of the FCMC Council might have appeared as a quick fix to boost the institution's tainted reputation.[162]

The Cabinet of Ministers indeed proposed a governance reform of the FCMC which provided changes to the appointment criteria, the grounds for dismissal and the appointment procedure of the members of the FCMC Council. Some of the changes clearly sought to increase the political say over the appointment and dismissal of the Council members. For instance, the proposal envisaged that the Parliament, upon the proposal of one third of its members, may dismiss the Council members if they fail to possess an impeccable reputation.[163] This criterion was not in any way defined in the legislative proposal implying a risk that the decision of the Parliament to dismiss Council members could be guided by political considerations. The legislative proposal also provided for the appointment of a new Council according to the new criteria and procedure. This would effectively mean the dismissal of all the existing members of the Council before the expiry of the term of their office and the appointment of new members.[164]

The proposal attracted harsh criticism from the Ombudsman[165] who argued that the proposed changes are incompatible with the autonomy of the FCMC under

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156 The decision was made in accordance with Article 126(1)(1) of the Credit Institutions Law.

157 The ECB withdrew the banking license of ABLV Bank on 18 July 2018 on the ground that the bank was subject to a liquidation procedure.

158 The amendments to the Credit Institutions Law were adopted by the Parliament on 13 June 2019.

159 S. Jemberga, *In the shadows of ABLV*, cit.

160 *Ibidem*.

161 See Introduction regarding the risk of black-listing of the county by FAFT.

162 A. Eglītis, Latvia to Purge Banking Watchdog Leadership After U.S. Pressure, Bloomberg, 13 June 2019.

163 Articles 13(5)(6) and 14(6) of the Law on the Financial and Capital Market Commission.

164 Point 21 of the Transitional Provisions of the Proposal of the Law “Amendments to the Law on the Financial and Capital Market Commission”.

165 Opinion of the Ombudsman of the Republic of Latvia No. 1-8/11, dated 11 June 2019, 2.

Latvian law and the Basel Core Principles for Effective Banking Supervision[166] ('Basel Core Principles') prohibiting political interference in the operational independence of financial supervisor.[167] Although the concerns voiced by the Ombudsman were not taken into account, the Parliament abandoned the proposal to replace all the members of the Council. This was however done only after the Chairman and the Deputy Chairman of the FCMC resigned from office.[168]

In the light of this politically charged process, bringing financial supervision under the shield of the Bank of Latvia is a welcome change that will strengthen the personal independence of the Chairman of the supervisory committee by insulating him from political pressure. Article 14.2 of the Statute of the ESCB and of the ECB prescribes that the statutes of the NCBs shall provide that the term of office of a Governor of a NCB shall be no less than five years. This provision should be read in conjunction with Article 130 TFEU, mirrored in Article 7 of the Statute of the ESCB and of the ECB, which provide for personal independence guarantees to 'members of decision-making bodies' of NCBs, rather than to Governors specifically. In that respect, the ECB has constantly opined that personal independence would be jeopardised if the rules relating to the security of tenure and the grounds for dismissal of Governors were not to apply to members of NCB decision-making bodies involved in the performance of ESCB-related tasks.[169] The new Law on the Bank of Latvia,[170] in full alignment with the EU law, provides that the rules regarding the security of tenure and grounds for relieving from office apply to all the Council members of the Bank of Latvia.

As a result of the extension of the central bank independence guarantee to financial supervision and resolution, the chairman of the supervisory committee and the chairman of the resolution committee now enjoy equivalent personal independence guarantees to the Governor. In this vein, they are protected against arbitrary relieving from office by limiting this possibility to cases where they no longer fulfil the conditions required for the performance of their duties or where they have been found guilty of serious misconduct. These conditions are autonomous concepts of EU law which means that their application and interpretation do not depend on the national context.[171] This conclusion is corroborated by the judgment in *Rimšēvičs v Latvia*, in which the Court of Justice of the European Union annulled a national decision ordering the temporary

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166 Basel Committee on Banking Supervision ('BCBS'), *Core Principles Methodology*, October 2016, Principle 1(1), 7.

167 Opinion of the Ombudsman of the Republic of Latvia No. 1-8/11, cit., 3.

168 The Chairman and the Deputy Chairman of the FCMC resigned five days before the third final reading of the amendments to the Law on the Financial and Capital Markets Commission; *Communication on the dismissal of Pēteris Putniņš from the office of the Chairman of the Financial and Capital Market Commission*, Latvijas Vēstnesis, 9 July 2019, No. 137.

169 Opinion of the ECB of 25 October 2019 on amendments to the Law on Latvijas Banka (CON/2019/36) ('Opinion CON/2019/36'), para 2.3.3.

170 Article 14(1).

171 Opinion of AG Kokott of 19 December 2018, ECJ, *Rimšēvičs v Latvia*, C-202/18, EU:C:2018:1030, para 77; Opinion CON/2019/36, para 2.3.2.

suspension of the Governor of the Bank of Latvia from office based on a broad construction of the independence of the NCB governors. It also follows from that judgment that mere suspicion of criminal conduct on the part of the Governor does not amount to 'serious misconduct' within the meaning of Article 14.2 of the Statute of the ESCB and of the ECB if it is not supported by sufficient indications to that effect.[172]

Furthermore, Article 130 TFEU prohibits national governments and other bodies from influencing the members of NCB's decision-making bodies in the performance of their tasks, including by amending national legislation. The ECB has consistently opined that the amending law should safeguard the security of tenure of the Governor and other members of decision-making bodies who are involved in the performance of ESCB-related tasks.[173] Thus, any legislative attempt to replace the Council members of the Bank of Latvia in charge of financial supervision or banking resolution before the expiry of their term of office could amount to an infringement of EU law.

B. Additional safeguards to financial independence

Additional safeguards are introduced in the new law in order to ensure that the conferral of new functions to the Bank of Latvia does not put it in a position where it has insufficient financial resources and inadequate net equity in order to fulfil its European mandate. The reason for this is that, if a NCB was dependent on the provision of financial resources by a government, there would be a risk that such support would be accompanied by certain conditions on the monetary policy of that NCB, thereby affecting its independence.[174]

The principle of financial independence set out in Article 130 TFEU requires that a NCB has sufficient financial resources not only to perform its ESCB-related tasks but also its national tasks, such as financial supervision and resolution. It also implies that a NCB should always be sufficiently capitalised.[175] The financial independence of the ECB is further detailed in Article 282(3) TFEU which provides for the separation of the ECB budget and funding from the EU budget. Articles 28 to 33 of the Statute of the ESCB and of the ECB provide for rules on the ECB's capital, foreign reserve assets and profits, which ensure that the ECB can finance its tasks itself and is thus financially dependent on neither the EU institutions nor the governments of the Member States.[176] The EU treaties do not explicitly provide for a similar requirement in respect to NCBs. It has been argued however that the EU law obliges the Member States to ensure that

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172 ECJ, 26 February 2019, *Rimšēvičs v Latvia*, joined Cases C-202/18 and C-238/18, EU:C:2019:139, paras 88-97.

173 ECB Convergence Report, June 2020, 24; see also Opinion of the ECB of 6 April 2018 on amendments to the Law on Hrvatska Narodna Banka and to the Law on the State Audit Office (CON/2018/17); Opinion CON/2019/36, para 2.2.1.

174 Opinion of AG Kokott of 31 March 2022, ECJ, *Banka Slovenije*, C-45/21, EU:C:2022:241, para 56.

175 ECB Convergence Report, June 2020, 26.

176 *Ibidem*, para 57.

NCBs have sufficient financial resources in order to maintain the credibility of, and confidence in, the NCB and thus the ESCB as a whole.[177] The reason for this is that, if a central bank is placed in a situation where it has very low or negative capital for a prolonged period due to a legal restriction on its ability to build up sufficient reserves, it may be incentivised to use monetary policy operations for the purpose of generating revenue to maintain market confidence in the effectiveness of its intervention.[178]

Latvian law sets out detailed provisions seeking to guarantee the financial independence of the Bank of Latvia in performing its tasks. The Bank of Latvia has a separate budget which is annually approved by its Council.[179] In line with the principle of full cost recovery and the prohibition of monetary financing,[180] financial market participants continue to bear all costs related to the regulation and supervision of the financial market and its participants and the implementation of resolution decisions. These functions are financed by the contributions of the financial market participants, and the amount of such contributions is determined by the Bank of Latvian on an annual basis.[181] These contributions are accumulated and managed by the Bank of Latvia in a national resolution fund and a deposit guarantee fund. The law authorises the Bank of Latvia to enter into loan and financial arrangements in financial markets and deposit guarantee funds with other EU Member States in case the financial resources accumulated in the national resolution fund and deposit guarantee funds are insufficient to finance bank resolution or disbursements to depositors, respectively.[182] These safeguards intend to ensure that the exercise of the new tasks is not financed from the reserves and, where necessary, from the capital of the Bank of Latvia.

Furthermore, the new law introduces several layers of protection which seek to insulate the resources of the Bank of Latvia from the losses arising from the exercise of its new functions. The first layer consists of tightening the liability regime for losses incurred as a result of the conduct of the Latvian central bank. The Bank of Latvia was previously liable for ordinary negligence, whereas the FCMC may be held liable only for wilful misconduct or gross negligence in the performance of its tasks.[183] The law envisages that the latter qualified liability standard now applies to the Bank of Latvia at large.[184] This change is consistent with the Basel Core Principles which require that supervisory laws must protect the supervisor and its personnel against lawsuits for actions taken or omissions made while discharging their duties in good faith and for the costs of defending

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177 *Ibidem*, paras 67 to 82.

178 *Ibidem*, para 78.

179 Article 21 of the Law on the Bank of Latvia.

180 Article 123 TFEU and Article 1(1)(b) of Council Regulation (EC) No. 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b(1) of the Treaty, OJ L 332, 31.12.1993, 1.

181 Article 24 of the Law on the Bank of Latvia.

182 Articles 121.[3] and 121.[4] of the Resolution Law; Article 21 of the Deposit Guarantee Law.

183 Article 111 of the Credit Institutions Law.

184 Article 26 of the Law on the Bank of Latvia.

such actions or omissions, so as to further enhance the position of the supervisory authority vis-à-vis the supervised entities.[185] Furthermore, most of the euro area Member States recognise the need to support a broad supervisory discretion via some form of protection from non-contractual liability claims.[186]

The second layer consists of ring-fencing of the resources that the Bank of Latvia allocates for the performance of its monetary and other central bank operations from other assets. Any court decision against the Bank of Latvia for the compensation of losses incurred as a result of the exercise of its supervisory or resolution functions is not enforceable against the assets that are used for monetary and other central bank operations.[187] The national law thus affords to these assets a similar immunity from post-judgment constraint measures to that afforded by the United Nations Convention on Jurisdictional Immunities of States and their Property 2004 to State property located abroad.

The institutional reform has brought the supervisory and resolution functions under the independence shield of the Bank of Latvia which has further insulated the performance of the functions from undue interference. The concentration of multiple powers within the Bank of Latvia needs to be however counterbalanced with adequate accountability mechanisms. Indeed, the central bank independence is an exception to a general principle that public administration should be subject to oversight by democratically elected institutions.[188]

4.2. Enhanced democratic accountability mechanisms

The consolidation of the institutional architecture arguably gives rise to issues of accountability, and this is for several reasons. First, the Bank of Latvia will be vested with far-reaching powers vis-a-vis financial market participants with implications for financial stability and other national interests. Furthermore, the financial stability mandate is qualitative in nature, which makes it more difficult for the democratically legitimised institutions to monitor and evaluate the central bank performance. Finally, the undifferentiated application of the central bank independence standard to all the tasks of the Bank of Latvia entails a risk of obstructing its accountability for the performance of its supervisory and resolution tasks.[189]

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185 Principle 2, para 9 of Basel Core Principles.

186 Para 1.7 of the Opinion of the ECB of 27 November 2012 on a proposal for a Council regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions and a proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No. 1093/2010 establishing a European Supervisory Authority (European Banking Authority) (CON/2012/96); L. D'Amico, *The Non-contractual Liability of Authorities composing the Single Supervisory Mechanism*, Eurojus.it, 29 August 2017, 3.

187 Article 26(2) of the Law on the Bank of Latvia.

188 O. Issing, *The Eurosystem: Transparent and Accountable or "Willem in Euroland"*, (1999) 39 Journal of Common Market Studies 3, 503-519.

189 Y. Mersch, *Central bank independence revisited*, cit.

Although international standards require to ensure that the supervisor is accountable through a transparent framework for the discharge of its duties,[190] they do not prejudice the manner in which the supervisor is held accountable under national law.[191] EU Member States are thus left with a large discretion in designing democratic accountability mechanisms that fit in their constitutional framework.[192] The Latvian democratic accountability framework is characterised by a close involvement of the Parliament in the oversight of the supervisor. The parliamentary oversight of the Bank of Latvia is exercised through the appointment of the members of its management body (A), and other ex post accountability mechanisms (B).

A. Democratic legitimation of the Council of the Bank of Latvia

The founding principle of the Latvian Constitution is the principle of democracy[193] which implies that public administration is subject to scrutiny and oversight of democratically elected institutions. The democratic control of autonomous public institutions, which do not form a part of the hierarchically organised public administration, including the Bank of Latvia, is exercised by the Parliament.[194] Although parliamentary oversight of the financial supervisor is a common feature of accountability frameworks of many EU Member States,[195] the involvement of the parliament in the appointment of the members of its managing body is less common.[196] Indeed, the requirement that all the members of the managing bodies of the financial supervisor need to be appointed by the Parliament is a distinctive feature of the Latvian accountability framework.

The Constitutional Court of Latvia had an opportunity to clarify the implications of the principle of democracy for the appointment procedure of the members of managing bodies of autonomous public law institutions. This question was raised in the context of a constitutional complaint introduced by a credit institution which sought to challenge the regulations adopted by the Council of the FCMC which provided for an increase of contributions of credit institutions to finance the operation of the FCMC. The applicant alleged that credit institutions were obliged to cross-subsidize supervision of other financial market participants in violation of his property rights and the principle of equality.[197]

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190 Principle 2, para 3 of Basel Core Principles; FSB Key Attribute 2.5.

191 See Article 21(4) of the SSM Regulation.

192 EBA Report, Section 5.2, 58.

193 Under Article 1 of the Constitution (*Satversme*), Latvia is an independent democratic republic.

194 E. Levits, *Valsts pārvaldes likuma koncepcija*, Latvijas Vēstnesis, 26 June 2002, No. 95.

195 EBA Report, Section 5.4, 63-64.

196 In most EU Member States either the executive branch of the government of the Head of the State is responsible for the appointment of the members of the managing body: EBA Report, Section 5.4, 44-45.

197 Constitutional Court of Latvia, 20 February 2020, case No. 2019-09-03, English summary of the judgment is available here.

The Constitutional Court found that the regulations in question can interfere with the property rights of the applicant. In assessing whether this restriction was based on law, the court estimated that the contested FCMC regulations would qualify as a 'law' only if they fulfilled certain formal and qualitative requirements. Where delegated regulatory powers are conferred on an autonomous public institution, the latter condition is fulfilled only if the decision-making body of this institution enjoys democratic legitimacy. 'If the issuer of a legal norm has been indirectly democratically legitimised, then the legislator must establish an appropriate mechanism of oversight and accountability in order to, *inter alia*, reduce the possibility of arbitrariness in its operations, in particular, with respect to issuing external regulations'.[198] Since the decisions of the supervisor may have important implications for financial institutions, consumers, and even national interests, 'the mechanism of the institution's oversight and accountability, […] should be commensurate to the essence and scope of the institution's powers'.[199] In other words, the regulatory power to adopt normative acts binding on the financial market participants may be conferred on an autonomous public law institution only if it may be held democratically accountable.

At the time when the contested FCMC regulations were adopted, only two out of five members of its decision-making body enjoyed an indirect democratic legitimisation. The Parliament was in charge of the appointment of the chairman and the deputy chairman of the Council of the FCMC, whereas the three remaining members of the Council, after being approved by the Governor of the Bank of Latvia and the Minister for Finance, were appointed and dismissed by the chairman of the FCMC. Considering the scope and importance of the regulatory power conferred on the FCMC, the Constitutional Court concluded that the Council of the FCMC did not have a proper democratic legitimacy in order to adopt the contested regulations and, hence, the regulations were declared to be unconstitutional.

These considerations equally apply to the Bank of Latvia which is also an autonomous public law institution[200] with regulatory power to adopt regulations necessary for the exercise of its tasks.[201] These powers have been considerably extended as a result of the reform so as to bring within its remit the power to adopt delegated normative acts binding on the financial market participants. In this context, the decision of the Constitutional Court has two major implications for the governance of the Bank of Latvia.

The first concerns the procedure for the appointment of the members of the Council of the Bank of Latvia. In order to ensure that the Council possess the necessary democratic legitimation, all the members of the Council are now elected by the Parliament. The second relates to the scope of the discretion granted

[198] *Ibidem*, para 23.

[199] *Ibidem*.

[200] Article 1 of the Law on the Bank of Latvia.

[201] Article 42 of the Law on the Bank of Latvia.

by the law to the Council in deciding which decision-making powers may be delegated to the supervisory and resolution committees. According to a broad reading of the decision of the Constitutional Court, the principle of democracy requires not only that the regulations but also supervisory decisions with systemic implications for financial institutions can be adopted only by a democratically legitimised decision-managing body.[202] The principle of democracy may thus place constitutional constraints on the Council's discretion to delegate decision-making powers to the supervisory and resolution committees. Latvian law does not however provide for similar procedural arrangements to the 'no objection' procedure under which a draft supervisory decision of the Supervisory Board is deemed to be adopted unless the ECB Governing Council objects. The Council of the Bank of Latvia will have to eventually arbitrate between different interests in deciding on matters of general relevance for financial market participants.

B. Soft ex post accountability mechanisms

Apart from the appointment procedure, several *ex post* accountability mechanisms are at the disposal of the Parliament to ensure that the powers delegated to the Bank of Latvia are exercised appropriately. The law affirms that the Bank of Latvia remains subject to the oversight of the Parliament but at the same time provides for additional channels for exercising such oversight. The main channel through which the Bank of Latvia could be held accountable was the possibility for at least five Members of the Parliament to address written questions to the Governor.[203] If these Members of the Parliament are not satisfied with a written reply, the Governor or his designated Deputy Governor has to also present the answer verbally during a sitting of the Parliament.[204] The verbal explanations together with the written answers are published in the official newspaper.[205] This accountability mechanism has been rarely used in practice. Additionally, the law now provides for the introduction of new reporting duties of the Bank of Latvia, namely, it has to submit an annual report to the Parliament and provide an overview of its activities to the relevant commission of the Parliament at least twice a year.

Overall, these accountability mechanisms are rather soft which is consistent with the strong institutional independence of the Bank of Latvia and the practice of other euro area Member States.[206] Nevertheless, the Parliament has been active in the past in making use of its powers to set up an *ad hoc* investigatory committee. Under the Latvian Constitution,[207] an investigatory committee may

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202 Explanatory Memorandum of the Law on the Bank of Latvia, para 15.3.2, 20.

203 Article 83 of the New Law on the Bank of Latvia; Article 119 of the Law on the Rules of Procedure of the Parliament; on the right to ask questions see also Opinion of the ECB of 29 October 2012 on amendments to the Law on Latvijas Banka (CON/2012/80), para 3.2.

204 Articles 121 and 122 of the Procedural Rules of Saeima.

205 Articles 121(5) of the Procedural Rules of Saeima. The verbal explanations together with written answers are also published on the website of the Parliament.

206 BCBS, *Report on the impact and accountability of banking supervision*, July 2015, 26-27.

207 Article 26.

be established upon the request of one third of the Members of the Parliament. Due to the low threshold, most of the investigatory committees have been so far set up upon the request of the political opposition. Their purpose is to politically assess the quality of the Government in a certain policy area or to investigate certain incidents.[208] Since the restoration of the independence of Latvia, seven investigatory committees have been established in order to inquire into banking incidents, including deficiencies in banking supervision.[209]

The investigatory committees are entitled to request information and explanations from public institutions, summon public officials and other persons and hold a public hearing.[210] The conclusions and proposals of the investigatory committee are summarised in a report which is endorsed by the majority vote of the members of the investigatory committee. The report is discussed in the parliamentary sitting and published in the official newspaper.[211] In the light of the political nature of the report, the conclusions of the parliamentary investigations should be critically assessed, and they may only have political implications.[212] Parliamentary investigations have nevertheless proved to be a useful instrument for mobilising public opinion and for exerting pressure on the government. Indeed, the parliamentary scrutiny has been in some cases followed by the resignation of senior officials of the FCMC[213] and new policy initiatives. For instance, the parliamentary committee established in 1996 after the bankruptcy of Banka Baltija recommended to create a specialised supervisory authority independent from the Bank of Latvia.[214] This reform was nevertheless implemented only in 2000 when a special government-mandated working group issued a similar recommendation.

5. Conclusion

The history of financial supervision seems to be repeating itself. In 2001, the Government decided to institutionally separate monetary and financial supervisory functions by transferring the banking supervision from the Bank of Latvia to the FCMC. Twenty years later the Parliament decided to reverse this choice by integrating the FCMC into the Bank of Latvia. This decision cannot

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208 R. Balodis, *Parlamentāru (parlamentārisku) izmeklēšanas komisiju statuss un to loma valsts pārvaldībā*, Jurista Vārds, 12 May 2015, No. 19 (871), 10-25.

209 Parliamentary commissions were, among others, set up in order to investigate the banking crisis in 1995, the bankruptcy causes of Banka Baltija AS in 1996, the resolution and restructuring of Parex banka AS in 2011 and the bankruptcy causes of Krājbanka AS in 2011. Reports of the parliamentary commissions are available here.

210 Article 6 of the Law on Parliamentary Investigatory Committees.

211 Articles 13 and 14 of the Law on Parliamentary Investigatory Committees.

212 According to Article 16 of the Law on Parliamentary Investigatory Committees, the report of the investigatory committee and facts established therein are not binding on the courts and other persons.

213 In 2011, Ms Irēna Krūmane, Chairperson of the FCMC, resigned following the parliamentary investigation of bankruptcy causes of Krājbanka AS.

214 Report of the investigative commission on the bankruptcy causes of Banka Baltija.

however be taken to demonstrate the superiority of a particular supervisory model over another.[215] The institutional reform can be rather seen as a politically driven post-crisis reappraisal of the institutional structure of financial supervision and an attempt to rebuild the reputation of the financial supervisor tainted by its inability to adequately supervise AML/CFT risks.

The EU financial integration has nevertheless facilitated the decision of the Latvian authorities to consolidate monetary policy, supervisory and resolution functions under a single institution. Assigning of the primary responsibility for defining and implementing the monetary policy to the Eurosystem in 2014 removed conceptual objections against the cumulation of monetary policy and supervisory functions within the Bank of Latvia. In parallel, the conferral of supervisory tasks on the ECB within the framework of the SSM affirmed that a unified supervisory model within central bank offers a workable alternative to the institutional separation of monetary policy and supervisory tasks. On a more general level, it can be observed that euro area NCBs are increasingly assuming the function of 'financial stability agencies' alongside their monetary policy functions.[216] This reflects a shift in the general perception of monetary policy institutions, with central banks being nowadays perceived as public policy institutions with the mandate to promote both monetary and financial stability. In that regard, the transfer of supervisory and resolution functions to the Bank of Latvia corroborates this trend.

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215 More generally, there is no conclusive evidence that any of the supervisory models have better resisted global financial crisis: IMF, United States Financial System Stability Assessment, IMF Country Report No. 247, July 2010, para 55; Explanatory Memorandum of the Law on the Bank of Latvia, para 3, 2.

216 R.J. Herring, J. Carmassi, *The Structure of Cross-Sector Financial Supervision*, (2008) 17 Financial Markets, Institutions and Instruments 1, 51-76.

The institutional landscape of the financial safety net in Poland after implementation of the EU financial law regulatory reforms. What are the local differences between Poland and the European Banking Union?

Jakub Kerlin[*]

Summary. 1. Introduction – 2. Structure and problems of the Polish banking sector – 2.1. Structure – 2.2. Problems – 3. Institutional structure of the financial safety net in Poland and its recently changing governance – 3.1. Government – 3.2. Central Bank – 3.3. National Competent Authority – 3.4. The Deposit Guarantee Scheme – 3.5. The National Resolution Authority – 4. Cooperation in the financial safety net – 4.1. National cooperation – 4.2. International cooperation – 5. (In) dependence of the institutions of the financial safety net – 5.1. Why has Poland not joined the EBU? Main reasons for opting-out – 5.2. Procedure of establishment of close cooperation – 5.3. Opting in or out – 5.4. Polish position – 6. Selected examples of the Polish approach to the implementation of the European resolution framework reforms – "the Polish way" – 6.1. Permanently active state aid scheme for cooperative banks and small commercial banks – 6.2. Higher target levels for the NRF and DGF comparing to the EU – 6.3. Coverage of the deposits of credit unions by the bank funded DGS – 6.4. National legal review – 7. Conclusions – 8. Appendix. Comparison of the Polish and EBU approaches to the resolution framework

[*] The views expressed in this article are personal and cannot be attributed to the author's employer or any institution with which the author is associated.

1. Introduction

The global financial crisis of 2007-2009 had significant impact on the European Union (EU) and revealed some deficiencies in the financial safety nets of its Member States. The crisis event has proven that strong institutional support and a unified regulatory framework is a necessity for the EU financial sector. During that period, cross-border crisis management was barely addressed in the EU provisions and the relations between the various national authorities were mostly based on bilateral, non-binding memoranda of understanding.

One of the responses to the crisis was establishing the European Banking Union (EBU). It has so far allowed the EU institutions to gain authority in such areas as banking supervision (Single Supervisory Mechanism (SSM[1])) and banking resolution (Single Resolution Mechanism (SRM[2])), which operate at the centralised level. Despite many attempts, the central single European Deposit Insurance Scheme (EDIS) is still in the development phase, however, a respective Deposit Guarantee Schemes (DGS[3]) directive, warranting harmonization (but not centralisation) at the level of Member States has been included in the body of the reformatory agenda. Currently, both the SSM and the SRM operate under responsible EU bodies (the European Central Bank and an EU agency the Single Resolution Board (SRB), respectively). However, they exercise their powers and fulfil mandates in cooperation with the respective national authorities from the Member States, which retained some powers and are involved in the decision-making process in composite procedures.[4]

Countries of the Euroarea (or at least those closely participating in the EBU), as well as those being members of the EU, but not participating in the EBU, have implemented the financial regulatory reforms imposed by the EU after the Global Financial Crisis in different manner, both in the legislative and practical aspects.[5] Even though the foundations of the financial safety net, as well as the very idea of its establishment and enhancement, are the same throughout the EU and are placed under the control of the European legislators, the way these provisions (having their roots in the EU law) are included with the body of national legal orders of the particular country and the approach

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1 SSM Regulation. Council Regulation (EU) No. 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, OJ L 287, 29.10.2013, 63.

2 SRM Regulation. Regulation (EU) No. 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No. 1093/2010, OJ L 225, 30.7.2014, 1.

3 DGS Directive. Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes, Text with EEA relevance, OJ L 173, 12.6.2014, 149.

4 V. Di Bucci, *Procedural and Judicial Implications of Composite Procedures in the Banking Union*, in C. Zilioli, K.-P. Wojcik (eds), *Judicial Review in the European Banking Union* (Edward Elgar, 2021), 114-129.

5 This is also a result of a reformatory policy mix of the EU-wide and internal market reforms and others being only Euroarea or EBU-specific.

to their application differs. In the first place, it is possible because part of the mentioned legislation is contained in the directives which leave some margin for discretion to the Member States. This is visible in particular in such areas as complexity of the national legislative acts, execution or application of law (its interpretation), placement of powers and their distribution among public institutions, their independence from the government as well as judicial control. Poland, which is a non-EBU Member State, might be a particularly interesting case to look at, as from the current activities of the organs of the financial safety net it seems it is finding its own way of implementing the newly created EU regulatory framework.

The aim of this article is to present the Polish institutional architecture of the financial safety net, focusing on the governance, cooperation and independence of its institutions as well as the European perspective and recent practice of the public organs, and where possible, comparing it to the centralised EBU practise (in particular in the field of resolution).

2. Structure and problems of the Polish banking sector

The structure of the banking sector and its domestic problems and particularities impact and explain some domestic legislative policy choices that have been made in relation to the implementation of the EU regulatory law as well as the development and the activity of the financial safety net in Poland. Therefore, before moving to the central point of the article, a short description of the Polish banking sector and its current trends must be provided.

2.1. Structure

Recently, the banking sector in Poland underwent a significant consolidation process in terms of a rapidly decreasing number of active credit institutions. From 2010 to the end of 2021 the number of commercial banks fell from 49 to 30. However, the process has not been caused by insolvencies, but rather market-based consolidations in the form of takeovers and mergers. An important characteristic feature of the Polish banking sector is a large but constantly decreasing number (529)[6] of rather small, local cooperative banks (employing nearly 30k employees in total) which operate within Institutional Protection Schemes (IPSs).[7] Another feature is the market presence of a number of small credit unions (24), as well as 37 foreign branches of credit institutions.[8] In terms of assets, the Polish banking sector is the 13th largest

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6 UKNF, *Informacja o sytuacji banków spółdzielczych i zrzeszających po I kwartale 2021 r.*, lipiec 2021 r., 3.

7 An IPS is as a contractual or statutory liability arrangement, which protects its member institutions and in particular ensures that they have the liquidity and solvency needed to avoid bankruptcy where necessary.

8 KNF, *Sprawozdanie z działalności Urzędu Komisji Nadzoru Finansowego w 2020 r.*, UKNF, 2021, 21-45.

in the EU (second in the non-EBU countries after Sweden) but in terms of the total number of authorized credit institutions (solo) it is the second largest in the EU (after Germany).[9]

At the end of June 2021, assets in the Polish banking sector accounted for about €550 billion.[10] Top banks in terms of total asset size are either state- or foreign-owned. The five largest banks constitute almost 50% of the Polish banking sector and are classified as so-called other systemically important institutions (O-SIIs). Overall, about 50% of commercial banks in Poland are institutions with predominantly foreign capital and 25% are owned and controlled by the Polish state treasury.

The Polish banking sector may as well be characterised by the lack of domestic private capital.[11] Therefore, in recent years, a political so-called "repolonisation" process of the banking sector has been undertaken, its main feature being the acquisition of commercial, foreign-owned banks by the Polish state-controlled capital.[12] It is a political concept of pursuing ownership changes, resulting from the belief that the level of dependence of domestic banks to foreign capital is excessive in Poland.

2.2. Problems

The overall stability of the banking system in Poland seems to be good. At systemic level it shows resilience to adverse shocks, such as short-term liquidity risks in domestic currency and contagion risks. But apart from the overall positive stability and abovementioned policy developments, there are also other elements worth mentioning which may influence the activities of the institutions of the financial safety net. Due to the COVID-19 pandemic, credit risk write-down value and provisioning for legal risks relating to mortgage loans have increased. The system is also troubled by low dividends and declining interest income (due to the low levels of the national interest rates), which translates into declining profitability of credit institutions. These trends affect mostly small and medium-sized entities.[13]

Apart from the impact of the pandemic, it is also worth noting a number of residual problems of domestic origin, which impact on the current condition, state and stability of the Polish financial system.[14] First of them is the weak capital

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9 EBF, *Facts & Figures*, Banking in Europe 2020, Statistical Annex.

10 NBP, *Dane finansowe sektora bankowego* (2021 r.).

11 A. Foltyn, M. Skowrońska, T. Kalicki, F. Lisak, *The Banking Regulation Review: Poland*, The Law Reviews, DZP, Warsaw 2021.

12 I. Pyka, A. Nocoń, *'Repolonization' Process of Domestic Banks. Analysis of Conditions and Opportunities*, Conference Paper, Contemporary Trends in Accounting, Finance and Financial Institutions (Springer, 2016).

13 A. Foltyn, M. Skowrońska, T. Kalicki, F. Lisak, *The Banking Regulation Review*, cit.

14 IMF, *Republic of Poland, Financial System Stability Assessment* 2019, IMF Country Report No. 39, February 2019.

condition of a large fraction of the Polish cooperative banks and the weakness of several medium-sized commercial banks, that has been caused chiefly by the high level of non-performing loans (NPLs). The capital position of the number of credit unions is also very weak. Legal risks relating to the foreign-currency mortgage loans (mainly mortgage loans in CHF) are growing, pending judicial uncertainty.[15] National macroprudential policy is yet untested as the body responsible for it was formed relatively not long time ago. Moreover, as Poland is not an EBU member, its potential problems are discussed and resolved mainly at the national level – yet some of them have been detected and communicated by international organizations as International Monetary Fund (IMF) or World Bank, which in their regular assessments have also presented methods of addressing them, as well as desired outcomes.[16] According to the organizations, under-resourcing of the institutions of the Polish financial safety net is likely to become apparent soon, due to an inevitable turn in the financial cycle and resource pressure caused by dealing with institutions impacted by the upcoming change. They also note that some measures are required to strengthen the independence of the Polish National Resolution Authority (NRA) and powers of the National Competent Authority (NCA).

The abovementioned structure specificity of the Polish banking sector, in combination with its regulatory isolation from the EBU as well as unresolved domestic problems gave rise to the current, specifically Polish, approach to the institutional structure of the domestic financial safety net. It also affects the national implementation of the EU financial reforms, which seems to be driven mainly by the national dynamics and has a strong national focus.

3. Institutional structure of the financial safety net in Poland and its recently changing governance

After the start of the economic transformation in the second last decade of the previous century, the financial safety net in the modern meaning was non-existent in Poland. The roots for it, however, had already been established by the national central bank. The institutions of the financial safety net slowly settled, following the pace of the emerging Polish market economy and development of the financial market. The current institutional organization of the Polish financial safety net can be described as mirroring the main European trends and solutions, however with some domestic peculiarities.[17]

The current institutional structure of the national financial safety net includes the government, the central bank, National Competent Authority (NCA), National

15 A portfolio of mortgage loans denominated in foreign currencies granted to consumers are declared void by the courts (when the case is brought to court). It poses a significant risks to the banks having such portfolios. See e.g. NBP, *Czerwiec 2021 r. Raport o stabilności systemu finansowego* (2021 r.).

16 IMF, *Republic of Poland*, cit., 5-6 and 22-24.

17 Z. Polański, *Poland and the European Banking Union: First experiences*, NBP, Economic Institute, Berlin, Europolis, 9 January 2017.

Resolution Authority (NRA) and the Deposit Guarantee Scheme (DGS).[18] In Poland such bodies are respectively:

1) The Council of Ministers (Rada Ministrów, RM) and in particular, the minister competent for financial institutions, which is currently the Minister of Finance (Minister Finansów, MF);

2) National Bank of Poland[19] (NBP, Narodowy Bank Polski) which acts as a lender of last resort;

3) Financial Supervision Commission[20] (Komisja Nadzoru Finansowego, KNF), which is designated as an NCA;

4) Bank Guarantee Fund[21] (Bankowy Fundusz Gwarancyjny, BFG), which houses both the DGS and NRA functions.

Chairpersons of all the above institutions (NBP, NCA, NRA-DGS) and a MoF are also members of the so-called Financial Stability Committee[22] (Komitet Stabilności Finansowej, KSF) purpose of which is, among others, to exercise macroprudential supervision and to coordinate the situation in case of a systemic crisis on the national financial market. In the below section the article will examine the above mentioned institutions.

3.1. Government

Apart from the systematically growing impact, the government has on the composition of the governing bodies of the other institutions of the financial safety net, no significant changes have been introduced to the Polish legal framework after the Global Financial Crisis in the fields of the functions the lawmakers have in the financial safety net, nor their impact. The competence for the financial institutions has always lain within the power of the Minister of Finance,[23] who in recent times seems to have a growing role and influence over the appointments of decision-makers in the financial safety net in Poland. That Minister of Finance is also responsible for preparation and adoption of the executive acts and ordinances, which implement the financial regulation acts as adopted by the Polish Parliament.

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18 More extensive approach will also include consumer protection offices: Office for Competition and Consumer Protection as well as Financial Ombudsman.

19 See Act on NBP, Ustawa z dnia 29 sierpnia 1997 r. o Narodowym Banku Polskim, Dz.U.2020.2027 t.j. z dnia 2020.11.17.

20 See Act on KNF, Ustawa z dnia 21 lipca 2006 r. o nadzorze nad rynkiem finansowym, Dz.U.2020.2059 t.j. z dnia 2020.11.20.

21 See Act on BFG, Ustawa z dnia 10 czerwca 2016 r. o Bankowym Funduszu Gwarancyjnym, systemie gwarantowania depozytów oraz przymusowej restrukturyzacji, Dz.U.2020.842 t.j. z dnia 2020.05.12.

22 See Act on KSF, Ustawa z dnia 5 sierpnia 2015 r. o nadzorze makroostrożnościowym nad systemem finansowym i zarządzaniu kryzysowym w systemie finansowym, Dz.U.2021.140 t.j. z dnia 2021.01.21.

23 See Act on KNF, Ustawa z dnia 21 lipca 2006 r. o nadzorze nad rynkiem finansowym, cit.

3.2. Central Bank

Similarly, for the National Bank of Poland (NBP), there have been no significant changes as regards the functions it performs in the national financial safety net recently. In this context, perhaps it is worth mentioning only that since 2010 the NBP is a member of the European Systemic Risk Board, where it contributes to the macroprudential oversight of the EU financial system and the prevention and mitigation of systemic risk. However, from the perspective of the institutional architecture of the financial safety net, the Polish central bank retained its long-standing role of being a lender of last resort. For confidentiality and financial stability reasons, information on that type of activity and its scope within the Polish central bank is not available for the public, however three publicly known issues require attention from the perspective of this article. The first is that acting as a lender of last resort and granting refinancing/emergency credit line is clearly regulated by the law.[24] It stipulates that the NBP may grant banks refinancing loans to replenish their cash resources. When granting a refinancing loan, the NBP shall be guided by the lenders' capacity to repay the loan and it may only grant a refinancing loan to a bank for implementing a recovery plan. If the financial standing of the bank using the refinancing loan deteriorates to the extent that would jeopardise its timely repayment, or if the bank fails to comply with the material provisions of the bilateral loan agreement, the NBP may terminate the agreement and demand early repayment of the loan, by a deadline shorter than specified in the initial agreement. In 2015, because of an early termination of the emergency loan contract, it became apparent that the NBP granted a last resort emergency funding to one of the larger cooperative banks in the liquidity distress. It amounted to PLN 500 million (c. €111 million) and was not fully repaid, due to the insolvency of the bank.[25]

It is worth recalling that the NBP is the only one institution of financial safety net for which its legal position and independence is regulated in the Polish Constitution (Article 277). The Management Board of the central bank is composed of the President of the NBP and from six to eight members (this number includes all the deputies of the President). This body governs all the activities of the NBP. President of the Republic of Poland, at the request of the President of the NBP, appoints the Members of the NBP Board, while the lower chamber of the Polish Parliament (by simple majority) appoints the The President of the NBP on prior request of the President of the Republic of Poland. The governance structure and the terms of appointment remain the same from the very founding of the institution and were not changed.

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24 See Article 42 of the Act on NBP.

25 Between 11 and 17 August 2015, following the announcement of the decision of the NCA to put the bank into the forced receivership, its customers withdrew deposits of the value of over PLN 961 million (c. €214 million), which accounted for almost 1/3 of the value of deposits held at the bank at that time. Due to the loss of liquidity, the bank applied to the NBP for granting refinancing credit of PLN 500 million, earmarked for restoring payment liquidity. The loan granted by NBP was secured by the state guarantee of 50%. For more see: Prezes Najwyższej Izby Kontroli, Wystąpienie Pokontrolne, Tekst Ujednolicony, KBF.411.001.01.2016, I/16/001, 2017, 10-12.

3.3. National Competent Authority

When it comes to supervision of the entities operating at the Polish financial market, the national legislature from 2008 followed the general trend in the EU,[26] which means transforming the defragmented functional model (i.e. supervision divided by line of business) to the single, integrated model. The prior system of sectoral supervision, exercised by separate national supervisory agencies for credit institutions, insurance and investment firms (securities market) was replaced and integrated in one NCA – in the Financial Supervision Commission. It was entrusted with the supervision of all credit institutions and all supervisory functions. The NCA currently supervises the banking, capital, insurance and pension sectors, payment institutions and payment service offices, electronic money institutions and credit unions. The policy choice of that time was to locate the supervisory functions in a newly established public authority and not in the already existing structures of the independent central bank (although bank supervisory function was a responsibility of a subdivision of the Polish central bank prior to 2008). This was in line with the-then European regulatory trend of separation of the banking supervision from the monetary functions and creating of highly specialized public bodies deemed to be more efficient and reacting quicker, not being exposed to the risk of forbearance. The reform of the financial supervision took place relatively early and was definitely planned and prepared before the Global Financial Crisis. It seems that the crisis experience was not detrimental to the shape of supervision nor the future of the newly established supervisory agency.

From the point of view of the aims of this article, it is worth exploring the composition of the governing body of the NCA, as well as its subsequent changes. Originally, (until almost the end of 2016) it was a collegial body composed of the:

- Chair of the NCA and its two deputies,
- Representative of the Minister of Finance,
- Representative of the minister competent for social security,
- President of the Central Bank (or its deputy or a designated representative),
- Representative of the President of the Republic of Poland.

At the end of 2016 an additional member was added, which was a representative of the minister competent for the economy (or its representative). Finally, at the end of 2018, the composition of the governing body competent to prepare and take all decisions was further changed and its number increased to twelve persons in total, by adding to the existing structure:

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26 To see the European dilemmas of that time and the main trends see e.g. S. Oosterloo, D. Schoenmaker, *A lead supervisor model for Europe*, (2004) 9 The Financial Regulator 3, 34-42.

- Additional deputy of the Chair of the NCA (three deputies in total),
- Representative of the President of the Council of Ministers,
- Representative of the NRA/DGS,
- Representative of the President of the Office of Competition and Consumer Protection,
- Representative of the Minister-Coordinator of Special Services.

The final three members only have the advisory role and take no formal part in the decision-making. Changes to the composition of the advisory board have been assessed rather positively. Inclusion of the new representatives, originating from highly specialized public offices, allows for better information sharing and better control and flow of information in such cases as e.g. misselling of financial products, popular frauds, insurance scams and systemic extortion of credits (the phenomenon which in recent years increased in Poland). However, at the same time, the presence of at least four active politicians with the rights to vote (ministers) may raise some concerns as regards the independence of actions by the NCA, which is described in Section F.

The ideas of housing the supervision authority back in the central bank (which were popular in some of the EU countries in response to the crisis) were not noticable that time, but returned to the political debate in Poland only in 2016.[27] It was then that the President of the NBP proposed to the lower chamber of the Polish Parliament a regulatory reform, aiming at returning the supervisory function to the central bank. As the main *ratio legis* he argued that, taking into consideration the possibility of shocks and problems of financial institutions headquartered in Poland, it will be easier to maintain the stability of the financial system. As the President of the NBP claimed, it would also be a more effective solution in a situation where the central bank not only plays a key role in conducting macroprudential policy, but is also responsible for microprudential supervision with corresponding proper instruments delivered from administrative powers at its disposal. It was pointed out that such an institutional solution (combining macro- and microprudential supervision in one institution) facilitates the coordination of both types of supervision and enables more efficient performance of the stabilising functions. According to the NBP, international experience shows that locating microprudential supervision in the central bank overall increases the effectiveness of supervision and activity of financial safety net institutions, and may be necessary especially in the case of tensions or systemic crisis. It was recognized by the NBP that for this reason, this solution has been implemented by most EU countries, as well as the majority of the EBU Member States. After the debate, the abovementioned argument and a proposal by the NBP has been met with no practical response from the lawmakers,

27 A. Glapiński, *Wypowiedzi na posiedzeniach Sejmu*, Posiedzenie nr 23 w dniu 20.08.2016 r. (2. dzień obrad).

although the draft bill was prepared by the NBP and the proposal was positively assessed by the IMF (however, under certain caveats).[28]

3.4. The Deposit Guarantee Scheme

The DGS function seems to be the least dynamic element in the Polish financial safety net from the functional point of view. It was created in early 1995 and housed in the BFG. In this respect, several iterations of regulatory changes were introduced, mainly driven by the evolution of the DGS framework at the EU level (e.g. increasing the coverage level to €100 thousand, liquidation of the loss-sharing, unified information on the deposit insurance principles). Significant regulatory reform (not induced by the EU) was made to introduce coverage of deposits placed in the credit unions under the BFG protection (financed by the commercial and cooperative banks),[29] which is also described in Section H of this article. But perhaps the most non-typical institutional feature differing from the "model" financial safety net point of view is the recent transformation of the Polish DGS and housing the NRA functions under its control, as introduced by the BRR Directive in 2013.[30] As regards the competencies of that organ of the public administration, they do not go beyond what is already known in the DGS and BRR Directives, however placing the NRA function in the DGS may be somehow surprising from the EU point of view and requires some explanation. Therefore, the governance structure of the DGS is explained below together with the NRA setup.

3.5. The National Resolution Authority

To best describe the institutional history of establishing a resolution agency in Poland, it is worth mentioning that the country started recognizing the scale of upcoming challenges resulting from the persistent threats to its financial system stability and inadequacy of the national legal solutions independently from the EU actions taking place concurrently. Therefore, lawmakers undertook actions aimed at creation of appropriate legal response quite early, even before the final version of the EU financial regulatory reforms was developed.

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[28] The specific decision-taking governance arrangements for supervisory decisions would have to be consistent with appropriate independence from government and need for selection of members by expertise rather than affiliation. See IMF, *Republic of Poland*, cit., 18.

[29] Until then, the credit unions were covered by their internal system of deposit protection.

[30] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No. 1093/2010 and (EU) No. 648/2012, of the European Parliament and of the Council Text with EEA relevance, OJ L 173, 12.6.2014, 190.

As early as 2011,[31] the KSF appointed a Working Group (led by the DGS agency) for the development of new legal solutions that were aimed at creating a model of restructuring banks in Poland. For that reason, the Minister of Finance started cooperation with the World Bank under Technical Advisory Work Programme.[32] The abovementioned actions resulted in the drafting of a special report that identified the main areas requiring legislative changes to create a legal framework for the resolution proceedings in Poland. Among other issues, it pointed that the new Polish NRA should have the powers necessary to carry out the restructuring process in relation to banks and a number of investment firms. At similar time, the IMF issued its regularly published report in which it concluded that the Polish financial safety net should feature a "clearly identified resolution authority", taking into consideration the Financial Stability Board's Key Attributes for Effective Resolution Regimes and evolving European legislation.[33] In the aftermath of the international cooperation, the Working Group proposed a draft bill, which, among other provisions, has designated the DGS agency to house the powers and functions of the NRA in implementation of the BRR Directive.

Both in the abovementioned final report of the World Bank and IMF document, it is difficult to find a clear or elaborative indication, as to why the BFG (DGS agency) is the best institutionally located authority of the Polish financial safety net to hold the NRA functions and powers. It seems that this topic is also omitted and remains unquestioned in the local academic publications explaining the Polish regulatory reforms, in which this choice is presented as granted.[34] However, the impact assessment of the abovementioned bill[35] has been provided to the Polish parliament, and this unique national choice is meticulously explained.

Firstly, financial regulatory reform in Poland took place relatively early compared to European counterparts (before a final proposal on reforming the financial regulatory framework from the EU has been presented). The initial stage of the domestic reforms has been driven by the cooperation with the advisors from outside the EU, for which nominating a DGS to be also the NRA is a more natural choice, stemming from the international

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31 Sejm, Uzasadnienie do Druku nr 215, Rządowy projekt ustawy o Bankowym Funduszu Gwarancyjnym, systemie gwarantowania depozytów oraz przymusowej restrukturyzacji, 2015, 4-5.

32 J.D. Pollner, *The Polish Bank Insolvency Regime. Issues and Assumption Paper for the Design of an Upgraded Bank Resolution Framework* (The World Bank, July 2012).

33 IMF, *Staff Country Reports, Republic of Poland 2012 Article IV Consultation*, July 2012, 20.

34 See e.g. K. Stępień, *Instytucje sieci bezpieczeństwa finansowego w Polsce z perspektywy instrumentów zapiewaniających stabilność finansową*, (2017) 9 Roczniki Ekonomii i Zarządzania 3, or Ł. Szewczyk, *Bankowy Fundusz Gwarancyjny jako organ resolution*, (2018) 356 Studia Ekonomiczne, or A. Janusz, *Resolution jako nowy obszar zadań Bankowego Funduszu Gwarancyjnego*, (2013) 47 Annales Universitatis Mariae Curie-Sklodowska, sectio H – Oeconomia 3.

35 Sejm, Uzasadnienie do Druku nr 215, cit., 53-65.

experience.[36] Secondly, the Polish DGS has previously been supporting bank and credit union restructuring as well as the takeovers in the banking sector, which was considered the operational benefit (the new NRA functions were in some extent similar to functions the Polish DGS had already been performing). Thirdly, for more than 20 years, the DGS has been collecting and administering the funds for banking industry and maintained regular and direct contacts with the credit institutions, which gave it some advantage in the field of the harmonized EU rules, taking into consideration the purpose of the resolution. It was also mentioned that the NCA is not best suited to assume this role in Poland, as a risk of forbearance will be too high (it is also recognized as serious threat in the provisions of the BRR Directive[37]). It may seem that the strongest arguments were the experience the DGS agency already possessed in the field, including managing the funds.[38]

When it comes to the composition of the decision-making bodies, the situation is a bit more complex than in the NCA, as the two governing bodies lead the DGS-NRA: Supervisory Board and Management Board. The Supervisory Board supervises the activities of the Management Board, issues guidelines and approves internal polices (e.g. drafting resolution plans or internal rules of procedure for carrying resolutions), as well as adopting the activity and financial plans of the DGS-NRA.[39] The Management Board of BFG is responsible for managing nearly all activities of the BFG and is responsible for decision-making, also featuring decisions related to triggering resolution action or use of the National Resolution Fund (NRF).[40] The Management Board of the BFG has always, since its inception, had the same composition, which is three to five members nominated by the Supervisory Board. The latter however, in years 1995-2016, has been composed of seven members. Until then, the members were appointed and dismissed by:

- two – the Minister of Finance,
- two – the President of the NBP,
- one – the Chairman of the NCA,
- two – the Polish Bank Association (nominated on the terms set out in their articles of association).

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36 Outside the EU, deposit insurers seem to have greater role in bank restructuring, e.g. FDIC in the US. However, outside European jurisdictions 'a least cost solution' dominates over the 'public interest assessment', which is a substantial difference for the activity of the agency operating as resolution authority.

37 See Recital 15 of the BRR Directive.

38 For more detailed analysis see J. Kerlin, *The Role of Deposit Guarantee Schemes as a Financial Safety Net in the European Union* (Palgrave Macmillan, 2017), 56-57.

39 See Article 8 of the Act on BFG.

40 See Article 11 of the Act on BFG.

After incorporating the functions of the NRA function in the DGS, the composition of the Supervisory Board was reduced to six persons and its composition changed to:

- three representatives of the Minister of Finance (the Chairman of the BFG must be nominated from their midst),
- two representatives of the NBP delegated by the President of the NBP,
- one representative of the NCA delegated by its Chair.

When voting, in the event of a tie, the President of the Supervisory Board has a casting vote, which (after the above-described reform) grants full indirect control over the Supervisory Board to the Minister of Finance. More on that is elaborated in the Section F.

4. Cooperation in the financial safety net

The division of competences of institutions in the Polish financial safety net could be described from the point of view of either internal national cooperation (among the institutions themselves) or a cooperation at the international level. The latter can have two dimensions: the first being cooperation between the national institutions in the international context (e.g. agreeing on the common, national position towards a banking group) and second dimension being cooperation of Polish institutions with the foreign counterparts and stakeholders (e.g. presenting or pursuing the common national position to external stakeholders).

4.1. National cooperation

When discussing cooperation at the national level, some elements of it may require additional explanation. First, there is no information available that would describe the formalized rules of agreement when deciding on the common position by the institutions of the financial safety net especially for the purposes of its presentation in the international context. However there must be a process of agreeing on the common stances for e.g. resolution colleges held by the Single Resolution Board or meetings of the European Systemic Risk Board. A formal platform well equipped to do so could have been KSF (which would also increase transparency and accountability), however, analysing the annual descriptions of its activity such point of activity of this institution is not covered. It seems that such positions are simply advanced by the bilateral exchanges or consultations between the institutions of the safety net.

Second, data gathering and exchange has always been a contentious point between the institutions due to its sensitivity and confidentiality. It seems that the European directives, as BRR Directive gave sufficient grounds for implementation of the provisions facilitating the information exchange between the members of the financial safety net, also at the national level in non-EBU countries like e.g. exchange of supervisory data or data about the covered deposits or joint on site inspections.[41] Currently there is no information available on the potential cooperation agreements or MoUs created between the institutions of the Polish financial safety net, apart from a trace of one drafted in 2008 (after the creation of the new NCA).[42] Based on that 'old' MoU, the NCA shares with the DGS the supervisory assessment of the banks, lists of supervisory scores awarded to individual banks, the content of post-inspection recommendations, information on supervisory decisions related to the imposition of an additional requirement on the bank capital or the bank's obligation to increase own funds as well as internal sectoral analyses. At the same time, the BFG committed to share ratings assigned to individual banks within the framework of the BFG analytical activity, results of its own inspections and recommendations previously provided to banks benefiting from the BFG financial assistance, information on BFG decisions on granting financial assistance to a bank, and sectoral analyses made in the BFG. However, it seems that the MoU mentioned is aimed at solving domestic problems of confidential information exchange, rather than serving any preparation of positions to be presented at the international fora of cooperation as e.g. resolution or supervisory colleges.

4.2. International cooperation

It seems that on the international level there are rather no clear *de lege ferenda* postulates to be easily formulated specifically for Poland, as no major concerns are raised by the industry, academics or the institutions of the safety net themselves. In this regard, Poland is experiencing general, well-identified problems of coordination between the smaller host and bigger home countries (for more details see also Section G of this article).[43]

Polish authorities of the financial safety net, as originating from the non-Banking Union country cooperate at the international level in the context of the Single Supervisory and Resolution Mechanisms as well as contribute to the works of the European Banking Authority.

Due to the clear definition of the National Competent and Resolution Authority, as well as introduction of the specific DGS provisions harmonized at the European level, there seems to be no visible conflicts of competence between the institutions of the financial safety net at the supranational level (in both dimensions described at the beginning of this Section). Perhaps the

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41 See e.g. Article 84 of the BRR Directive.

42 KNF, BFG, *Komunikat BFG i KNF z dnia 12 czerwca 2008 r. w sprawie podpisania umowy o współpracy i wymianie informacji* (2008).

43 For details see e.g. World Bank Group FinSac, *Banking supervision and resolution in the EU. Effect on small host countries in Central, Eastern and South Eastern Europe*, Working Paper, April 2019, 27-47.

only one issue worth mentioning here is the potential accountability gap[44] or lack of enhanced control over the international activity and decision making of the institutions of the Polish financial safety net, especially when it comes to the so-called 'joint decision' process which takes place at resolution colleges organised for the EBU and non-EBU Member States hosting the same banking group for which a coordinated plan of action is needed (e.g. agreeing on the resolution strategy for entire group).[45] However, as mentioned earlier, no specific tensions between the national players were revealed and the accountability gap seems not to raise concerns in Poland.

At the same time, the implementation of the SSM framework and SRM framework provide for quite detailed rules for representation of the institutions of the financial safety net in the works of the Single Supervisory[46] and Resolution[47] Mechanisms, while the international cooperation of DGSs seems to be less encouraged by the DGS Directive.[48] When it comes to detailed representation rules for the supervisory and resolution colleges, information exchange and agreeing on the common 'national' position, there is no publicly available material or literature that would describe either such experience in Poland, or outcome. At the same time, the SRB does not make data on the number of reached joint decisions with the authorities of the non-EBU Member States or detailed reports from the resolution college meetings publicly available.

Taking the second dimension of the international cooperation into account, it may seem that there are no visible tensions between Poland as non-EBU Member State and its European counterparts. In the European Banking Authority

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44 For more see D. Fromage, P. Dermine, K. Tuori, P. Nicolaides, *ECB independence and accountability today: towards a (necessary) redefinition?*, (2019) 26 Maastricht Journal of European and Comparative Law 1, Special issue: *The ECB's accountability in a multilevel European order*.

45 For more see e.g. A. Smoleńska, *Multilevel cooperation in the EU resolution of cross-border bank groups: lessons from the non-euro area Member States joining the Single Resolution Mechanism (SRM)*, (2021) Journal of Banking Regulation.

46 See in particular Recital 13, Articles 6, 52, 116-117 and 158 of the CR Directive. 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 Text with EEA relevance, OJ L 176, 27.6.2013, 338-436 as well as Commission Delegated Regulation (EU) 2016/98 of 16 October 2015 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards for specifying the general conditions for the functioning of colleges of supervisors (Text with EEA relevance), OJ L 21, 28.1.2016, 2.

47 For more details see in particular Recitals 17, 33, 96-99, Articles 88-90 of the BRR Directive and Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges (Text with EEA relevance) C/2016/1691, OJ L 184, 8.7.2016, 1.

48 See in particular Recital 51, Article 3(2) and 14 of the DGS Directive.

(EBA) reports on the activity of the resolution colleges which discuss and agree preferred resolution strategies, tensions between the national authorities are not recognized. For 2020, EBA stated that "*the proposals made in the 2019 […] for increased engagement with competent ministries and administrators of deposit guarantee schemes, did not generate detailed discussion*" which seems to suggests rather low engagement of the observers (other than NRA members) in the works of the resolution colleges. This might be particularly true for Poland if one assumes that currently the only non-governmentally controlled institution of the financial safety net is NBP (see also Section F).

For instance in the field of resolution, in principle when deliberating on the cross-border group, the resolution authorities shall strive for a joint decision (in other words NRAs hosting the parent of the banking group should try to find a compromise solution for the resolution plan that would be accepted by all Member States where the subsidiaries are located). If the compromise solution is not found, each of the parties may turn to the EBA for mediation to find a compromise solution. So far, in respect of resolution, a mediation activity of EBA was revealed only in 2017.[49] The EBA informed that it performed one binding mediation, in which the problem was solved by an amicable agreement of the parties involved in the conciliation stage, and one non-binding mediation, which also ended with an agreement of the parties concerned. On a later date it was revealed that a binding mediation (mentioned in the previous sentence) concerned Romania and the Single Resolution Board,[50] while the details of the non-binding mediation are not publicly known. As for supervisory matters, mediation is also possible. In 2018, EBA informed that it helped several binding and non-binding mediations where the parties solved complex supervisory disputes, however (again) due to confidentiality reasons, the countries as well as matter of the dispute were not revealed to the wider public.[51]

The above cases allow to conclude that mediation requests are not popular among the non-EBU Member States and are rather incidental (at least for resolution matters), either because the counterparts (SRB and non-EBU country, e.g. Poland) agree on a joint solution, or instead of looking for a compromise solution, they prefer not to agree to the joint approach and "go its own way", without mediating and not insisting on the joint decision.

As for the international cooperation between the institutions of the financial safety net in Poland and their international counterparts, it seems that NCA has created more than 60 Memorandums of Understanding with the counterparts from the EU, outside Europe as well as entered twelve Written Coordination and Cooperation Arrangements of supervisory colleges, which

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49 EBA, *Annual report 2017*, 74-76.

50 Romanian NRA and the SRB. See: EBA, *Decision of the European Banking Authority on the settlement of a disagreement. Public*, 27 April 2018.

51 EBA, *Annual report 2018*, 64-65.

is a popular activity among the European supervisors.[52] However, there is lack of similar corresponding activity at the Polish NRA side. For instance, the Polish NRA could have signed a non-binding cooperation arrangement with the NRAs of the EBU (as its closest counterparts) based on Article 34(4) of the SRM Regulation; however, it seems that so far, no such document has created. Perhaps the reason for it is that the currently existing regulatory framework is sufficiently detailed that additional arrangements are redundant for smooth functioning of the authorities.[53]

5. (In)dependence of the institutions of the financial safety net

It may seem that the balance of power in the Polish financial safety net is quite far from the "model" one and that it has recently changed dynamics. Already, at the emergence of the financial reforms in 2013 (bank resolution, macro prudential supervision, etc.), IMF pointed to a number of systemic weaknesses related to the governance issues in the Polish financial safety net. It was suggested that the representatives of the banking sector (two members nominated by the bank association) should be removed from the governing body of the DGS (which was not yet the NRA that time). This postulate materialized, however, the financial reforms of governance of the DGS-NRA went even further and after the reforms of years 2016-2018 described above, the independence of the governing body of the DGS-NRA (as well as NCA) may not be the strongest, as increased influence of the Minister of Finance is visible (see also Section D – National Resolution Authority).

For the NRA-DGS the term of the President of the Management Board (who effectively takes decision e.g. to trigger a resolution or adopt a resolution plan) and all its members lasts only three years. They could be dismissed at any time by the Supervisory Board of the BFG. Meanwhile, the Supervisory Board is composed of the three members appointed by the Minister of Finance (50% of votes) and in the event of a tie, the President (which is nominated by the MoF) has a casting vote.

For the NCA a similar situation has been identified, however the dismissal of the Chair of the KNF is legally more complex and requires specific conditions to be met. The Prime Minister shall dismiss the Chair of the NCA before the end of the term of office only in the case of a valid

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52 More than 60 Memorandums of Understanding are available at the NCA website.

53 See e.g. the level of detail in describing procedures in the Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges (Text with EEA relevance), C/2016/1691, OJ L 184, 8.7.2016, 1.

conviction for an intentional crime, resignation from the position, loss of Polish citizenship, or loss of the ability to perform the entrusted duties as a result of a long-term illness lasting more than 3 months.[54] In the case of the NCA it has been observed by the international bodies that existing governance framework compromises some operational independence. The main reason is under-resourcing of the NCA and strong resource pressure resulting from persisting dealing with troubled institutions (see Section C). IMF concluded that *while there was not observable improper influence on the NCA arising from greater state control, shortcomings in its budget and governance structure raised questions about whether it had the necessary degree of independence*. However, it is worth raising here that the substantial state control of the financial system and the ownership organized within the office of the Prime Minister, which at the same time has substantial influence over the NCA, may not be an optimal solution.[55] In this context, recent EBA report[56] on the independence of the supervisors could be recalled. Although that report does not invoke any individual examples pertaining to the specific Member State, there are findings which are convergent with the one of the IMF (mentioned above) that special scrutiny must be given to "*the greater clarity on personal independence (such as terms and removal conditions for NCA senior management and board members, conflicts of interest of staff and the scope of non-contractual liability for CAs and their staff) and further consideration of what is required to ensure the independence of financial and staff resources while ensuring accountability*".[57]

Seven out of nine voting members are linked (directly or indirectly) to the government (while 3/4 directly being its representatives). Therefore, there is a concern that the KNF may not have sufficient independence or freedom to act separate from the government. As pointed out by the IMF, the need for independence has greater importance given the state's significant control of the financial system and the need to ensure that state-controlled institutions continue to operate on commercial terms, and that supervision across the financial sector is even handed and free from conflicts of interest. The recent legislation appears to further weaken the NCA's independence. The IMF has concluded that, while it may appear that the large scope of representation of different stakeholders in the KNF's governing body may achieve an objective of more coordination among government agencies, the risk is that the enlarged composition of the governing body increases political influence, excessively broadens the access to confidential supervisory information, and adds to existing inefficiencies in decision-making. The governance arrangements for the KNF, potentially compromising independence, are also inappropriate

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54 See Article 8 of Act on KNF, Ustawa z dnia 21 lipca 2006 r. o nadzorze nad rynkiem finansowym, cit.

55 See IMF, *Republic of Poland*, cit., 5, 9, 15-16.

56 EBA, *Report on The Supervisory Independence of Competent Authorities*, EBA/REP/2021/29, 18 October 2021.

57 *Ibidem*, 8.

for the decisions it is required to take. They appear to be hindering its effectiveness.[58]

For the governance of the NRA-DGS, strengthening independence of the BFG from the state control is constantly repeated by the IMF, which mentioned that[59] *[t]he BFG Board and BFG's independence is neither stipulated in law nor assured in practice, allowing for the dismissal of Board Members by a decision of one institution (the MoF).* The recommendation in the same vein is raised towards the NCA's independence, which according to the IMF, needs to be strengthened further.[60] Having majority of externally selected members on the NCA governing body session compromises its operational independence and does not guarantee that all its actions are subordinate to the primary objective of safety and soundness of credit institutions. Such issue may also be lifted up to the level of international cooperation fora, as e.g. resolution colleges, which may impede their effectiveness.

5.1. Why has Poland not joined the EBU? Main reasons for opting-out

After describing the institutional structure of the safety net in Poland and modalities of cooperation between its authorities, it is worth considering why having so many similarities to the other BU countries and considering high level of harmonisation of regulatory framework in the EU, Poland did not decide to join this project. The following section explains the main arguments Poland has raised to justify its decision not to join the EBU. This policy position seems not only to be quite stable in time, but also shapes the way the national regulatory reform of financial law is prepared and applied and shapes the way the EU financial laws are implemented.

5.2. Procedure of establishment of close cooperation

For the 19 Member States belonging to the Euroarea, their inclusion in the EBU project was automatic. In other words, it was not left for the Member State belonging to the Euroarea to decide whether to opt in or out. The remaining eight Member States not having the eurocurrency were presented with a choice. They could either join the EBU project by establishing close cooperation with the ECB and transfer some of the powers to the EU level, or stay aside and implement the new supervisory and resolution framework to their national legislation, retaining some discretion and national specificity.

Any EU Member State whose currency is not the euro can participate in the SSM and the SRM. This process is realized by requesting the establishment of close cooperation between the ECB and the respective NCA in a given Member

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58 See IMF, *Republic of Poland*, cit., 5, 9, 15-16.

59 *Ibidem*, 6, 23.

60 IMF, *Republic of Poland: Financial System Stability Assessment*, IMF Country Report No. 221, July 2013, 4 and 28.

State.[61] Once close cooperation has been established, such a Member State joins both the SSM and the SRM concurrently.[62]

5.3. *Opting in or out*

A valid question that a researcher should ask is what is the response to EBU ideas from the non-participating Member States and, in particular, what were the main reasons for joining or not joining the EBU, as well as ennumerating the main perspectives or points of view presented by non-euro currency Member State. This topic seems to be quite well researched and described in the literature. It seems that there is no clear *status quo* as regards the benefits for opting in. E.g. Belke[63] et al. (2016) proclaims that for non-euro currency countries the benefits of joining the EBU are uncertain, while regulatory costs are more concrete. Instead, P. Hüttl and D. Schoenmaker[64] (2016) point out that at least six countries currently opting out have strong arguments to join the EBU – to obtain the benefit of greater financial stability. Paper of the World Bank Group[65] (2019) presents more balanced approach, presenting better contagion effect management and guaranteed "single" approach towards the same banking group as the main argument for joining, while the main disadvantages listed are the risk of "branchisation" and transition to weaker supervisory practice. From the point of view of further deliberation in this article, it is worth recalling in particular what position Poland had, how it evolved, and where it is heading.

5.4. *Polish position*

Since the creation of the EBU the potential benefits of establishing close cooperation between the Polish NCA and the ECB have been widely debated in

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61 For details see: Regulation (EU) No. 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) (ECB/2014/17), OJ L 141, 14.5.2014, 1-50.

62 The scope of application of the SRM is linked to the SSM. As explained in recitals of the SRM Regulation there is a significant level to which the supervisory tasks attributed to the SSM and resolution action are interwoven. The fact of being subject to supervision by the SSM constitutes a specific attribute that places the entities falling within the scope of application of SSM Regulation in an objectively and characterised distinct position also for resolution purposes. Therefore the unity of scope of entities being covered by the SSM and SRM Regulation was proposed and implemented to facilitate the proper and stable functioning of the internal market. See Article 4(1) of the SRM Regulation as well as its Recital 15. In simple terms, SRM Regulation applies only in respect of institutions whose home supervisor is the ECB or the NCA in Member States, whose currency is the euro, or in Member States whose currency is not the euro which have established a close cooperation in accordance with Article 7 of SSM Regulation.

63 A. Belke, A. Dobrzańska, D. Gros, P. Smaga, *(When) should a non-euro country join the banking union?*, (2016) 14 The Journal of Economic Asymmetries, 4-19 or A. Reich, S. Kawalec, *The Banking Union: state of the art*, mBank – CASE Seminar Proceedings No. 137/2015, 36-40.

64 See e.g. P. Hüttl, D. Schoenmaker, *Should the 'outs' join the European Banking Union?*, (2015) 3 European Economy.

65 World Bank Group FinSac, *Banking supervision and resolution in the EU*, cit., 35-36.

the country. It is worth recalling that Poland has already joined the Economic and Monetary Union (EMU) in May 2004, as a Member State with a derogation, which for the currency is only temporary. In practical terms, this means that Poland is legally required to introduce the euro, and after the monetary transition it will automatically become part of EBU. However, the timing of the introduction of the new currency is not specified, and derogation to join the Euroarea has been in effect for more than 15 years. Putting the conditions of joining the Euroarea aside, let's focus on the Polish policy stance towards the EBU.

The Polish outlook to join EBU is often described as a "not positive", "wait and see",[66] or even "opposing" approach.[67] Indeed, at the time when potential opting-in was considered, the Polish central bank communicated that before submitting any request to the ECB the non-euro area country shall assess to what extent the benefits of joining the EBU outweigh the costs of severely limiting the role of the national financial safety net (in particular in a situation when the national authorities function effectively).[68]

The analysis (although it was performed only at the initial stage of the EBU establishment) of the Polish Central Bank lists only two obvious benefits of joining the EBU. First is an opportunity for an opt-in country to participate in pan-European mechanisms and benefit from increased European integration, which could translate into improved attractiveness of the country's financial sector for foreign investors. This was however made conditional on the effective functioning of the EBU in practice (which, at the time of performing the analysis, was unknown). According to NBP, such benefit was especially important to a non-euro country with a banking sector in a weak condition. Therefore, this aspect was of less importance for Poland. The second reason was creating an easier business and regulatory environment for the cross-border banking groups, which could benefit from the common supervisory standards and unified regulations. The third was easier access of the Polish authorities to information about parent banks from countries participating in the SSM (especially important as most of the biggest banks operating in Poland are foreign and EU-owned), as well as inclusion in the core of supervisory works, as e.g. Joint Supervisory Teams or Joint Resolution Teams for banking groups and overall reduction of the coordination issues that may arise between the host-home countries. These two latter arguments were considered to be applicable to Poland and worth consideration. According to the Polish central bank, considering the situation at the end of 2014, if Polish NCA was to establish close cooperation with the ECB, banks covering approximately 2/3 of Polish banking sectors' assets (as entities dependent on a euro area parent and the three "most important" banks incorporated in Poland) would be subject to the direct supervision of the ECB.

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66 A. Belke, A. Dobrzańska, D. Gros, P. Smaga, *(When) should a non-euro country join the banking union?*, cit., 16.

67 World Bank Group FinSac, *Banking supervision and resolution in the EU*, cit., 35.

68 National Bank of Poland, *The economic challenges of Poland's integration with the euro area*, Warsaw, March 2015, 84.

At the same time, the Polish central bank lists a number of limitations resulting from the participation in the EBU. One of the most significant issues is the lack of influence on the decision-making in the ECB. According to NBP, opt-in countries can only participate in the work of the ECB Supervisory Board, but are excluded from the process at the level of the ECB's Governing Council, which limits their influence on the whole decision-making process in the SSM. Meanwhile, an opt-in country has to strictly follow the instructions of the ECB in the field of microprudential supervision, even if – in an extreme case – this could have an undesirable effect on the national banking sector. This disadvantage is, according to NBP, not compensated by the possibility to terminate the close cooperation, which is not further explored in the report.

Second argument presented against joining EBU was a potential ECB policy *to be inclined to waive the application of the prudential requirements to individual entities, enforcing them only at the level of groups supervised within the SSM, while expecting parent entities to guarantee the transfer of assets and liquidity to their subsidiaries should subsidiaries' solvency or liquidity be threatened*.[69] In the case of banks from euro area countries, such a situation should not increase the risk, as they have access to liquidity facilities from the ECB and possible funding from the European Stability Mechanism (ESM). However, this may constitute a threat to financial stability for an opt-in country, which does not have access to the abovementioned backstops. Finally, it was concluded that the potential benefits of joining the EBU by Poland did not outweigh the potential disadvantages.[70]

It seems that the list of arguments against joining the EBU is in fact longer or, as some authors pointed out,[71] Poland is simply among the countries which opted out *because its governments' policy preference of banking nationalism conflicts with the BU's idea*. In this context it is worth recalling that the peak of research activity and policy interest in the area of the EBU accession was seen in years 2014-2016, while in the recent years the national authorities are not performing any further analysis of the subject (the impulse for such research from the government side also seems to be lacking). However, one could argue that there was sufficient time to assess the first results and achievements of the SSM and SRM and there is additional empirical evidence that could be factored in to the analysis of potential benefits of joining the EBU. With the larger body of data available, the "wait and see" approach seems to be outdated.

Current reforms of the regulatory framework are focused on the national issues. The conclusions drawn from the Global Financial Crisis may differ for Poland and the majority of the EU countries (in particular Euroarea countries). The reason for this is that the Global Financial Crisis did not have such a

69 *Ibidem*, 84.

70 *Ibidem*.

71 K. Mero, D. Piroska, *Banking Union and banking nationalism – Explaining opt-out choices of Hungary, Poland and the Czech Republic*, (2016) 35 Policy and Society, 215-226 as well as later on repeated by World Bank Group FinSac, *Banking supervision and resolution in the EU*, cit., 35.

strong impact on the Polish financial sector and economy, therefore joining the EBU does not seem to be attractive in the context of potential crisis-management. Poland, as the only EU Member State, retained a positive pace of growth of GDP. Financial institutions headquartered in Poland were not in distress, so no state intervention was needed.[72] Moreover, the Polish banking sector accumulated relatively low levels of NPLs and the profitability of the sector overall remained continuously high during the crisis. There might be a domestic belief that it was the result of high quality banking policy and especially financial supervision,[73] as well as solid economical foundations, however it seems that this was rather an effect of the conservative and traditional banking model popular in Poland.[74]

The abovementioned experience can explain the relatively small willingness to join the newly created strengthened safety net of the EBU, as the case of the Global Economic Crisis may have proven that the national setup is sufficient to cope with global problems. Also relatively recent assessments e.g. by the IMF show that this situation persists.[75]

6. Selected examples of the Polish approach to the implementation of the European resolution framework reforms – "the Polish way"

As Poland is an EU Member State, its legal system shall reflect the legal solutions in force across the EU. However being the EBU opt-out country allows financial safety net institutional set-up to manage or even solve some issues of the domestic banking sector, without the interference with the EU regulators and without lifting the national problems to the EU levels for decision making. EU regulations (through which the BU safety net is harmonised) are directly applicable, while the EU directives (through which non-EBU safety net is harmonized) need a respective national implementation to the country legal order, allowing for some deviations. However, it seems that the directives related to the financial stability and safety net were adopted in Poland with some delays due to the development of special underlying provisions (e.g. for resolution of credit unions). The transposition delay in Poland covers not only the CR Directive and the BRR Directive, but also the DGS Directive and their further iterations (e.g. BRR Directive II[76]). A number of academics pointed

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72 See e.g. J.F. Abreu, M. Guerra Alves, M.A. Gulamhussen, *State interventions to rescue banks during the global financial crisis*, (2019) 62 International Review of Economics & Finance, 215 or M. Iwanicz-Drozdowska *et al.*, *European Bank Restructuring During the Global Financial Crisis* (Palgrave Macmillan, 2016), 19.

73 K. Mero, D. Piroska, *Banking Union and banking nationalism*, cit., 224.

74 T. Przybiciński, *Developing Economic Market Order in Poland under Global Financial and Economic Crisis Circumstances*, (2011) 85 Prace i Materiały Instytutu Rozwoju Gospodarczego SGH, 241-272.

75 IMF, *Republic of Poland*, 2019, cit., 46-47.

76 European Commission, Bank recovery and resolution directive II (BRRD II) No transposition measures communicated, 4 June 2021.

out that Poland is among three countries with the longest accumulated delay across the three directives important from the financial stability point of view. M. Koetter *et al.*[77] present a number of reasons why certain delays occurred and what the main determinants of the prolonged implementation were. As a research gap it was pointed, that the relationship between the industry representatives, rule-setters and specific policymaking (also policy needs) may be better identified to prove the links between them.

Below (and in the appendix) there are some examples, that are an attempt of presenting some of the national policy choices in the context of the implementation of the EU regulatory framework in four areas. It will be presented in particular by showing that the adjustability of the common EU rules to the specificity of the local finance plays a dominant role in Poland. It seems that Poland's policy choice (position of the lawmakers) is to differ from the European rules (where possible) and pursue the modified rules, which will better respond to the domestic problems that require addressing.[78] A specific combination of increasing governmental role in the Polish financial safety net (described in Sections D and F) and below examples show, that European regulatory provisions are specifically implemented and then applied[79] in a way allowing to target and solve domestic problems with national means but through the specific use of the European regulatory framework. Four examples are given below and a comparison of Polish and EBU approaches to the resolution framework is presented in the table in the appendix.

6.1. Permanently active state aid scheme for cooperative banks and small commercial banks

In 2016 Poland entered discussions with the European Commission on the notification of a state aid scheme for potential resolution actions for cooperative and commercial banks in distress.[80] The scheme was under the regime of DGS and BRR Directives. Poland claimed that the only credit institutions eligible to benefit from the scheme are banks with the total assets of less than €3 billion.[81] The budget envisaged by Poland for this scheme is PLN 29 billion (c. €6.44 billion). The scheme was approved by the European Commission and it was decided that the aid is compatible with the internal market pursuant to Article

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[77] M. Koetter, T. Krause, L. Tonzer, *Delay determinants of European Banking Union implementation*, (2019) 58 European Journal of Political Economy, 1-20.

[78] It is not assessed in a negative context, but rather shows tendency towards solving domestic issues at the national level.

[79] Applied in a way which, perhaps at the level of EBU, will not be applied in the same way (see e.g. state aid scheme for cooperative banks).

[80] European Commission, Resolution scheme for cooperative banks and small commercial banks, State aid SA.46575 (2016/N) – Poland, Brussels, 20.12.2016 C(2016) 8780 final.

[81] Banks with total assets above this threshold will not be covered by the scheme and any resolution action applied to them involving the use of state aid will therefore have to be notified individually for assessment and approval by the Commission.

107(3)(b) of the Treaty on the Functioning of the European Union.[82] Such scheme, even though it was notified in 2016, keeps being prolonged and is still in force in 2021.[83] In 2020, two resolution actions were declared by the BFG with the use of the state aid scheme. It was used for capital injections for bridge banks and grants for the sale of business.[84] The total use of the Polish National Resolution Fund (NRF) for these cases was at the level of €191.565k (c. €43 million). As described in the report of the NBP,[85] if Poland was in the EBU, the assessment of the necessity of the use of the resolution fund for the resolution action would have lied outside the national authority. It might only be a speculative statement, as there is no empirical evidence, but the assessment of necessity for the use of the resolution fund for the banks with the total assets of below €3 billion could have been resolved differently while lifted up to the level of the EU (different assessment perspective and wider EBU perspective and policies). This, in turn, proves that argument for Poland retaining full resolution powers at the national level remains valid.

6.2. Higher target levels for the NRF and DGF comparing to the EU

Agreeing on the target levels for the funds for the potential resolution action (NRF) and the deposit guarantee (DGF) was accompanied by a lively discussion in the EU. The BRR Directive requires the Member States to ensure that they collect at least 1% of covered deposits until the end of 2024, but it was left open for the Member States to increase the national target level. For the EBU countries, the threshold of 1% of the covered deposits is fixed in the SRM Regulation.[86] Similarly, the DGS Directive requires Member States to raise at least 0.8% of the value of covered deposits (in some scenarios even 0.5%) but for EDIS part (still in construction), the percentage of value covered may be subject to change.

While transposing both regulatory directives, Poland calibrated its domestic needs depending on the domestic crisis scenario, and introduced values different from the EU thresholds. For the NRF there is a floor of 1% and a cap of 1.2% for banks, while credit unions are to cover a very low target quota of respectively 0.1% and 0.14% of covered deposits.[87] Targets for the banks need to be assessed as rather high in Poland (compared to other EU countries).[88] Low target quota for the credit unions can be explained by potentially lower chances on meeting the

[82] Consolidated version of the Treaty on the Functioning of the European Union, OJ C 326, 26.10.2012, 47-390.

[83] At the time of drafting this paper it was prolonged until 29.10.2021.

[84] European Commission, Fifth prolongation of the resolution scheme for cooperative banks and small commercial banks, State Aid SA.58389 (2020/N), Brussels, 29.10.2020 C(2020) 7400 final.

[85] National Bank of Poland, *The economic challenges of Poland's integration with the euro area*, cit.

[86] Article 69(1) SRM Regulation.

[87] Article 297 of the Act on BFG.

[88] See the world's overview here: IADI, *Deposit Insurance Fund Target Ratio*, Research Paper, July 2018.

conditions for any resolution action (general lack of public interest), however, it was not explained in the publicly available impact assessment.[89]

For the DGF for the banks the target quota determined in the legal act ranges from 0.8% to 2.6% for banks and between 0.8% and 1% for the credit unions.[90] Here again, the concentration and fragmentation of the national banking sector took a decisive role in calibrating the above targets, which enhances the effectiveness of the overall scheme as it allows for national approach to the maximum levels of the DGF and NRF funds.[91]

6.3. Coverage of the deposits of credit unions by the bank funded DGS

Credit unions in Poland are the institutions excluded from the CR Directive, which take deposits from the public and grant credits from their own accounts. In 2006, the Polish credit unions peaked in number and activity. Their number amounted to 70, the number of clients exceeded 1.5 million and total assets – 1.3 billion euros (it constituted 20% of the value of assets of all Polish cooperative banks). However, at the same time, they were excluded from the state supervision of the NCA and not covered by the public DGS system.[92] From 2009 there were attempts to proceed with a regulatory reform, which have, in 2012-2013, resulted in their inclusion under NCA supervision and public DGS coverage. This regulatory change was welcomed, among others, by the ECB, which stressed that such change will contribute to the financial stability in Poland.[93] After the NCA audit[94] it was apparent that the situation of the credit unions sector is not good, as 31% of them regularly reported losses, NPLs are reaching 30%, 50% of credit unions declared capital ratio lower than 4% and, some of them, even below 0%. Indeed, after the deposits have been covered with the public DGS since 2013, 11 credit unions became declared insolvent and deposits of the value amounting to €1 billion have been reimbursed to 246k depositors. As the credit unions have joined the DGS relatively recently, there was a *free rider* problem, as most of the deposit reimbursements were paid by the contributions paid-in by the commercial banks.[95] Global Financial Crisis and an update of the European regulatory agenda were used as an excuse in Poland for a rapid inclusion of credit unions to the public deposit insurance system without paying any entry contributions and immediate withdrawals from the DGS after insolvencies of the credit unions.

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[89] Sejm, Uzasadnienie do Druku nr 215, cit.

[90] Articles 287-288 of the Act on BFG.

[91] J. Kerlin, *The Role of Deposit Guarantee Schemes as a Financial Safety Net in the European Union*, cit., 118-134 and 203-247.

[92] They were members of their own, private guarantee fund.

[93] ECB, Opinia do druku nr 695, Opinia EBC w sprawie spółdzielczych kas oszczędnościowo-kredytowych (CON/2013/5), 14 stycznia 2013 r.

[94] UKNF, *Informacja dla Komisji Nadzoru Finansowego Raport o sytuacji spółdzielczych kas oszczędnościowo-kredytowych*, maj 2013 r.

[95] BFG, *Raport Roczny 2020*, 23.

6.4. National legal review

Last element covered by this article is the organization of the legal review of the administrative decisions based on the new regulatory framework. Administrative acts of the institutions of the financial safety net in Poland are reviewable by the national administrative courts and only indirectly by the European Court of Justice, through the pre-judicial questions posed by the referring national courts. When implementing the BRR Directive in the Polish national order, the lawmaker introduced deadlines for the Polish administrative courts to ensure quick adjudication of resolution cases, which was a choice of the Polish legislator aiming at obtaining legal certainty after resolution action as soon as possible. The first instance of administrative court has 30 days to adjudicate the case, and second instance administrative court is given 2 months to decide on it. The time limits specified are, however, counted in a specific manner, as the time for adjudication is suspended for the performance of certain activities (e.g. collection of documentation, etc.). Such a national specificity may be assessed rather positively, as resolution case is an administrative process, which does not require production of many evidences.

While searching the database of the Polish administrative courts, the number of published cases with the involvement of the NRA reaches 400 and the majority of them relate to two resolution actions (out of three in total). Both litigated resolution schemes were adopted in 2020 and at the time of drafting this article, they were already adjudicated and the decision of the BFG to adopt the resolution scheme was upheld.[96] The appeal cases in the second (and final) instance are pending. It seems that the national legal review and, in particular, fixed time limits for the administrative courts to adjudicate the case are Polish national specificity and seem to result in faster legal review, than could be expected at the European level.

7. Conclusions

The reforms of the institutional sphere of the Polish financial safety net took place in three waves. First were the nationally induced reforms related to the creation of the NCA and housing its functions in the independent agency, that were introduced right before the Global Financial Crisis. Immediately after that crisis, there were no new institutional changes proposed, mainly due to the satisfactory financial stability position of the credit institutions headquartered in Poland and lack of domestic problems with the credit institutions of that time. The EU-induced reform of enhancing DGSs and introducing the NRA to the Member States (including Polish financial safety net) was prepared and implemented in Poland in 2013-2016, in line with the respective EU regulations, however in cooperation with the standard-setters from outside the

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96 See e.g. joined cases VI SA/Wa 317/20 and 320/20 – Wyrok WSA w Warszawie z dnia 4.12.2020. The reasoning behind the other resolution action is not yet publicly available.

EU. Early start of the reforms, as well as non-European technical advisory, resulted in NRA function being peculiarly placed in the existing DGS agency. However, it seems that this policy choice works well in practice and meets the main objectives of a nefficient and active NRA. National and international cooperation between the institutions of financial safety net seems to work well, but the Financial Stability Committee could have been used as a platform to enhance it.

Since 2016, there seems to be a new momentum for the Polish financial regulatory agenda developing. Nationally induced reforms of governance for the institutions of the financial safety net took place (NCA, NRA/DGS). They made both the NCA and NRA-DGS agency more dependent on the government. These changes have been noticed by the international bodies (IMF, World Bank), that expressed concerns in this regard. It is also a time of increased activity of both NRA and DGS function. It seems that, because of these recent legal changes in the agency structure, both transparency of actions and accountability of the financial safety net may suffer, however it is difficult to find a convincing empirical proof, as it will only be visible taking into consideration its future actions, considering that the first round of judicial review of decisions (e.g. issued by the NRA) is not yet concluded.

Although during the Global Financial Crisis Poland was rather successful in terms of financial stability, there remained some domestic structural problems to be solved in the medium-term horizon (as e.g. weak capital position of some of the Polish banks). Therefore, on this occasion Poland tried to implement not only the provisions as proposed by the EU. Polish lawmakers used these new laws to solve some problems of the domestic financial sector (e.g. weakening position of the credit unions and their coverage by officially recognized DGS, notification of the state-aid program for small cooperative banks, higher target levels for banks for ex-ante contributions collection, etc.). Such approach might be assessed positively overall, however it also comes at a cost (e.g. increased contributions to the DGS by healthy banks).

After initial enthusiasm in assessing potential ways forward for Poland to establish a close cooperation with EBU, there seems to be less incentives to join it. More focus is placed on the domestic problems of the financial market, its national control and pursuing domestic ideas for combating the issues that arise (however, to large extent, they cannot regulate foreign capital owned banks). Although the initial plan of regulators was to reassess the benefits of participation in the EBU after gathering its first experiences, no further update from the government has been given for almost 7 years after the first assessment was performed. It seems that institutions of the Polish financial safety net are more focused on the internal and domestic problems, over which they try to retain full control, and decision-making powers. However their actions are still within the limits set by the EU legal regulatory framework. This activity often takes place by “gold plating” some of the EU regulatory rules to implement more restrictive, detailed and targeted solutions, if such options to modify EU regulations are available to a Member State but to the detriment of the internal market.

8. Appendix. Comparison of the Polish and EBU approaches to the resolution framework

	EBU	Poland
Resolution authority	Single Resolution Board & the net of the NRAs	NRA only
Governance of the supervisory body of the resolution authority	Plenary Session - representatives of the NRAs of the participating Member States	Supervisory Board - indirectly controlled by the Minister of Finance nominating the majority of its members
Governance of the executive body of the resolution authority	Executive Session - selected by the European Commission and approved by the European Parliament and the Council	Management Board - selected by the Supervisory Board of the NRA
Dismissal of the executive body of the resolution authority	Stipulated in law and close to the standard for central banks	Decision of the Supervisory Board controlled by the Minister of Finance
Fund target level (cap) for the resolution purposes	at least 1% – the same for all covered institutions	1.4% for credit institutions and investment firms 0.14% for credit unions
Revision of a decision on ex-ante contributions	challengeable act in the EU courts	admissibility of potential claim not tested
Share of irrevocable payment commitments (IPC)	15%	30%
Type of collateral for IPCs	cash only	bonds of the state treasury bills/notes of the central bank
Experience of the use of the resolution fund for smaller entities	no data	possible (practical examples)
Time for review of resolution scheme decision given to the reviewing court	not defined	30 days for Ist instance adjudication 2 months for IInd instance adjudication

National authorities for macroprudential supervision within the European Union

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1. Introduction. From the European System of Financial Supervision to the Single Supervisory Mechanism

The architecture of macroprudential supervision within the European Union (EU) is quite complex. It is divided into several authorities, which can be distinguished according to the nature of the powers exercised and their subjective and objective scope.

The complexity of the macroprudential institutional framework is the result of the different phases which have characterised the development of the financial supervision within the EU after the 2007-2009 financial crisis.

Firstly, the EU created its own supervisory network (the European System of Financial Supervision – ESFS), establishing three European Supervisory Authorities (ESAs)[1] and the European Systemic Risk Board (ESRB)[2], so that the ESFS covers both macroprudential and microprudential supervision.

The ESRB is the specialized body for the oversight of the systemic risk on the EU financial system. Namely, pursuant to the Article 3(1) of the Regulation 1092/2010 (ESRB Regulation), the ESRB "*is responsible for the macroprudential oversight of the financial system within the Union in order to contribute to the prevention or mitigation of systemic risks to financial stability in the Union that arise from developments within the financial system and taking into account macroeconomic developments*".

The ESRB's decision-making body is the General Board, which is made up of representatives of national central banks and national and European financial

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1 See 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, OJ L 331, 15.12.2010, 12-47; Regulation (EU) No. 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/77/EC, OJ L 331, 15.12.2010, 84-119; Regulation (EU) No. 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/79/EC, OJ L 331, 15.12.2010, 48-83.

2 Regulation (EU) No. 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, OJ L 331, 15.12.2010, 1-11.

supervisory authorities.[3] The ESRB is chaired by the President of the European Central Bank (ECB).

The scope of the ESRB's powers is certainly broad in both objective and subjective terms. Under the first point of view, the mandate of the ESRB, as clearly described and delimited by Article 3(1) of the ESRB Regulation, extends to the entire EU and embraces the entire financial system since it is composed – under the second point of view – not only of banks, but of financial intermediaries, markets, market infrastructures, including the shadow-banking system. Moreover, its toolkit is the classic soft-law one, given its power to adopt warnings and recommendations (the latter are backed by the comply or explain mechanism). In addition, there is a number of additional powers (information, analysis, cooperation), many of which are instrumental to the adoption of the above-mentioned warnings and recommendations.[4]

With particular regard to the banking system, the adoption of the Capital Requirements Regulation (CRR)[5] and the Capital Requirements Directive (CRD)[6] has certainly enriched the institutional landscape of macroprudential supervision, by requiring for the designation of the national authorities in charge of the application of certain macroprudential measures harmonized at European level (National designated authorities – NDAs). On the other hand, CRR/CRD

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3 Pursuant to Article 6 ESRB Regulation, members of the General Board with voting rights are: the President and the Vice-President of the European Central Bank (ECB); the Governors of the national central banks (Member States may alternatively nominate a high-level representative of a designated authority pursuant to Directive 2013/36/EU or Regulation (EU) No. 575/2013); a representative of the Commission; the Chairperson of the European Banking Authority (EBA); the Chairperson of the European Securities and Markets Authority (ESMA); the Chairpersons of the European Insurance and Occupational Pensions Authority (EIOPA); the Chair and the two Vice-Chairs of the Advisory Scientific Committee; the Chair of the Advisory Technical Committee. Members of the General Board without voting rights are: a high-level representative per Member State of the national supervisory authorities, of a national authority entrusted with the conduct of macroprudential policy, or of the national central bank; the President of the Economic and Financial Committee; the Chair of the Supervisory Board of the ECB; the Chair of the Single Resolution Board established by Regulation (EU) No. 806/2014 of the European Parliament and of the Council.

4 In addition to the issuing of warnings and recommendations and monitoring the respective follow-up, ESRB is also entitled to carry out the following tasks: determining and/or collecting and analysing all the relevant and necessary information, for the purposes of achieving its objectives; identifying and prioritising systemic risks; cooperating closely with all the other parties to the ESFS (where appropriate, providing the ESAs with the information on systemic risks required for the performance of their tasks; developing a common set of quantitative and qualitative indicators to identify and measure systemic risk; and participating in the Joint Committee); coordinating its actions with those of international financial organisations, particularly the IMF and the FSB as well as the relevant bodies in third countries on matters related to macroprudential oversight; carrying out other related tasks as specified in Union legislation (Article 3(2) ESRB Regulation).

5 Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012, OJ L 176, 27.6.2013, 1-337.

6 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176, 27.6.2013, 338-436.

package also assigns to the ESRB specific tasks to coordinate Member States' macro-prudential policies and, in particular, the ESRB: provides guidance to the NDAs on setting countercyclical buffer rates (Article 135 CRD); provides opinions on systemic risk buffer (Article 133 CRD) and on the proper use of national flexibility measures under Article 458 CRR;[7] issues recommendations on some systemic risk buffer rates (Articles 133 and 134 CRD).

The effects of the establishment of the SSM also affected the area of macroprudential supervision, assigning to the European Central Bank (ECB) specific tasks also in that field pursuant to Article 5 of the SSM Regulation (SSMR).[8] Profiles related to the safeguard of financial stability are linked to the establishment of the SSM and to the role played therein by the ECB as well. Pursuant to Recital 55 of the SSMR, "*[t]he conferral of supervisory tasks implies a significant responsibility for the ECB to safeguard financial stability in the Union*". It is worth noting that macroprudential policies have highly technical nature and involve some key tools of prudential supervision. The conferral of a macroprudential capacity upon the ECB (albeit within the limits marked by Article 5 of the SSMR) should not be read separately from microprudential powers that the ECB also holds. Such attribution rather favours the necessary coordination of micro and macro tools, many of which result in applying capital ratios,[9] also ensuring consistency with monetary policy.[10]

Therefore, the importance that the SSMR itself assigns to the safeguarding of financial stability does not mean that the ECB is being given functions and powers similar to those inherent to microprudential supervision. Indeed, as it will be better emphasised below, the ECB's macroprudential powers do not include the direct activation of macroprudential measures, but rather the topping up of buffers and measures "*aimed at addressing systemic or macroprudential risks at the level of credit institutions subject to the procedures set out in the Regulation*

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7 Article 458 CRR allows national authority to address changes in the intensity of macroprudential or systemic risk in the financial system by means of stricter national measures.

8 Council Regulation (EU) No. 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, OJ L 287, 29.10.2013, 63-89.

9 Recital 24 SSMR: "*Additional capital buffers, including a capital conservation buffer, a countercyclical capital buffer to ensure that credit institutions accumulate, during periods of economic growth, a sufficient capital base to absorb losses in stressed periods, global and other systemic institution buffers, and other measures aimed at addressing systemic or macroprudential risk, are key prudential tools. In order to ensure full coordination, where national competent authorities or national designated authorities impose such measures, the ECB should be duly notified. Moreover, where necessary the ECB should be able to apply higher requirements and more stringent measures, subject to close coordination with national authorities. The provisions in this Regulation on measures aimed at addressing systemic or macroprudential risk are without prejudice to any coordination procedures provided for in other acts of Union law. National competent authorities or national designated authorities and the ECB shall act in respect of any coordination procedure provided for in such acts after having followed the procedures provided for in this Regulation*".

10 G. Napoletano, *Legal aspects of macroprudential policy in the United States and in the European Union*, Quaderni di Ricerca Giuridica della Consulenza Legale della Banca d'Italia No. 76, June 2014, 186.

(EU) No. 575/2013 and Directive 2013/36/EU in the cases specifically set out in relevant Union law" (Article 5(2) SSMR).

Against this framework, the ECB's macroprudential powers can be deemed as limited under different points of view: (i) from an objective perspective, the ECB has asymmetric powers (only topping up) with regard to the macroprudential instruments set forth under CRR/CRD package; (ii) from a subjective perspective, the ECB's macroprudential powers encompass the SSM scope of application, hence they (only) involve entities defined as "*credit institutions*" under EU law.

It is – as mentioned at the beginning – a rather articulated and layered regulatory and institutional framework. One thing, however, seems to be clear: the national dimension retains an essential role in the macroprudential policy and directly influences the institutional architecture of the relevant supervision.

Under this point of view, the macroprudential field is defined as "*the most significant example*" of "*the exercise of parallel competences by the ECB and national authorities*",[11] since "[a]*s the euro area's central bank with extensive expertise in macroeconomic and financial stability issues, the ECB is well placed to carry out clearly defined supervisory tasks with a focus on protecting the stability of the financial system of the Union*" (Recital 13 SSMR).

It is worth clarifying, in any case, that it is a parallelism of competences of asymmetrical nature, since – as already mentioned above – the rationale behind the system of macroprudential supervision outlined in the SSMR is based on the assumption that the national authority takes the initiative for the exercise of macroprudential powers within its own jurisdiction, whereas the intervention of the ECB presupposes that the ECB itself deems necessary to apply more stringent measures than the national ones.

Thus, given the strongly national dimension of macroprudential policy, the purpose of this paper is to illustrate the institutional architecture of national macroprudential authorities within the European Union.

In fact, there are two different macroprudential authorities at national level: one designated on the basis of the provisions of the CRR and CRD in order

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11 P.G. Teixeira, *The Single Supervisory Mechanism: Legal and Institutional Foundations*, in *Dal Testo unico bancario all'Unione bancaria: tecniche normative e allocazione di poteri*, Quaderni di Ricerca Giuridica della Consulenza Legale della Banca d'Italia No. 75, March 2014, 85: "*The SSM Regulation provides that both the ECB and the national authorities may exercise macro-prudential tasks and activate the respective tools provided by EU law. This is because there is both a European and national dimension in the developments of the financial system and the economy. For example, a bubble in the prices of certain assets may occur either as European-wide trend or a specific national event. At the same time, the macro-prudential instruments complement the micro-prudential supervisory tools to safeguard the soundness of individual banks. Accordingly, the ECB should also be able to use them to ensure the effectiveness of its supervision. This system of parallel competences operates on the basis of mutual obligations of consultation between the ECB and national authorities. It bears some resemblances to the parallel competences in EU competition law, with the main difference that the ECB cannot preempt the actions of national authorities but may take action to go beyond national authorities, thus preventing any passivity in macro-prudential supervision*".

to exercise the specific macroprudential powers provided therein; the other, whose establishment is recommended by the ESRB, entrusted with the general conduct of macroprudential policy. It is necessary to add to this dichotomy, on the one hand, the leading role that national central banks have always played in this area and that the European framework recognises and enhances, and, on the other hand, the particular position held by the ECB, entrusted with specifically circumscribed powers in the macro area.

2. National designated authorities within CRR/CRD package

As already mentioned, the CRR and the CRD demand for the designation of national authorities in charge of the application of certain macroprudential measures harmonized at European level (NDAs). However, NDAs are not necessarily responsible for the exercise of all those macroprudential powers as in the majority of cases they may be exercised either by the NDAs or the National Competent Authorities (NCAs) in charge of microprudential supervision.

Under Article 136(1) CRD, it is provided that "*[e]ach Member State shall designate a public authority or body (a 'designated authority') that is responsible for setting the countercyclical buffer rate for that Member State*". It is indeed the only macroprudential measure in respect of which the designation of a specific authority is expressly required.

In all the other cases it is envisaged that the authority tasked with the exercising of certain macroprudential powers may be either the NDA or the NCA. Such an approach is followed:

- to identify global systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs), which have been authorised within their jurisdiction (Article 131(1) CRD also provides that, for the purposes of identifying G-SIIs and O-SIIs, Member States may designate more than one authority);
- to set the systemic risk buffer (SyRB) and identify the exposures and subsets of institutions to which it applies (Article 133(3) CRD);
- for the setting of higher risk weights for exposures secured by mortgages on immovable property (Article 124 CRR);
- for the setting of higher Loss Given Default (LGD under Article 164 CRR) to avert or mitigate systemic risks stemming from exposures to the real estate sector;
- to implement national measures stricter than the ones set forth under CRR and CRD in case the designated authority identifies changes in the intensity of macroprudential or systemic risk in the financial system, which could have serious negative consequences for the financial system and the real economy in a specific Member State (so called 'flexibility clause' pursuant to the Article 458 CRR).

In view of the aforementioned distinction of wording, one might wonder what is the rationale behind the different choice made by the European legislator and whether such a choice results in an actual and substantial difference of institutional regime.

As regard the first issue, attention should be paid to the particular nature of the counter-cyclical capital buffer (CCyB).

CCyB is an additional capital buffer aiming at reducing the procyclicality of the financial system by building up capital reserves during expansions in the financial cycle to absorb potential losses during contractions. Cumulative (pro-cyclical) risk increases with excessive risk exposure in boom phase and excessive risk aversion in bust phase (*time dimension* of the systemic risk), so that the creation of financial buffers on a large scale in good times (counter-cyclical approach) should limit the build-up of financial risks, since financial institutions would be allowed to release the buffers in hard times, when financing within the markets becomes more expensive.[12] It is therefore a measure of a purely macroprudential nature, expression of the aforementioned counter-cyclical approach, which operates according to different and opposite dynamics towards the procyclicality of the microprudential supervision.

Less clear-cut, however, is the nature of the other measures described above, the activation of which may be left to the NCA.

The problem is not so much the fact that these are measures affecting the capital requirements of those subject to them. Currently, all the macroprudential measures harmonized at European level are capital-based and, from this perspective, CCyB makes no difference since it is an add-on to minimum capital requirements. Rather, there are measures that, while fulfilling a macroprudential function, are certainly closer to proper microprudential tools. With respect to the latter, it could be deemed that the possibility of devolving the exercise of the relevant power to the NCA (which is a microprudential supervisory authority) reflects on an institutional level the characteristics of the measures.

With regard to the second issue above, it should be made clear that, on the one hand, the CCyB provisions do not exclude that the designated authority for the setting of the buffer is the NCA itself. Indeed, it is not uncommon for such

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[12] Macroprudential policy aims at contributing to the safeguard of the stability of the financial system as a whole by limiting, preventing and mitigating the systemic risk, which means "*a risk of disruption in the financial system with the potential to have serious negative consequences for the real economy of the Union or of one or more of its Member States and for the functioning of the internal market*" (Article 2(c) of the ESRB Regulation). Addressing systemic risk requires for a wide scope (in order to face the cross-sectional dimension of such a risk) and a counter-cyclical approach (in order to face the time dimension of it). See D. Salomone, *The SSM's macroprudential tasks and their relationships with the ESRB's mandate*, in R. D'Ambrosio (ed), *Law and Practice of the Banking Union and of its governing Institutions (Cases and Materials)*, Quaderni di Ricerca Giuridica della Consulenza Legale della Banca d'Italia No. 88, April 2020, 109 ff.

correspondence to occur in practice when, for example, both roles are assigned to the national central bank.On the other hand, when providing that the authority responsible for the application of the above-mentioned measures shall be the competent authority or the designated one, the relevant provisions require in any case an act of designation by the Member States, regardless of whether this designation concerns a specific authority empowered to do so or the NCA itself. If therefore an act of designation is in any event necessary, there seems to be room for the view that, even if the power is conferred upon the NCA, the latter should be also considered as NDA for the specific purpose of exercising the power in question.

3. Coordination among NDAs and other national and European authorities

Coordination between different national authorities is needed, but the rationale under the need for cooperation does not seem always the same.

Articles 124 and 164 CRR, relating to some sectoral risk weights, are worth underlining.

In both provisions it is expressly envisaged that "*where the authority designated by the Member State for the application of this Article is the competent authority, it shall ensure that the relevant national bodies and authorities which have a macroprudential mandate are duly informed of the competent authority's intention to make use of this Article, and are appropriately involved in the assessment of financial stability concerns in its Member State*" (Articles 124(1a) and 164(5) CRR).

The underlying rationale is clear: as the measure at stake consists of a macroprudential tool, the NCA activating it must inform the authorities empowered with a specific macroprudential mandate in order to enable the latter to participate in the financial stability assessment.

It is not equally crystal clear to which authorities having "*a macroprudential mandate*" Articles 124 and 164 CRR refer to. In particular, one might wonder whether the provisions refer to NDAs (naturally, the ones designated in relation to macroprudential measures other than those covered by the provisions) or they have a much broader scope, also involving national macroprudential authorities that do not have their legal basis in the CRR/CRD package (it could be the case of the national authority responsible for conducting the macroprudential policy in the relevant Member State).

The broader and more comprehensive interpretation seems to be preferred because of both literal and teleological arguments. Indeed, the provisions at stake refer to "*authorities which have a macroprudential mandate*", which do not necessarily result in NDAs. Moreover, an authority with a general macroprudential mandate can be considered in a better position than a NDA (which has a sectoral macroprudential mandate) when assessing the financial stability profiles related to the application of certain measures.

However, coordination between different national authorities is also required in the opposite hypothesis, i.e. when an authority other than the NCA has been designated.

Still remaining with the example of Articles 124 and 164, it is likewise stated that "*[w]here the authority designated by the Member State for the application of this Article is different from the competent authority, the Member State shall adopt the necessary provisions to ensure proper coordination and exchange of information between the competent authority and the designated authority for the proper application of this Article. In particular, authorities shall be required to cooperate closely and to share all the information that may be necessary for the adequate performance of the duties imposed upon the designated authority pursuant to this Article. That cooperation shall aim at avoiding any form of duplicative or inconsistent action between the competent authority and the designated authority, as well as ensuring that the interaction with other measures, in particular measures taken under Article 458 of this Regulation and Article 133 of Directive 2013/36/EU, is duly taken into account*" (Articles 124(1a) and 164(5) CRR).

The reasons behind the coordination appear different from the previous case.

In fact, in the event that the NCA itself is designated to activate the measure in question, the involvement of the macroprudential authority is functional to assess the underlying financial stability profiles, i.e. those aspects that directly affect the sources of systemic risk. The NCA, although designated to exercise the specific power, does not have a general macroprudential capacity.

In the second case, such a need does not seem to arise so clearly since, having the Member State decided to designate an authority other than the NCA, it can be assumed that this choice has fallen on an entity that already holds a macroprudential mandate. The legislator's attention therefore shifts to the need to prevent the two authorities (one with a micro mandate and the other with a macro mandate) from taking actions that are inconsistent with each other.

In order to ensure consistency not only at the national level but also at the European level, the exercise of macroprudential powers by the NDA is generally preceded by a phase of dialogue with certain European bodies.

Thus, when applying sectoral risk weights according to Articles 124 and 164 CRR, a NDA has to notify the EBA and the ESRB, which provide the Member State concerned with their respective opinions.[13]

The collaboration framework is more complex in case of activation of the SyRB under Article 133 CRD as, in such a case, the NDA is responsible not only

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[13] Furthermore, pursuant to Articles 124 and 164 CRR, EBA, in close cooperation with ESRB, has to develop draft regulatory technical standards to specify the types of factors to be considered for the assessment of the appropriateness of the risk weights or of the LGD. The ESRB, in close cooperation with the EBA, may issue recommendations in order to provide guidance to the NDA.

for the setting of the measure, but it also has to identify the exposures and subsets of institutions to which it applies. Regardless of the regulatory power conferred upon the EBA to issue, after consulting the ESRB, guidelines on the appropriate subsets of exposures to which the NDA may apply the SyRB, it is worth mentioning that Article 133 CRD distinguishes different levels of cooperation, involving the NDA, the EBA, the ESRB and the Commission with an increasing degree of involvement, depending on whether the buffer to be applied exceeds certain thresholds laid down in the CRD itself.

It might also happen, however, that the application of the SyRB has cross-border effects. This is the case where the institution to which one or more SyRB rates apply is a subsidiary, whose parent is established in another Member State, or where such a buffer applies to exposures located in third countries. In the first case, the NDA has to notify the authorities of that Member State. In the second case, the NDA has to notify the ESRB, which forwards such notification to the supervisory authorities of those third countries.

The framework governing cooperation between the NDA and other authorities is equally complex (perhaps even more when considering the authorities involved) in the event that the former intends to activate the flexibility clause under Article 458 CRR, which regulates the case the NDA "*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 that cannot be addressed by means of other macroprudential tools set out in this Regulation and in Directive 2013/36/EU as effectively as by implementing stricter national measures*". In that hypothesis, the NDA has to notify its intention to apply such a national measure to the Commission and to the ESRB, which in turn will forward the notification to the European Parliament, the Council and the EBA.

While the role of the EBA and the ESRB in this process is to give an opinion as well, there is a strong involvement of the Commission and the Council, which is justified by the need to assess also other profiles in addition to financial stability. Indeed, "*if there is robust, strong and detailed evidence that the measure will have a negative impact on the internal market that outweighs the financial stability benefits resulting in a reduction of the macroprudential or systemic risk identified, the Commission may, within one month, propose to the Council an implementing act to reject the draft national measures*" (Article 458(4) CRR).

Less articulated is the procedure for setting the CCyB, where it is only provided that the NDA notifies the ESRB with each change of the countercyclical buffer rate and the information required in Article 136 CRD.[14] The rationale for not providing complex application procedures based on the involvement of

[14] Pursuant to Article 135 CRD, "*ESRB may give, by way of recommendations in accordance with Article 16 of Regulation (EU) No. 1092/2010, guidance to authorities designated by Member States under Article 136(1) on setting countercyclical buffer rates*".

multiple authorities seems to lie on the circumstance that the CCyB is a measure affected more than others by national specificities.[15]

4. NDAs within the ESRB's framework

As already mentioned at the beginning of this paper, the ESRB is responsible for the macroprudential oversight of the financial system within the Union (Article 3(1) ESRB Regulation) and the ESRB performs the mandate conferred upon it by a soft-law toolkit, given its power to adopt warnings and recommendations.[16]

Pursuant to Article 16(2) ESRB Regulation, warnings and recommendations are addressed, among others, to the "*national authorities designated for the application of measures aimed at addressing systemic or macro-prudential risk*".

The inclusion of NDAs among the potential addressees of warnings and recommendations issued by the ESRB does not give rise to any particular concerns.

Indeed, the ESRB has no power to intervene directly by introducing macroprudential measures, neither at the European nor at the national level. In case that a source of systemic risk should be identified, the ESRB's response is the issuing of a warning where such systemic risks are deemed to be significant, or of a recommendation if those risks require remedial action (Articles 3 and 16 ESRB Regulation). In any case, the action has to be taken by the relevant addressee.

In order for the ESRB to play an effective role in safeguarding financial stability, it is therefore essential that its warnings and recommendations can be addressed to all those authorities that have the power to take the necessary measures to this end. NDAs certainly fall into the latter category, as they exercise binding powers for the adoption of the macroprudential measures regulated in CRR/CRD.

However, NDAs might be relevant also in the context of the ESRB's organisational framework.

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15 According to Article 136(2) CRD, "*Each designated authority shall calculate for every quarter a buffer guide as a reference to guide its exercise of judgment in setting the countercyclical buffer rate in accordance with paragraph 3. The buffer guide shall reflect, in a meaningful way, the credit cycle and the risks due to excess credit growth in the Member State and shall duly take into account specificities of the national economy*".

16 Having regard to the comply-or-explain mechanism backing ESRB recommendations, it could be argued whether one can speak of semi-hard power in this case. See International Monetary Fund, *Key aspects of macroprudential policy*, 10 June 2013, 27: "*The strength of* [macroprudential] *powers can vary and be: • "hard" (direct), enabling the policymaker to have direct control over the calibration of specific macroprudential tools, • "semi-hard," enabling the policymaker to make formal recommendations, coupled with a 'comply or explain' mechanism, or • "soft," enabling the policymaker to express an opinion, or a recommendation that is not subject to comply or explain*".

It is worth remembering that, according to the text of Article 6 ESRB Regulation as it originally was adopted in 2010, the Governors of the national central banks were the only 'national-representatives' with voting rights within the General Board, which is – as already mentioned – the ESRB's decision-making body.

As part of the reform of the ESFS conducted in 2019, Regulation (EU) 2019/2176 of 18 December 2019[17] amended the Regulation establishing the European Systemic Risk Board, by also intervening on the rules governing the composition of the General Board. Namely, in order to provide for flexibility as regards the selection of the member of the General Board with voting rights, the current Article 6 ESRB Regulation allows Member States to choose their voting representative between the Governor of the national central bank and a high-level representative of a designated authority pursuant to the CRD or CRR, where that designated authority has the leading role in financial stability in its area of competence.

This possibility of choice by the Member State is therefore subject to two conditions:

(i) the NDA is not the national central bank (NCB);

(ii) the NDA plays the leading role in financial stability in its area of competence.

While the first of the aforementioned conditions is easy to verify, as it results in a completely formal fact, the same cannot be said for the second condition. Ascertaining the leadership role requires assessing not only the mandate inherent in the designation under the CRR/CRD, but also the set of powers characterising that authority within the national architecture of macroprudential supervision.

However, in case the representative of the NDA is appointed as a voting member, the representative of the NCB is member of the ESRB's General Board without voting rights (Article 6(2)(a) ESRB Regulation).

If, on the other hand, the NDA is the national central bank itself, there should not be room for a choice by the relevant Member State.[18]

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17 Regulation (EU) 2019/2176 of the European Parliament and of the Council of 18 December 2019, amending Regulation (EU) No 1092/2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, OJ L 334, 27.12.2019, 146-154.

18 Recital 9 of the above-mentioned Regulation 2019/2176 clarifies that "*That flexibility as regards the selection of the member of the General Board with voting rights does not affect Member States in which the national central bank is a designated authority pursuant to Directive 2013/36/EU or Regulation (EU) No. 575/2013*".

5. The European Central Bank as NDA

Pursuant to Article 9(1) SSMR, "*[f]or the exclusive purpose of carrying out the tasks conferred on it by Articles 4(1), 4(2) and 5(2), the ECB shall be considered, as appropriate, the competent authority or the designated authority in the participating Member States as established by the relevant Union law*".

In general, Article 5(1) SSMR states the power of national authorities to apply requirements for capital buffers to be held by credit institutions at the relevant level in accordance with the pertinent Union law, in addition to own funds requirements referred to in point (d) of Article 4(1) SSMR, including countercyclical buffer rates and any other measures aimed at addressing systemic or macroprudential risks provided for and subject to the procedures set out in CRR and CRD in the cases specifically envisaged in relevant Union law. There is however an obligation for the national authority to notify the ECB in advance of its intention to exercise one of these macroprudential powers. Upon notification, the ECB is given the power to raise objections to which the national authority must give due consideration, but which are not binding.

Beyond prior interlocution, therefore, the first paragraph of Article 5 SSMR does not regulate the exercise of macroprudential powers by the ECB and for this reason it is not referred to in Article 9 SSMR itself.

Different it is the case governed by the second paragraph of the same Article 5 SSMR.

Indeed, if the above-mentioned paragraph 1 of Article 5 SSMR deals with the case where the activation of a macroprudential tool is deemed as necessary by the national authority, the second paragraph foresees the conditions for the ECB to directly act in the macroprudential field. Namely, Article 5(2) SSMR provides for the right upon the ECB to apply higher capital requirements and/or more stringent macroprudential measures (topping-up power), including higher capital buffers on individual banks based on macroprudential factors arising in the country where the bank is located.

For the purposes of the exercise of the topping-up powers by the ECB, macroprudential tools indicate any of the following instruments (Article 101 of Regulation 468/2014[19] – SSMFR):

(i) the capital buffers within the meaning of Articles 130 to 142 CRD;

(ii) the measures for domestically authorised credit institutions, or a subset of those credit institutions pursuant to Article 458 CRR;

(iii) any other measures to be adopted by NDAs or NCAs aimed at addressing systemic or macroprudential risks provided for and subject to the

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19 Regulation (EU) No. 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank, national competent authorities and national designated authorities, OJ L 141, 14.5.2014, 1-50.

procedures set out in CRR/CRD in the cases specifically envisaged in relevant Union law.

Some specific considerations are worth mentioning with regard to the so called macroprudential use of Pillar 2.

Pillar 1 is the minimum capital requirement applying to all banks. Pillar 2 comprises additional requirements that can be imposed by supervisors on a case-by-case basis.[20]

Articles 103 and 105 CRD IV were deemed to provide an adequate legal basis for a macroprudential application of Pillar 2, as the "*systemic liquidity risk that threatens the integrity of the financial markets of the Member State concerned*" was one of the element to be assessed when deciding on the Pillar 2 measure to be adopted. In order to clearly distinguish macroprudential measures from microprudential ones, the CRD V[21] finally repealed the above-mentioned Article 103 and amended Article 105 by deleting the reference to the assessment of the systemic liquidity risk when determining the relevant requirement. Hence, it seems no longer possible to use Pillar 2 capital requirements for macroprudential purposes. One could argue whether such a use of Pillar 2 is still available for the ECB pursuant to Article 16(2) SSMR, which provides the ECB with the power to require additional own funds "*[f]or the purposes of Article 9(1)*" of the SSMR itself. The answer should be negative as the ECB cannot top-up a measure that the NDA is prevented to adopt. Indeed – as already noted – ECB is tantamount to a NDA "*[f]or the exclusive purpose of carrying out the tasks conferred on it by Articles […] 5(2)*" (Article 9(1) SSMR).

In any case, it is to be ruled out that, in exercising its top-up power, the ECB may have recourse to macroprudential measures other than those harmonised at European level. Indeed, even if the literal wording of Article 5(2) SSMR does not shine in terms of clarity with regard to this particular aspect, as it refers to "*the procedures set out in the Regulation (EU) No. 575/2013 and Directive 2013/36/EU in the cases specifically set out in relevant Union law*" but not to the measures, Article 1 SSMR states that "*[t]his Regulation is also without prejudice to the responsibilities and related powers of the competent or designated authorities of the participating Member States to apply macroprudential tools not provided for in relevant acts of Union law*".

20 Pillar 2 aims at addressing risks that are not sufficiently covered by Pillar 1 and is based on the Supervisory Review and Examination Process (SREP). The rationale underpinning Pillar 2 is "*to complement the minimum requirements prescribed by regulators (Pillar 1) with tailored supervisory measures based on a thorough analysis of the bank's riskiness, including a review of its self-assessment (Pillar 2)*" (M. Bevilacqua *et al.*, *The evolution of the Pillar 2 framework for banks: some thoughts after the financial crisis*, Questioni di Economia e Finanza (Occasional Papers) della Banca d'Italia No. 494, April 2019, 5.

21 Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019, amending Directive 2013/36/EU, as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures, OJ L 150, 7.6.2019, 253-295.

However, if a "*NDA does not set a buffer rate, this does not prevent the ECB from setting a buffer requirement in accordance with this Regulation and Article 5(2) of the SSM Regulation*" (Article 102 SSMFR). This rule aims at overcoming inaction bias, if any.

Close cooperation between the ECB and the involved NDA is needed (see Article 5(4) SSMR) when the former intends to exercise its macroprudential powers as well. The ECB has to notify its intention to the concerned NCAs or NDAs ten working days prior to taking such a decision. Where the concerned authority objects, it has to state its reasons in writing within five working days and the ECB has to consider those reasons prior to proceeding with the decision.

Provision is also made for the national authority itself to propose to the ECB the exercise of its powers under Article 5(2) SSMR, in order to address the specific situation of the financial system and the economy in its Member State. It is unclear whether, in such a case, the ECB may refuse to exercise this power despite the request of the national authority and whether it may deviate from the latter's possible instructions on the use of a particular instrument. An affirmative answer seems preferable as the rule under consideration provides for a mere proposal by the national authority, as such unsuitable to bind the ECB in the exercise of a power of its own, namely the top-up one. Moreover, the affirmative answer appears to be in line with other cases similarly provided for in the SSMR, where the faculty of proposal would not seem to bind the exercise of a power that is and remains the prerogative of the authority to which the proposal is addressed.[22]

As to the provision in Article 5(5) SSMR, according to which "[w]*hen carrying out the tasks referred to in paragraph 2, the ECB shall take into account the specific situation of the financial system, economic situation and the economic cycle in individual Member States or parts thereof*", it is a further confirmation of the fact that systemic risk is strongly influenced by national specificities, which therefore macroprudential policies must take into account whenever action is needed.[23]

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22 See, for instance, Article 18(5) SSMR: "*In the cases not covered by paragraph 1 of this Article, where necessary for the purpose of carrying out the tasks conferred on it by this Regulation, the ECB may require national competent authorities to open proceedings with a view to taking action in order to ensure that appropriate penalties are imposed in accordance with the acts referred to in the first subparagraph of Article 4(3) and any relevant national legislation which confers specific powers which are currently not required by Union law. The penalties applied by national competent authorities shall be effective, proportionate and dissuasive*". It does not seem that the ECB's request binds the NCA to apply the sanction, which, on the contrary, is the result of a procedure that the NCA itself instructs and concludes.

23 See also Article 2(c) ESRB Regulation, which refers the systemic risk to "*one or more of its Member States*", in addition to the Union as a whole.

The specificities that accompany the exercise of macroprudential powers by the ECB are also expressed on a procedural level. According to the Article 13h(3) of the ECB Rules of Procedure,[24] when adopting decisions for the purpose of carrying out the tasks referred to in Article 5 SSMR, the "*Governing Council shall have the right to endorse, object to or amend proposals of the Supervisory Board*". On the other hand, when adopting decisions in the microprudential field (namely, decisions for the purpose of carrying out the tasks referred to in Article 4 SSMR), Article 13g of the ECB Rules of Procedure only provides for an objection power upon the Governing Council.

ESRB warnings and recommendations may be addressed to the ECB too. In the context of the above-mentioned reform of the ESFS, Regulation 2176/2019 amended the ESRB Regulation by expressly including the ECB in the list of potential addressees of ESRB's warnings and recommendations "*for the tasks conferred to the ECB in accordance with Articles 4(1), 4(2) and 5(2) of Regulation (EU) No. 1024/2013*" (Article 16(2) ESRB Regulation).[25]

For the sake of completeness, it is worth mentioning that, as regards the institutional framework, there are relevant links between the ECB and the ESRB. According to Regulation (EU) 1096/2010,[26] the ECB ensures a Secretariat and thereby provides the ESRB with analytical, statistical, logistical and administrative support.

Moreover, the ESRB is chaired by the President of the ECB.[27]

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24 Decision of the European Central Bank of 19 February 2004 adopting the Rules of Procedure of the European Central Bank (ECB/2004/2), OJ L 80, 18.3.2004, 33-41.

25 In the Explanatory Memorandum of the ESRB reform, one can read that "[i]*t is also proposed to include the ECB as a possible addressee of ESRB warnings and recommendations for ECB tasks conferred to it by the Single Supervisory Mechanism Regulation (Regulation (EC) No. 1024/2013), i.e. for supervisory tasks not pertaining to the conduct of monetary policy. This would address the current asymmetry whereby national authorities can receive such warnings and recommendations as members of the General Board, but these are not sent to the ECB as the competent or designated authority at Banking Union level*".

26 Council Regulation (EU) No. 1096/2010 of 17 November 2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board, OJ L 331, 15.12.2010, 162-164.

27 Following the above-mentioned ESFS reform conducted in 2019, the President of the ECB has the chair of the ESRB on a permanent basis, while the previous text of the Article 5(1) ESRB Regulation provided that "*The ESRB shall be chaired by the President of the ECB for a term of 5 years following the entry into force of this Regulation. For the subsequent terms, the Chair of the ESRB shall be designated in accordance with the modalities determined on the basis of the review provided for in Article 20*". The rationale of such a choice is clarified in Recital 5 of the Regulation 2019/2176: "*The President of the ECB has chaired the ESRB since its establishment, pursuant to Regulation (EU) No. 1092/2010 until 15 December 2015 and thereafter on an interim basis. During that period, the President of the ECB has conferred authority and credibility on the ESRB and ensured that it can effectively build and rely on the expertise of the ECB in the area of financial stability. It is therefore appropriate that the President of the ECB chair the ESRB on a permanent basis*".

6. The macroprudential mandate of national authorities

According to the ESRB Recommendation 2011/3,[28] Member States have been recommended to "*designate in the national legislation an authority entrusted with the conduct of macro-prudential policy*" in order to "*ensure that macro-prudential policies can be pursued at national level upon the initiative of the national macro-prudential authority, or as a follow-up to recommendations or warnings from the ESRB*".

National Macroprudential Authority recommended by the ESRB is worth distinguishing from the NDA. The latter – as already mentioned – is entrusted with the power to activate some specific macroprudential tools set forth under CRR/CRD, whilst the mandate of the National Macroprudential Authority is enshrined in a more general way. The conduct of macroprudential policy to be carried out by it is in fact composed of a plurality of powers. Having regard to the minimum tasks of identifying, monitoring and assessing risks to financial stability and of implementing policies to achieve its objectives by preventing and mitigating those risks, the ESRB recommends Member States to "*ensure that the macro-prudential authority has the power to require and obtain in a timely fashion all national data and information relevant for the exercise of its tasks, including information from micro-prudential and securities market supervisors and information from outside the regulatory perimeter, as well as institution-specific information upon reasoned request and with adequate arrangements to ensure confidentiality*" and to "*entrust the macro-prudential authority with the power to designate and/or develop the surveillance approaches for identifying, in coordination or together with the micro-prudential and securities market supervisors, the financial institutions and structures that are systemically relevant for the respective Member State, and to determine or recommend on the perimeter of national regulation*".

Even more general is the description of the toolkit to be made available to the authority, which should have "*control over appropriate instruments for achieving its objectives*". However, Member States have been recommended by the ESRB to assess, in cooperation with the macroprudential authorities, whether the macroprudential instruments already provided are sufficient to effectively and efficiently pursue the objective of macroprudential policy and, if the assessment indicates that the available instruments are not sufficient, to consider additional ones. To this end, an indicative list of measures has been suggested by the ESRB itself.[29]

The similarity with the organisation of the powers of the ESRB itself, whose founding Regulation emphasises the importance for the Board to have a

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[28] Recommendation of the European Systemic Risk Board of 22 December 2011 on the macro-prudential mandate of national authorities (ESRB/2011/3), OJ C 41, 14.2.2012, 1-4.

[29] On the basic macroprudential toolkit to be developed by Member States, see Recommendation of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (ESRB/2013/1), OJ C 170, 15.6.2013, 1-19.

sufficiently complete information landscape at its disposal in order to be able to exercise its functions profitably, is quite obvious.[30]

Without prejudice to the need for a National Macroprudential Authority, the ESRB recommendation is neutral in terms of institutional and organisational architecture that each Member State intends to give to its authority. From that perspective, in fact, the National Macroprudential Authority recommended therein might be a single institution or a board composed of several institutions. The two institutional and organizational models (single institution or board composed of several institutions) are more or less equally represented in the experience of the EU countries.

In any case, it may happen that the role of National Macroprudential Authority and the role of NDA are undertaken by the same institution.[31] This is indeed the solution often followed in those countries that, between the two organizational models of the National Macroprudential Authority, have opted for the single institution.

On the contrary, in countries where the NDA under the CRR/CRD is different from the National Macroprudential Authority,[32] the organisational model chosen for the latter is often that of the board composed of several institutions. The decision to separate roles and responsibilities thus goes hand in hand with the decision to foster dialectic within the authority conducting macroprudential policy.

7. The (leading) role played by the National Central Bank

National Central Banks (NCBs) have always been well-placed in countering systemic risk, having regard to the macroprudential mandate they already had.

The role played by NCBs in the macroprudential sphere has been further enhanced in the construction of the European macroprudential framework.

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30 Pursuant to Article 3(2)(a) ESRB Regulation, the Board "*shall carry out the following tasks: (a) determining and/or collecting and analysing all the relevant and necessary information, for the purposes of achieving the objectives described in paragraph 1*".
In order to ensure appropriate and reliable information flows, cooperation among all the authorities participating to the ESFS is required (see Article 2(4) ESRB Regulation, which recalls the principle of sincere cooperation under Article 4(3) of the Treaty on European Union).
In more specific terms, Article 15 ESRB Regulation states that "[t]*he ESAs, the European System of Central Banks (ESCB), the Commission, the national supervisory authorities and national statistics authorities shall cooperate closely with the ESRB and shall provide it with all the information necessary for the fulfilment of its tasks in accordance with Union legislation*". It also provides for a particular procedure in case of collection and exchange of information.

31 It is the case of Belgium, Cyprus, Czech Republic, Estonia, Finland, France, Greece, Ireland, Lithuania, Malta, Poland, Portugal, Romania, Slovakia, Sweden. Bulgaria can also be included in this model as both authorities involved (Bulgarian National Bank and Financial Supervision Commission) undertake the functions of National Macroprudential Authority and NDA.

32 It is the case of Austria, Croatia, Denmark, Germany, Hungary, Latvia, Luxembourg, Netherlands, Slovenia, Spain, Italy.

Recital 24 ESRB Regulation underlines that the "*ECB and the national central banks should have a leading role in macro-prudential oversight because of their expertise and their existing responsibilities in the area of financial stability*". This finding is directly reflected in the composition of the General Board (the decision-making body of the ESRB), in which the Governors of the NCBs were always members with voting rights before the reform of the ESRB carried out in 2019.

A similar argument can be made towards the National Macroprudential Authorities under ESRB Recommendation 2011/3, which requires that "*the central bank plays a leading role in the macro-prudential policy*". This requirement has resulted in the NCB itself being assigned the role of National Macroprudential Authority or in the NCB being given a leading position within the board, in the case of the model based on a board composed of several authorities.

However, as already mentioned, Article 6 ESRB Regulation allows Member States to choose their voting representative in the General Board of the ESRB between the Governor of the NCB and a high-level representative of a NDA, when that designated authority has the leading role in financial stability in its area of competence. One could argue that, in case the NDA is different from the National Macroprudential Authority and the representative of the former is appointed as voting member within the General Board, the NCB could only take part to the meetings of the General Board, but it would not have voting rights, while playing a leading role in the National Macroprudential Authority. Such an eventuality, which is possible in the abstract, should not pose any substantive concerns, since the option of choosing the representative of the NDA instead of the NCB Governor is conditional on the NDA having a leading role in financial stability in its area of competence.

8. Concluding remarks

The exam carried out in this paper is intended to give a picture of the particular complexity of the macroprudential framework within the European Union, to which, moreover, scholars do not seem to have devoted the same attention as to the microprudential aspects of the Banking Union.

As we have seen, the plurality of authorities involved (some operating at the national level, others at the European level) corresponds to diversifications under different points of view: the nature of the powers exercised, some of which are expressed in binding measures (for example, the powers exercised by NDAs, NCBs and ECB), while others are expressions of soft-law or – if preferred – semi-hard law (ESRB and National Macroprudential Authority); the territorial scope of application, if we consider that the activities of the ESRB involve the entire Union, while the powers of the ECB are limited to the States participating to the SSM; in terms of subjective scope, if we consider that the powers of the NDA and the ECB are exercised with respect to credit institutions, while the ESRB and the National Macroprudential Authority must turn their attention to all the players in the financial system (including the shadow-banking system sector). It is worth mentioning, moreover, the circumstance that, at present, only some macroprudential measures are harmonised at the level of EU legislation.

The complex institutional architecture is certainly the result of the stratification of the various historical steps from the creation of the ESFS to the SSM. However, historical evolution alone is not sufficient to explain this complexity, since in other areas (e.g. microprudential supervision) it has not prevented the creation of more pyramid-like (albeit equally complex) institutional structures.

A key aspect has rather been the circumstance that macroprudential supervision is politically sensitive (it is no coincidence that one prefers to speak of macroprudential policy[33]). For the purposes of regulatory choices, this leads to pay special attention to national specificities when activating a macroprudential measure. At the level of institutional choices, this justifies the preservation of a significant margin of power in the hands of national authorities.

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[33] For the consideration of the macroprudential approach as a policy, see R.M. Lastra, *The Macroprudential Approach: Policy, Supervision or Regulation?*, in *Macroprudential Matters. Critical analysis of macroprudential and financial stability policy in the UK and globally*, 25 October 2021: "*The literature sometimes refers to macroprudential regulation, some other times to macroprudential supervision and finally it also refers to macroprudential policy. In my opinion, the 'macropru' approach is best characterised as policy. While regulation refers to the establishment of rules, to the process of rule-making and encompasses a wide range of norms, emanating from national authorities (laws, statutes, statutory instruments), supra-national institutions, international organizations and soft law standard setters, and self-regulatory organizations. Supervision is a multi-faceted concept, which generally refers to the monitoring and oversight of the safety and soundness of financial institutions, as well as to risk control and compliance with rules. Policy is a broad concept that refers to actions, decisions and other formal and informal mechanisms – including regulatory and supervisory tools – adopted by the competent public authorities in the pursuit of an objective (or set of objectives)*".

Part II: The impact of the creation of the Banking Union on the EBA

The effects of the Banking Union on the functioning of the European Banking Authority

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1. Introduction

The European Banking Authority (EBA) celebrated its ten-year anniversary in 2021, and the first pillar of the so-called 'Banking Union' (BU), the Single Supervisory Mechanism (SSM) is celebrating its own in 2024. Since its creation in 2014, a lot has been written about the BU from different viewpoints.[1] Less so, though, from the vantage point of looking at the effects of the BU on a pre-existing EU authority in the area of banking (the EBA). This article constitutes a contribution to the literature from that vantage point, seeking to offer a more systematic overview of the BU effects on the EBA's role and nature, following the first decade of their co-existence.

The brief for the authors was to examine whether the BU had an effect in a particular jurisdiction or from a particular viewpoint; and, in the affirmative, to explore that effect in terms of its nature and magnitude. Such an objective implies a comparison of the 'pre-BU' with the 'post-BU' setting. Where this is done in the context of national jurisdictions, i.e. national case-studies, the comparison implies the examination, essentially, of whether the europeanisation of banking supervision has achieved its objectives. Thus, the emphasis there, is on whether the BU has enabled the *substantive* aspects of banking regulation and supervision, i.e. whether it managed to create efficient banking and financial markets, and to avoid banking failures or mitigate their effects.

On the other hand, in the case of examining the effect of the BU on the EBA, one is found in a context whereby two European-level authorities are involved, one being 'sub-European' in terms of jurisdictional-geographical reach (as the BU relates only to the Eurozone). This requires that the analysis necessarily focuses on the *institutional* design of financial services' regulation and supervision, i.e. on the regulatory challenges resulting from the EU multi-level governance *itself*. In such a context, the 'pre-BU' analysis requires a return to the evolution of the EU financial sector institutional framework, so as to hopefully shed light on the rationale behind this *particular* institutional choice for europeanising banking supervision,

[1] Such as by financial lawyers with an emphasis on these 'sectoral' objectives of the BU in the banking sector (see E. Ferrán, *European Banking Union: Imperfect, But It Can Work*, University of Cambridge Faculty of Law Legal Studies Research Paper Series 30/2014); by administrative-public lawyers (A.H. Türk, *European Banking Union and Its Relation with European Union Institutions*, in M.P. Chiti, V. Santoro (eds), *The Palgrave Handbook of European Banking Union Law* (Palgrave Macmillan, 2019)); from the viewpoint of the BU's effects on private law (see C. Hadjiemmanuil, *The Banking Union and Its Implications for Private Law: A Comment*, (2015) 16 European Business Organization Law Review, 383) or via the lenses of the interplay between inter-governmentalism vs supranationalism (e.g. D. Schäfer, *A Banking Union of Ideas? The Impact of Ordoliberalism and the Vicious Circle on the EU Banking Union*, (2016) 54 Journal of Common Market Studies, 961).

i.e. for the creation of such a geographically sub-EU authority in light of, and in a way *despite*, the existence of another pre-existing EU authority with competences in this area, the EBA. The 'post-BU' analysis can then be carried out against this baseline. In that sense, the specific institutional choice of the BU reflects a specific EU response to age-old debates about the institutional design for financial services regulation:[2] the combination of a (partially) europeanised supervision, which is, nevertheless, separated from regulation. Ultimately, this comparison of the 'before' the BU with the 'after' can provide us with some views on the merit of those institutional design choices.

In light of the above, *Section II* looks at the historical background of the EU institutional organisation for the financial services sector and briefly lays out the approaches taken at different phases in its evolution, in relation to the two challenges/contexts mentioned above (subject-matter complexity and EU multi-level governance complexity). *Section III* focuses on the effects of the BU on the EBA, looking first at the formal ones (i.e. those deriving from the amendments to the EBA's founding Regulation after the creation of the BU); and then at the 'real-life', practical effects of the BU on almost all of the EBA's tasks and powers. *Section IV* concludes, taking into account the insights from previous sections, and offers preliminary thoughts in light of recent developments that suggest further institutional complexity on the horizon (such as in the areas of anti-money laundering, cryptocurrencies and cybersecurity/digital operational resilience).

2. BU – The background

A fuller historical account of the evolution of the EU institutional framework for the financial sector in light of wider institutional debates has been undertaken elsewhere,[3] so a high-level survey of the different phases of the evolution of that set up will suffice here, as the basis for the ensuing discussion. The table that follows provides an overview of that evolution, which is briefly explained subsequently.

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2 These are age-old debates discussing the trade-offs between different institutional models, building on the combination or separation of monetary policy and banking regulation, banking regulation and supervision, banking supervision and resolution, sectoral or integrated regulation or 'twin peaks' regulation and related debates about functional regulation, 'chinese walls' and questions of independence.

3 See D. Chatzimanoli, *Law and governance in the institutional organisation of EU financial services: The Lamfalussy procedure and the single supervisor revisited* (European University Institute, EUI PhD theses, Department of Law, 2009); Id., *The ESA's Technical Standards: still fit for purpose? A primer and a proposal for reform. The case study of supervisory reporting* (forthcoming).

<table>
<tr><th colspan="4">Table. The evolution of the EU financial sector's institutional framework</th></tr>
<tr><th></th><th>SUBSTANTIVE ASPECTS</th><th>INSTITUTIONAL ASPECTS – EU</th><th>INSTITUTIONAL ASPECTS – FINANCE</th></tr>
<tr><td>Phase 1 –

Early phase</td><td>Regulation: national

+ negative EU-level integration

+ extensive use of directives

Supervision: national</td><td rowspan="2">Pre–Amsterdam Treaty

– Council = sole legislator, deciding via unanimity

– Comitology

– Meroni doctrine (limited EU agencies' powers)

Amsterdam Treaty (1999)

– European Parliament (EP) co-legislator with Council

– Council deciding via Qualified Majority Voting</td><td>Informal 3L3 Committees (CESR, CEBS, CEIOPS) of national authorities as fora for exchanging experiences</td></tr>
<tr><td>Phase 2 –

Lamfalussy (2001)</td><td>Regulation: national

+ start of European positive integration (increasing 'regulation proper')

+ increasing use of Regulations

Supervision: national

+ informal coordination via 3L3 Committees</td><td>– Formal recognition of 3 L3 Committees to assist with harmonisation of supervisory practices (Level 3)

– Commission and private sector to assist with enforcement (Level 4)</td></tr>
<tr><td>Phase 3 –

Lamfalussy + De Larosiere (2009)</td><td>Regulation: as in phase 2

+ further EU harmonisation

+ ESAs drafting TS

Supervision:

– for banking and insurance as in Phase 2, with added EU coordination by the ESAs

– for credit rating agencies and trade repositories in the securities sector, european supervision (by ESMA)</td><td>Lisbon Treaty (2009)

– Increased EP powers

– Delegated and implementing acts

– Limitation of comitology to implementing acts that are not ESA-drafted</td><td>– 3L3 Committees turned into European Supervisory Authorities (ESAs), drafting some of the delegated and implementing acts for the COM (at Level 2) and 'overseeing the supervisors' (at Level 3 – with the exception of ESMA supervisory powers in specific subject – matter areas)</td></tr>
<tr><td>Phase 4 –

De Larosiere + Banking Union (2014)</td><td>Regulation: as in phase 3

Supervision: as in phase 3 except for banking where it is European (SSM) but only for the Eurozone</td><td>As in phase 3</td><td>As in Phase 3

+ Single Supervisory Mechanism

+ Single Resolution Mechanism</td></tr>
</table>

2.1. Before the BU

a. The beginnings

In line with the EU's general approach to gradual integration,[4] during a first phase, EC/EU financial regulation began departing from the fully-national regulation and supervision that characterised the pre-EC/EU era, and started to move towards some initial harmonisation in the form of 'negative integration'. This meant that, from a substantive regulatory viewpoint, the emphasis was on implementing the basic Treaty objectives of removing obstacles in the cross-border provision of financial services. This was done mainly via the extensive use of directives, which rely on national transposition to achieve their objectives, while leaving the means for achieving those objectives to the Member States' discretion. As a result, most of regulation, during this first phase, remained national, with some EC/EU level coordination, while the supervision of the rules remained fully national. In *institutional* terms, the general EC/EU rule-making approach, based on the principle of subsidiarity (already established earlier, but confirmed with Art. 5 of the Treaty of Amsterdam), applied. This was a direct result of the supranational nature of the EU, which meant that harmonisation/europeanisation would take place only where necessary, so that the remaining areas would continue to fall under Member States' competence. Further, where there was actually a need for European-level action, European Court of Justice jurisprudence limited the possibilities of delegating policy decisions to non-elected bodies, such as EU agencies.[5]

Nevertheless, it soon became apparent that such institutional arrangements had led to an extremely long-winded and cumbersome process, especially for a fast-paced sector like finance. Hence on July 17, 2000 the European Council set up a 'Committee of Wise men', known as the Lamfalussy Committee (from the name of the person heading it) entrusting it with the mandate to propose solutions for improving that institutional rulemaking set-up for the finance sector in ways that would render it more efficient, but which would also avoid the need to amend the Treaties.

b. Lamfalussy

The Lamfalussy Committee proposed a, now famous, four-level process.[6] At Level 1 ('L1') of that process were the basic acts, adopted by the legislators. Here the Committee's proposal, from a *substantive* regulation viewpoint, was the

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[4] See among numerous publications: M. Dougan, *Minimum harmonisation and the internal market*, (2000) 37 Common Market Law Review, 853; D. Chatzimanoli, *Law and governance in the institutional organisation of EU financial services*, cit., 48 f. regarding the general EU approach on minimum harmonisation and the use of mutual recognition.

[5] Meroni & Co., Industrie Metallurgiche, SpA v High Authority of the European Coal and Steel Community, Case 9-56.

[6] The Committee of Wise Men (Lamfalussy Committee), *Final Report on the Regulation of European Securities Markets* (2001). It was adopted by the European Council in Stockholm on 23 March 2001, for all sectors.

‘twist’ that these basic acts should only cover basic principles so as to allow for their easier and swifter adoption by the legislators. This would also necessitate, *institutionally*, delegation to the Commission of powers to specify the details of the basic acts in the form of Level 2 (‘L2’) acts with the help of so-called Comitology committees (essentially ‘small versions’ of the Council, in different formations, each competent in a specific subject-matter, and made up of representatives from relevant Member State Ministries[7] – i.e. Ministries of Finance in the context of this paper). It also meant that further details harmonising supervisory practices (as the lattter remained national) would be achieved via soft law (non-binding) measures at Level 3 (‘L3’) of the process. These would be produced by the three pre-existing Committees which, since then, came to be known as ‘3L3’ committees: the Committee of European Securities Regulators (CESR), the Committee of European Banking Supervisors (CEBS) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS). These were informal *fora* of national supervisors that had developed spontaneously in the preceding years as places where to exchange views and experiences. Finally, at Level 4 (‘L4’) the Committee called for enhancing the role of the European Commission and the private sector to assist with the better enforcement of EU financial law.

c. Global financial crisis and de Larosière

The Lamfalussy approach was welcomed as a helpful step in improving EU financial sector processes. Nevertheless, with the advent of the 2007-2008 crisis it was soon made evident that the harmonisation achieved via those ‘softer’ ways of coordination at the EU level, while positive, had its limitations. Hence the mandate attributed to a new Committee of wise persons, chaired by Jacques de Larosière (and being named after him, as well). The de Larosière Committee essentially made two proposals. The first related to aspects of macro-prudential regulation, where it suggested the creation of the European Systemic Risk Board (ESRB), under the auspices of the European Central Bank (ECB),[8] with the proposal that the ESRB would be able to issue recommendations relating to macro-economic risks, which could affect micro-supervision.

The de Larosière Committee’s second proposal related to the micro-supervisory aspects of the system, in particular: it proposed the creation of the European System of Financial Supervision (ESFS), essentially made up of three European Supervisory Authorities (ESAs) that would succeed the previous 3L3 Committees. In terms of *substance*, the report proposed fuller harmonisation via the increased use of fully and directly applicable Regulations at Level 1, with the ESAs having the role of ‘holding the pen’/drafting the L2 Regulations for the European Commission to ultimately adopt them – also in

[7] For a fuller background on Comitology see, among others, H.C.H. Hofmann, G.C. Rowe, A.H. Türk, *Administrative Law and Policy of the European Union* (Oxford University Press, 2011), 264f.

[8] J. de Larosière *et al.*, Report of the high level group on financial supervision in the EU (2009). The report was also adopted by the European Council in its Spring meeting of that same year.

the form of Regulations. The soft harmonisation of supervisory practices would continue, as with the 3L3 committees, with the development of L3 guidelines and recommendations by the ESAs; this would ensure that, despite supervision remaining national,[9] there would be a gradual, increased convergence of supervisory practices over time. Such proposals were consistent with the *wider EU institutional* framework for the functioning of EU agencies, as the three new ESAs would develop only *draft* acts for the European Commission (which the latter would adopt as delegated or implementing Regulations – in the meantime having been made possible with the adoption of the Lisbon Treaty). As a result, the ESAs would avoid taking policy decisions, while in terms of supervision they would only be overseeing national supervisory authorities – both ensuring full consistency with the *Meroni* doctrine. So, while supervision would generally remain national,[10] this approach would allow increasingly strengthened EU-level coordination and the gradual development of the first elements of a europeanised supervisory culture.

At that time, there was some discussion, in literature and in policy, about europeanising supervision for the *whole* of the EU, arguing that it was necessary from a policy viewpoint, and feasible from a legal viewpoint.[11] Ultimately, though, there was no consensus on that approach at the level of the political debate, and, as the saying goes, the rest is history: the EBA became (a nuanced sort) of EU regulator (given its role to only produce *draft* L2 measures) but not an EU supervisor. It would take the ensuing financial crisis and the latter's transformation into a sovereign debt crisis in the EU to reveal the need for further harmonisation, not just in terms of establishing the same substantive rules across the EU, but also in the realm of supervision. In the meantime, the EU law of the agencies had been updated and the *Meroni* doctrine had been softened, clarifying that agencies could be delegated further powers, under strict conditions.[12]

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[9] At least initially. In 2009 ESMA was entrusted with the supervision of Credit Rating Agencies (CRAs) and other such areas have and are being added. The spirit of the De Larosière report in fact envisaged the creation of the ESFS (where the final 'S' stands for 'supervision') as a framework for the increasing Europeanisation of supervision. From a legal viewpoint the compatibility with EU law was essentially based on the principle of subsidiarity, i.e. the suggestion that some objectives can better, or only, be achieved via concerted action at EU level – see 52, point 208 of the de Larosière report. This was further supported by the careful delimitation of the technical areas where such supervisory powers are delegated. This was later confirmed by the *short selling* judgment – see n. 13 below.

[10] With the nuances mentioned above, see n. 9.

[11] See e.g. D. Chatzimanoli, *Law and governance in the institutional organisation of EU financial services*, cit., 295 f.

[12] See Case C-270/12 *UK v European Parliament and Council of the European Union* [2014] ECLI:EU:C:2014:18 (ESMA-short selling), and J. Pelkmans, M. Simoncini, *Mellowing Meroni: How ESMA can help build the single market* (*CEPS*, 18 February 2014).

2.2. *The BU*

a. The rationale for the BU

In its formative years, EU financial regulation had focused on building a single market in financial services (mainly, as already mentioned, by the removal of obstacles to the freedom of cross-border provision of banking services). From a substantive regulatory viewpoint this prioritisation meant putting at the background any harmonising ambitions relating to the framework for handling banking crises and banks' recovery and resolution, which thus continued to remain exclusively national.[13] This approach initially bore fruit: given the benign economic climate of the time, cross-border mergers and acquisitions in the banking sector resulted in increasingly bigger cross-border banking groups, some even bigger, in economic terms, than the countries of their incorporation.[14] Nevertheless, the advent of the crisis brought on the realisation that the EU financial regulation and supervision set up was incomplete.

Seen *from the point of view of the banks' counterparties*, the above-mentioned scenario led to what is known as the 'sovereign loop'. Given that the rules for a bank's 'death' were national, when institutions found themselves in financial difficulties, it meant they had to resort to their national governments for assistance. As a result, the banks' counterparties, with the knowledge that eventually the banks would be saved by their national governments, ended up, in essence, equating the banks' creditworthiness with that of their national governments. Thus, the fate of the banks got inextricably linked to the fate of the public debt of their country of incorporation. This constituted the first element threatening the EU internal market's integrity and risking its fragmentation.

From the point of view of the banks themselves, the above scenario meant more incentives to resort to a soft break-up of their group: despite the mergers and the cross-border expansion they had undertaken, banks were cognizant that they would eventually have to be 'saved' along national lines, in case of difficulties. As a result, they began to organise themselves along those same national lines, including by decreasing cross-border lending within their group and intra-group transactions. This was a second element threatening the 'balkanisation' of the EU financial market, reversing the progress made in the preceding decades.

Finally, *from the point of view of the supervisory authorities involved*, a further third element resulted from the fact that resolution rules were national

13 Also given the sensitivity involved in using taxpayers' money to save ailing banks or insure their deposits, and the objective to retain supervision national (hence the 'saving' of banks should also remain a national competence).

14 See E. Liikanen *et al.*, *High-level Expert Group on reforming the structure of the EU banking sector* (2 October 2012), 40, where EU banks are compared with their US counterparts and are found similar in terms of the ratio of assets to GDP.

in nature. Home supervisors had to take the prudent approach of limiting 'their own' banks from carrying out large activities outside their jurisdiction (even if within a banking group), on the logic that their taxpayers could end up paying to save those banks if they eventually got into trouble. On the flip side, host supervisors considered that they had no control over the foreign banks failing in their territory, despite still being expected to compensate the consumers of those banks in their jurisdictions – hence they had incentives for blocking more of these foreign banks' assets for such purposes within their country. This resulted in a practice by both home and host supervisors known as 'ring-fencing' and, as a consequence of that, in the decreasing trust among supervisory authorities.

b. The institutional outcome

In light of such complexities, the EBA's governance and institutional design, (as with all ESAs) was based on its intergovernmental character, a novelty in EU agency law up to the time of the ESAs' creation,[15] arguably necessary given the sensitive national interests that relate to this sector. In the case of the EBA, in particular, the changing supervisory 'climate' described in the previous section illustrated the limits of this intergovernmental-heavy approach in achieving further integration (in either the area of supervision or that of resolution) – and the EU seemed now in urgent need of such integration. Thus, e.g. 'voluntary' mediation was arguably a very useful tool functioning as a 'carrot' inviting collaboration among competent authorities, and 'compulsory' mediation and breach of Union law investigations were instead functioning as 'sticks'; further, the EBA also had a useful role within colleges of supervisors, coordinating them and thus inciting and urging for increased cooperation and exchange of information among competent authorities; and the EBA also availed of other tools for achieving supervisory convergence. Ultimately, though, all such tools found their limit in the fact that, in the majority of cases, they could only be successful upon the condition of 'voluntary' acquiescence of national competent authorities, they could only be achieved slowly and were also easy to reverse, given their basis on that national authorities' voluntary compliance. This is not to suggest that there was no supranational element present, or that the ESAs and the EBA, in this case, had *no* powers or no successes whatsoever: indeed, a supervisory authority request for mediation renders the procedure binding, and the ESAs can initiate binding mediation on their own initiative. The point being made here instead, in the spirit of the 'law in context' approach, is that in practice such formal legal enabling provisions had (and have) only been used rarely, and that this, although being one of the strengths of the EBA, is also quite

[15] D. Chatzimanoli, *A Crisis of Governance? From Lamfalussy to de Larosière or bridging the gap between Law and new Governance in the EU financial services sector*, (2011) 2 European Journal of Risk Regulation, 322.

revealing in terms of the prevalence of the intergovernmental element.[16] Drawing a parallel with economic analysis of markets, while up to that point the 'regulatory competition market' had functioned freely and spontaneously, there was now increasing evidence of a need for public intervention! This took the form of 'compulsory' harmonisation in the form of europeanising banking supervision in the eurozone.

Obviously, the presence of non-Eurozone member states with strong and influential financial sectors and most notably the United Kingdom (at that time still within the EU), meant that the political will to europeanise supervision found its limits to the Eurozone's geographical scope. It was thus, that focus was placed on the ECB, whose legal status as an EU institution, provided for in the Treaties, was seen as attractive. This was further enhanced by the ECB's role as the EU's independent central bank, as well as its successful track record in the monetary realm. From a formal-legal viewpoint, there was also a 'comforting' enabling clause, a legal basis for carrying out banking supervision, Article 127(6) TFEU, that had laid dormant until that time. As a result, all led to the proposals of basing the BU's supervisory pillar on the ECB. With regard to the resolution arm, no such favourable conditions existed, hence the development of a new authority (the Single Resolution Board, or SRB) to be placed at the centre of the single resolution mechanism (SRM) along with the creation of a Single Resolution Fund (SRF).

Thus, in 2014, the first two pillars of the BU were put in place: with regard to the first pillar, the *supervision of significant institutions* (SIs) was allocated to the SSM arm of the ECB, with the *supervision of less significant institutions* (LSIs) being 'delegated' to the national authorities members of the SSM, albeit with the SSM being the ultimate responsible about their fate, too (see

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[16] One main argument of the weakness of that intergovernmental nature is the need for national supervisory authorities to take hard decisions against their peers in a context of a 'repeat game'. This means that as national supervisors know they could also be potentially subject to their peers' judgement in the future, they would tend to refrain from, for example, agreeing to the ESAs' starting an own initiative mediation, or to each of them separately requesting mediation from the ESAs, or more generally criticising or appropriately disciplining those peers, or at least not to the extent that a separate 'independent' (i.e. non-peer) party would. [That was in essence the logic behind the criticism that the EBA was subject in later years, too, in the context of the non-'condemnation' of the Danish supervisors' weaknesses in terms of the anti-money laundering (AML) supervision of Danske Bank. See for example J. Brunsden, *EBA faces calls to reform after dropping Danske Bank probe*, Financial Times, 28 April 2019]. Despite such limitations, the EBA's institutional design could of course also achieve synergies, *exactly* due to its voluntary/soft nature, even though, sadly, we may never find out all of the details of such EBA achievements e.g. in restoring trust among EU supervisors via mediating among competent authorities, given the requirement to keep those confidential in order for them to be effective. (Indeed, while that confidentiality rule in mediation can be seen as a weakness of the institutional design, it is, at the same time, a precondition for achieving an environment of trust for competent authorities. The EBA's former Chair, Andrea Enria (and by now also former Chair of the SSM), has alluded to many such achievements even at the height of the crisis, which had contributed to the avoidance of the further break-up of the EU single market in his speech *The Single Market after the Banking Union* at the AFME and EBF 'Banking Union in Europe' Conference, Brussels, 18 November 2013.

Article 4(1) and 6(4) to (5) SSM Regulation). Corollaries to the creation of this supervisory pillar of the BU were: the incorporation of the SSM into the ESFS without affecting in principle any of the ESAs (Article 3 SSM Regulation); and the establishment of 'chinese walls' between supervisory and monetary tasks within the ECB (see Article 25(1) to (4) SSM Regulation). In terms of the second pillar, the *resolution* of all credit institutions subject to the SSM supervision was europeanised via a similar mechanism, the SRM;[17] in both of these areas, the EBA retained its role of contributing to the completion of the Single rulebook in the areas of supervision and resolution.

The envisaged development of the *third pillar* of the BU, the creation of a single European Deposit Insurance Scheme (EDIS), is meant to increase resilience against crises as the safety of deposits would be the same across the EU without differences across Member States. Fiscally it is also expected to be useful as risks would be spread 'across the board' and funding would need to be raised over a larger number of firms. According to the proposal made by the Commission in 2015,[18] the idea was that it would be established in 3 stages (covering reinsurance, coinsurance, then full insurance), that it would be supported by a Deposit Insurance Fund (DIF),[19] and that it would be administered by the SRB and participating Deposit Guarantee Schemes (DGSs). Nevertheless, the adoption of the EDIS has been halted, with only some aspects of the related Single rulebook having been or in the course of being harmonised. There are those who argue that it is less useful for the EU to have a common DGS, or that it is not sustainable long-term and therefore not so urgent, to establish – and of course it is turning to be quite controversial given its linkages with fiscal governance.[20]

3. BU – Its effects on the EBA

The approach taken in this article is to start with examining the letter of the law, i.e. the formal amendments effected on the EBA founding Regulation which essentially relate to its governance. But while the formal amendments to the EBA Regulation are the minimum necessary amendments to ensure that the BU is compatible with the rest of the institutional architecture, arguably the full view of the real dynamics unfolds in the daily practice of the law, which might reveal unexplored, unplanned and unexpected patterns. With that in mind, and in the

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17 According to C.V. Gortsos, *Towards a "European banking union: the European Commission's proposal on the creation of a 'single resolution mechanism' in the banking sector*, ECEFIL Working Paper Series 2012/6, 46, this was necessary because the SRM mechanism is a more complicated case as it is also made up of the SRB and the SRF, whose nature is intergovernmental.

18 European Commission, Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme, COM(2015) 586 final.

19 *Ibidem*, 51.

20 *Ibidem*.

spirit of applying a 'law in context'/'law in practice' approach,[21] the article then proceeds to look at some 'real-life' de facto effects which become evident when one looks at how the EBA has been carrying out its tasks and using its powers in practice, so far, during its co-existence with the BU. To note that the analysis in this paper focuses on the supervisory pillar of the BU, both due to space limitations, but also arguably as it has the 'lion's share' in the EU landscape.

3.1. Formal Amendments to the EBA governance

The formal analysis of the effects of the creation of the BU *supervision* pillar on the EBA, involves the following legal texts: Regulation 1024/2013 (SSM Regulation, or SSMR); Regulation 468/2014 (SSM Framework Regulation, or SSMFR); and Regulation 1022/2013 (the EBA Amending Regulation). It should be noted that the EBA founding Regulation has undergone several amendments as part of the regular, tri-annual, review required by its own Article 81(1) (similarly for its sister authorities ESMA and EIOPA – hence this is colloquially referred to as 'the ESAs review'). As such, not all changes included in the above-mentioned amendment of the EBA Regulation are necessarily related to or caused by the BU, and therefore they will not constitute the focus of the analysis here.[22]

Seen through this 'filter', the EBA Regulation amendments do not appear to be as numerous. This is not surprising, given that the BU affects mainly the NCAs' position and status, as it is *these* national powers which became europeanised with the creation of the BU. Thus, from the point of view of the EBA, its relation with the SSM is, in nature, similar to the one it has with any other supervisory authority – the main difference being the wider (supra-national) extent of the ECB's jurisdiction, albeit limited to the Eurozone. Further, by looking more closely at these formal changes to the EBA governance, it becomes apparent that some of them are a rather 'automatic' reflection of the institutional design decision that the BU represents, as was explained in the previous sections and they require no further explanation. These include amendments like those relating to Article 2(2)(f) and 4(2)(j) of EBA Regulation which makes sure that the definition of 'competent authority' includes the ECB in relation to the supervisory tasks that have been conferred to it.

The focus here is therefore on the EBA Regulation amendments that affect the EBA and its governance in a 'core' manner. Those comprise two categories of amendments: firstly, those that derive from the fact that a new EU-level supervisory authority with geographical competence encompassing the whole of the Eurozone was established and became part of the ESFS; secondly, those

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21 For some general background on the 'law in context approach' see R. Cotterrell, *Subverting Orthodoxy, Making Law Central: A View of Sociolegal Studies*, (2022) 29 Journal of Law and Society 4, 632-644.

22 Of course, the distinction between changes caused by the BU and others is merely a heuristic distinction to assist with our analysis – hence some of those amendments may be indicative of other indirect effects on the EBA's tasks and powers, and therefore are considered again later, as they could relate to the BU or could be BU-inspired, where they can affect institutional 'checks and balances'.

amendments that provide for flexibility so that the institutional framework can be reviewed. These two categories of amendments are examined in sections a and b below, respectively.

a. A Eurozone-wide supervisory authority

i. ECB participation in the BoS – Article 40 EBA Regulation

Amendments to Article 40 of the EBA Regulation relate to the ECB participation in the EBA Board of Supervisors (BoS), the EBA's highest decision-making body and the equivalent of a 'general assembly' or a 'plenary' of all representatives from national supervisory authorities (its tasks are laid out in more detail in Article 43 EBA Regulation). First of those amendments is that relating to Article 40(1)(d) EBA Regulation: this provides for an SSM representative in the EBA BoS, albeit without any voting power; and a non-SSM ('ECB proper') representative but only in relation to discussions that do not relate to specific financial institutions. With regard to the former, it is only natural that a representative of that new EU-level authority is also present in the EBA BoS but it is also natural that they should not have a vote, given the overlap of the SSM membership partially with the EBA BoS membership, i.e. that the SSM constituent national supervisory authorities are also members of the EBA BoS with their own voting powers. On the other hand, the presence of the 'ECB proper' representative, i.e. a non-SSM representative of the ECB in the EBA BoS, also makes sense. In essence it is a continuation of the pre-BU set up where the ECB was participating already in the EBA BoS work given its expertise as a central bank; the additional condition that it can participate only in BoS work that does not relate to specific institutions is further justified by the need to respect the 'chinese walls' between the ECB's monetary and supervisory tasks; it is also consistent with the division between regulation and supervision, more generally, which is reflected in the more general rule that non-voting members and observers shall not be allowed to attend the BoS discussions relating to individual financial institutions (set out in Article 44(4) EBA Regulation).

ii. BoS voting modalities (double majority) – Article 44 EBA Regulation

This is the most prominent amendment of the EBA governance caused by the BU. It relates to the overhaul of the EBA's BoS voting modalities to ensure that there will not be any 'soft coordination' of competent authorities participating in the SSM in the context of the EBA work. This becomes clearer by 'borrowing' a metaphor often used in the financial markets, where reference is made to individuals or companies with enough financial power to influence the price of stocks, as 'whales'.[23] Transposing this concept to the regulatory context would suggest that, if the 'whale' of the ECB were to move within

[23] See e.g. Medium, *Understanding Whales, Bulls and Bears* (31 October 2018) or Annie Z, *What is a Whale in Stocks? Unveiling 4 Stock-Picking Secrets of Whales*, Finance Futurists, 25 November 2021.

the rather small overall regulatory ‘pond’ of the EU (with only a few small ‘fish’, the non-SSM jurisdictions, surrounding the whale) it could cause that pond to move, along with its other inhabitants, in the direction of the whale’s movement.

In order to avoid (or at least arguably only mitigate) such effects on the internal market, and to preserve the latter’s integrity, the solution found was to suggest, via an amendment to Article 44 EBA Regulation that, ‘on top’ of the previously established voting modalities for the BoS as a whole (i.e. depending on their importance, the achievement of either qualified majority voting or simplified majority voting), there should also be separate simple majorities in each of the two constituencies of authorities: the ones participating in the SSM (the ‘ins’) and the ones that do not (the ‘outs’). This is known as the ‘double majority’ requirement and has been extensively discussed by academics and practitioners alike,[24] hence its treatment here will be limited to the summary of the issues and concerns that it raises. These most notably imply that the EBA decision-making can more easily ‘fall hostage’ to small blocking minorities, thereby becoming inefficient and slow. This strong inter-governmentally-led character of the ESAs was already present in the original design of the EBA.[25] The new arrangements brought on by the BU, though, i.e. the double-majority voting, exacerbate such difficulties,[26] given that it is that inter-governmental nature which allows a few (mostly small) non-SSM participating countries to create a blocking minority for the achievement of a majority among the ‘outs’, since these ‘outs’ are few, compared to the ‘ins’.

iii. Management Board composition – Article 45(1) 1st subparagraph EBA Regulation

The amendment of Article 45(1) third subparagraph of the EBA Regulation is the third of these more ‘direct’ amendments affecting the EBA governance; it relates to the amendment in the governance of the other main organ of the EBA, its Management Board, which functions as its ‘executive’ body and has the tasks and functions set out in Article 47 EBA Regulation. This amendment seeks to somehow again safeguard against the same concerns that inspired the double majority in the context of the BoS. Here, though, given the composition of the Management Board (made up of the EBA Chairperson and six BoS members), it was chosen to establish the requirement of a minimum number of two representatives of non-participating Member States as a ‘rough proxy’ of their representation in the BoS. Indeed, back in 2014 (and earlier, when the SSRM was

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24 N. Moloney, *European Banking Union: Assessing its risks and resilience*, (2014) 51 Common Market Law Review, 1609; E. Ferrán, *European Banking Union*, cit.; S. Cappiello, *The EBA and the Banking Union*, (2015) 16 European Business Organization Law Review, 421.

25 As was explained earlier under Section 2.2, b. The institutional outcome.

26 S. Cappiello, *The EBA and the Banking Union*, cit. and N. Moloney, *European Banking Union*, cit., who analyse this aspect in more detail and who identify a conflict with the requirement of Article 42 ESA regulations that Board of Supervisor (BoS) members shall not seat in that body in their capacity as representatives of national authorities and related interests.

being developed, i.e. in the pre-Brexit era), the non-participating Member States were 9 out of a total of 28, which would equate to a 32.14 percentage – almost the same percentage as the 2 out of a total of 6 voting Management Board members equates to (which is almost 33%).

b. Review clauses

A second group of amendments is constituted by those that are a direct result of the BU, without affecting the EBA governance *yet*, but which instead provide for the possibility to review the EBA governance in the future: these are the amendment to Article 81(3) EBA Regulation providing for the possibility to entrust the EBA with further supervisory responsibilities in the future; and the insertion of the new Article 81a providing for the review of the BoS voting arrangements in Articles 41 and 44 EBA Regulation at a future time, if it happens that the non-participating Member States' number is diminished to four.

The former of those provisions leaves open the possibility for assigning the EBA more supervisory responsibilities in the areas of its scope of action more in general – arguably this should not be taken as necessarily implying a big overhaul of the interaction and/or allocation of competences between the EBA and the SSM, especially given the references also to 'infrastructures of pan-European reach' and the 'stability of the *internal market* and the cohesion of the Union *as a whole*' (my emphasis), which serve as reminder that europeanisation of supervision is currently happening only within the Eurozone (with the exception of the Markets in Crypto Assets Regulation or MiCA, for which see more below).

The latter of those articles serves as a flexibility valve for the potential updating of the voting mechanisms in the BoS, as the Eurozone eventually expands (as it is hoped and envisaged). The points to note in this regard are: firstly, that this eventuality is getting increasingly close following Brexit and given the announced adoption of the Euro by more Member States[27] (which is also provided for in their accession treaties). Secondly, this article merely provides for a Commission review and analysis of the situation, in the first place, which suggests a chronologically subsequent development of legislative proposals for the adoption of any changes to those voting arrangements; this would imply a longer time gap between the diminishing number of non-participating countries and the effective date of a new voting mechanism for the EBA.

Finally, it is to be noted that reference is made to the voting arrangements described in Articles 41 and 44 EBA Regulation, i.e. with regard to the BoS governance, while no explicit mention is made to Article 45 and the EBA's Management Board governance – arguably the European Commission's analysis during its review, would 'pick up' on this discrepancy and would cover it in its legislative proposals, as well.

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[27] These currently include Bulgaria, Czechia, Hungary, Poland, Romania, and Sweden. See the European Commission's Convergence Report, Institutional Paper 294, June 2024.

3.2. Indirect effects on EBA tasks and powers

Further to the formal changes affecting the EBA governance, this Section takes a look at how the advent of the BU has so far influenced *in practice* the discharge of the EBA's tasks and powers. To continue with the metaphor used earlier, that of the whale in a pond, the idea would be to explore in what other ways the whale can affect the life of the pond, even if, and after the movements of the whale have been 'regulated' to take into account the movement of the other animals in the pond. In such a regulatory pond, could such a whale's slower, imperceptible (even for it) movements, while appearing small and unrelated, lead to alternative ways in which the whale dominates the life of the pond?

In order to assist with this analysis, another heuristic classification, that distinguishing the agencies' tasks into 'quasi-regulatory', 'quasi-executive' and 'quasi-adjudicative' (inspired from the classical distinction of political power into legislative, executive and judicial) is employed here.[28]

a. Quasi-adjudicative tasks

Starting with the 'quasi-adjudicative' tasks of the EBA, i.e. those involving the EBA's tasks under Article 17 (breach of Union law – BUL), Article 18 (emergency situations) and Article 19 (resolution of disagreements among competent authorities – mediation[29]), there are special provisions in Article 44(1) fourth and fifth subparagraph EBA Regulation. Article 44(1) fourth subparagraph sets out the rules for deciding the composition of the panels to be established for the BUL and mediation procedures (as well as for the specific recommendations of Article 22(4) around systemic risk, and the peer review panels of Article 30): consensus or, in its absence, three quarters majority of all BoS members. The actual BoS decision-making for those cases is envisaged to be via a written 'non-objection' procedure, set out in Articles 44(3a) and (3b) – provisions inserted with the latest updates of the EBA Regulation in 2019. These provide, respectively, that the peer review panel's proposal is adopted unless a simple majority of all voting members objects; and for BUL and mediation, that the panel's decisions are adopted unless simple majorities from either the 'ins' or the 'outs' object. Compared to those, for emergency situations (where no panels are envisaged), Article 44(1) fifth subparagraph instead provides that the BoS decides based on a simple majority of its voting members, which includes a simple majority of the BU 'ins' and a simple majority of the 'outs'. So essentially, the double majority rule

[28] See D. Chatzimanoli, *Law and governance in the institutional organisation of EU financial services*, cit., 195 f. explaining the background for this heuristic in the historical roots of agencies, the inspiration for which is to be found in the US independent administrative agencies (which were really independent and therefore also considered to have all three types of powers in their specific ratione materiae scope of action). To be sure, this is more a continuum rather than a tripartite classification as such, hence it would be possible for some of these comments to be considered under different headings; the ones in which they appear in this paper reflect only one possible approach in their examination.

[29] This is often colloquially referred to as 'mediation' in the supervisory community, even though this is inaccurate from a legal perspective (as in mediation there is no 'authoritative' decision of the mediator that binds the parties, which is the case in arbitration instead).

is only applicable with regard to the relevant preparatory panels only with regard to peer reviews (and there it's a *simple* overall majority that is combined with the double majority of the 'ins' and 'outs'); while with regard to BoS final decisions, the double majorities (combined with an overall *simple* majority of all members) apply only with regard to Article 18 EBA decisions relating to emergency situations and, via the 'non-objection' procedure, to peer review decisions under Article 30, but not for the rest (decisions under Articles 17, 19 or 22(4)).

A potential explanation for these deviations from the overall considerations relating to the 'whale moving the pond' could be found in the manner in which the corresponding provisions are expected to be run, in accordance with Article 41, paragraphs 2 and 3, respectively relating to BUL and disagreements among competent authorities. These two provisions set out rules about participation in the relevant panels of potentially conflicted parties, so one could expect that if an 'in' country was involved in either a BUL or a disagreement, then that country, but also the SSM, would probably be prohibited from participating in the panel as they would have 'an interest in the matter' or 'direct links'. But even with that 'comfort' in place (and the increased 3/4 majority as default option for adopting the related panels), still the ultimate decision-making within the BoS in these two areas remains under the 'default' simple majority of the BoS members.

Further, the BU institutional design which includes, within the SSM, an Administrative Board of Review (Article 24 of the SSM Regulation) implies that the role of the EBA is expected to diminish in relation to at least Articles 17 and 19 EBA Regulation, even if only due to the fact that intra-Eurozone disagreements or breaches of law would be expected to be resolved within the SSM as a 'first line of defence'; as a result, one would expect that the EBA's involvement would be pushed to the 'margins' of the Eurozone, mainly where disagreements arise between 'ins' and 'outs' or where there are disagreements between EU Member States on the one hand, and EEA/EFTA authorities, on the other.

Finally, the 'bigness' of the SSM and its particular status would also create *de facto* difficulties for the carrying out of the EBA's tasks under these Articles in general (and with the particularities explained above relating to Articles 17 and 19). One can only assume that it would 'take a lot' practically, 'psychologically' and behaviourally for the EBA to launch a BUL investigation procedure targeted at the SSM/ECB.

b. Quasi-Regulatory tasks

With regard to the quasi-regulatory tasks of the EBA (covered by Articles 10-16 EBA Regulation), on the face of it, the creation of the BU was irrelevant to them, as the BU did not alter the institutional landscape vis-a-vis EU level rule making.[30] Arguably, though, some tensions persist, which are mostly related to the general role of the ECB, rather than its specific arm for banking supervision,

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30 S. Cappiello, *The EBA and the Banking Union*, cit. also makes a similar point and indeed clarifying how there is no real overlap between the tasks of EBA and the ECB but rather complementarity.

the SSM, but which are suggested here as indirect indications of how the SSM further adds to the ECB's 'footprint' as an institution, and *de facto* tilts the balance even more unevenly than is already the case in favour of the weight of an EU institution, prescribed in the Treaties, versus an EU agency. What follows are selected areas illustrating the potential for such tensions.

i. ECB opinions on L1 text

In formal terms, due to the role of the ECB and its privileged position in the Treaties, it also has the power to issue Opinions adopted pursuant to Article 127(4) TFEU and thus influence the direction of basic acts in the areas of finance. Of course, this is not a formal change, effected as a result of the BU, as it indeed precedes the BU, i.e. this was a power that the ECB always availed; further, it is accompanied by the structural independence of the SSM which separates it formally from the monetary role of the ECB. Nevertheless, it is to be wondered whether that privileged position of the ECB takes on a different colour when seen in the light of monetary competences being combined with banking supervisory ones within its one 'single roof' following the assumption by the ECB of the BU competences.

Similar considerations could apply *mutatis mutandis* to the other 'hat' of the ECB, that of providing the secretariat to the macro-prudential pillar of the de Larosière proposals, the ESRB. While *its* powers are equally soft (if not softer) in nature as it can only issue recommendations, it is nevertheless probable that, on the basis of the areas in which it can (and has been active), it can exert considerable 'real-life' pressure on the EBA (and the other ESAs).[31]

ii. 'Bigness' prevailing over double-majority voting

A different but related aspect results from the fact that, despite the double majority analysed in the previous Section, the ECB/SSM can be a huge influence on the EBA's regulatory output, given the nature of the ECB and its 'bigness'. Hard evidence might be equally hard to find about such type of effects (and it is rather in the realm of political science to explore this further), but even from a purely 'anecdotal' viewpoint, and again in light of wider contextual understanding of the law, it would not be an extraordinary claim to suggest that the mere 'rumour' of the SSM being opposed to a certain regulatory approach could sway representatives of supervisory authorities under its realm away from even raising the topic 'on the EBA table', irrespective of whether it relates to significant or less significant institutions (given the SSM's powers also in the latter context).[32]

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31 The more recent example of topics that the ESRB recommendations can cover is Recommendation of 2 December 2021 on a pan-European systemic cyber incident coordination framework for relevant authorities (calling essentially for the 'front-loading' of the creation of a system for cyber incident reporting for the financial sector in the EU, ahead of its formal adoption and entry into force of the digital operational resilience act, known as DORA, which provides for a similar mechanism. See below n. 48, Article 49).

32 See Council Regulation (EU) No. 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (SSM Regulation) [2013] OJ L 287/63, Article 4(1).

When it comes to the EBA, while, again, difficult to prove (given it requires analysis of subjective mindsets), one cannot easily discount the operational difficulties where the SSM exhibits particular sensitivity for specific topics: in those cases the EBA staff is arguably called to tread a fine line between retaining (and demonstrating) their independence while, on the flipside, avoiding the risk of delaying or derailing an already long-winded regulatory process, which might result from ignoring such dynamics. Even without such a potential psychological factor at play, the SSM views can represent a major influence on the EBA's regulatory output, based on genuine other ways of influencing the EBA's regulatory work, such as via input provided to the cost-benefit/impact assessment analysis of the EBA's envisaged actions, or to discussions of borderline legal mandates relating to the EBA's products and their scope of action. This can be particularly so in areas of EBA soft regulatory instruments (mainly guidelines and recommendations) where the EBA's discretion is greater than in the case of developing draft technical standards. In the case of soft instruments, where less formal procedures are applicable, with less interaction, for example, with the European Commission (other than in its role as observer in the EBA work), the potential for that informal influence on the EBA's work increases. Such influence is further made possible given the wider supervisory, legal and data resource pool available to the SSM, compared to the other, national, supervisors as well as the EBA (explored in the next Section). Where no hard opposition from non-participating countries is at play, arguably this type of SSM *de facto* influence can take bigger dimensions.

iii. Compliance with EBA soft law

But there is a flipside to the 'bigness' when it comes to EBA soft regulatory law and the obligation, in the case of guidelines and recommendations under Article 16 EBA Regulation, for supervisory authorities to comply or, in the case of non-compliance, explain the reasons for their non-compliance. Some apprehension was originally attached to the legal awkwardness resulting from the fact that an institution such as the ECB, whose existence is recognised in the Treaties, would be obliged to justify its reasons towards an EU agency, developed by way of secondary EU legislation.[33] It appears, though, that 'law in action' caused a different train of events to enter in motion: the ECB in practice has acquiesced to such procedure,[34] taking it extremely seriously. This is illustrated by its own dedicated webpage, mapping out its compliance with such soft regulatory products of the EBA.[35] One explanation for this is arguably to be found in the increasing realisation of the potential for synergies with the

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33 See N. Moloney, *European Banking Union*, cit., for a more extended discussion.

34 See also Opinion of the European Central Bank of 27 November 2012 on a proposal for a Council regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions and a proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No. 1093/2010 establishing a European Supervisory Authority (European Banking Authority) [2013] OJ C 30/6, section 3, 9.

35 European Central Bank, Compliance with EBA guidelines and recommendations.

EBA in achieving regulatory harmonisation in the EU and thereby ease the harmonisation process further, also for the SSM in the supervisory realm. This is in fact a great incentive for the ECB to comply with EBA soft law, especially as, in its supervisory function, it has to apply both EU as well as national law, given the related options and national discretions, which remain numerous in the EU basic sectoral acts.[36]

c. Quasi-Executive tasks

With regard to the EBA's quasi-executive tasks, again on the face of it the BU brought no real effect on the EBA, given that the EBA never had supervisory powers. Nevertheless, as EBA's main role in relation to supervision is 'to supervise the supervisors', when one of the supervisors it oversees is such a large one, it leads us back to the original issue of the 'whale in the pond'. As the quasi-executive tasks do not relate to developing draft technical standards, those quasi-executive tasks are adopted via simple majority of all BoS members, hence such 'bigness' takes on an additional dimension.[37]

i. 'Bigness'

A first point resulting from the ECB 'bigness' are the *differences in resources* for the ECB and EBA. As the ECB is a larger, older and more 'established' organisation than the EBA, it is only natural that it has more resources to apply to its 'regulatory competition' with the EBA, thus raising the chances that it will 'prejudice' the outcome of formally purely EBA-owned procedures. When 'resources' are considered in their financial dimension, the issue does not relate only to the size of the resources available to the ECB; it also relates to the ways in which it can receive those resources in the first place: given its independence and its institutional status in the EU, it is easier and faster for the ECB to tap into more resources when needed than the EBA, which depends on the European Commission's budgetary proposals and longer EU institutional approvals.

The resources discussion has a second dimension: that of *human* resources, which calls for some additional observations. Firstly, from a formal viewpoint, the ECB can *require* NCAs' assistance even in areas of its exclusive competence; in the EBA context, despite the EBA's pedigree as CEBS and its collegiate

36 For more details on the difficulties this poses for the SSM, see G. Bassani, *The legal framework applicable to the single supervisory mechanism: tapestry or patchwork?* (Wolters Kluwer, 2019). At this point it is interesting to compare the situation with the SRB: as that is an EU agency, similarly to the EBA, one would expect even less issues with their compliance towards EBA soft law. A quick survey of the compliance tables of the EBA Guidelines and recommendations in the area of resolution, though, suggests at best some inconsistency in the SRB's practice in reporting compliance or otherwise see 'Summary of compliance notifications' table which can be found on the EBA's website. While very plausible explanations (such as bureaucratic inefficiencies and/or limited resources) could be behind such a poor record, it is in any case interesting to note, at a more general level, that provisions in the ESAs Regulations previously requiring them to provide annual accounts of non-compliant authorities have unhelpfully been removed following the latest round of the ESAs review.

37 It remains to be seen (and this might be helpful to add to political science research agendas) whether in practice national competent authorities (NCAs) acquiesce to SSM views easily.

approach to rely on voluntarily contribution of assistance, there is no structural obligation as in the SSM context. From a less formal viewpoint, the creation of the BU meant the creation of additional competition for the EBA for the expertise that lies in the market/industry and the ESFS, also given the apparent greater/better contractual arrangements that the ECB can apply vis-a-vis the EU Staff regulations regime. Arguably, the ECB's independence also allows more flexibility in the organisation of the details of such a collaboration. On the other hand, there is anecdotal evidence that ECB and EBA exchange of staff has been on the rise, allowing both a cross-fertilisation and exchange of ideas as well as chances for professional development and motivation from getting a rounded experience. Nevertheless, any remaining 'risk of defections' would seem to burden the EBA more than the ECB, especially given the ECB is a larger organisation and with more prospects for career advancement, particularly so with regards to the more senior members of staff.

Finally, arguably there is also a concern of the wider 'weight' of the ECB on the work of the EBA, especially with regard to specific subject-matter areas that are related in particular to the ECB's role with its monetary 'hat' on, where *data* resources and access are crucial. Among the different examples one could cite, a telling one in that respect is arguably the case of supervisory reporting. One of the largest pieces of regulatory work of the EBA, on which it was been working rigorously since its establishment, relates to the development of a series of interrelated draft Implementing Technical Standards (ITS) on the supervisory reporting and market disclosure of firms. Despite that, in 2015 the ECB issued its own 'European Reporting framework' (ERF)[38] whose nomenclature itself competed for attention within the European setting (and confusing from an EU legislative drafting point of view, given its scope was only Eurozone-wide, rather than EU-wide). That ECB-developed framework also benefited from the ECB's increased pecuniary, human and data resources and managed to develop first updated validation rules for the EBA's ITS reporting and disclosures. This, on the one hand, helped advance the work of the EBA, but it obviously, on the other hand, can also be the source of *de facto* pressure on the EBA to 'accept' such preliminary ECB work as 'a given', on the basis of the expertise involved in its preparation, its linkages with the monetary policy-related reporting as well as the need to avoid duplication of work and limit unnecessary burden to the industry.

ii. Supervisory handbook

An interesting area in the EBA's 'quasi-executive' powers is its task, as per Article 8(1)(aa) and Article 29(2) of EBA Regulation, to develop supervisory (and resolution) handbooks – in reality representing a point in the spectrum between its quasi-regulatory and quasi-supervisory/executive powers. The original logic and rationale behind such supervisory handbooks was the practical objective to

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38 The EFR (for which see for more information here: European Central Bank, *European Reporting Framework (ERF): key facts and information* (2015)) was replaced by the Integrated Reporting Framework (IRef), based on the Banks' Integrated Reporting Dictionary (BIRD).

contribute to a vision where all supervisors around the EU would carry out their supervisory assessments based along the same thought process in order to reach their supervisory judgement according to similar supervisory methodologies and philosophies.

While the development of such rulebooks was not meant as yet another layer of formal legal tool to add to the already complicated layers of rules on banking regulation and supervision, in the latest versions of the relevant provisions of the ESA Regulations (and therefore also the EBA's), this tool has taken on a 'hardened' character, illustrated by the added specifications of the proportionality requirements such rulebooks are subject to or the explicit additional procedural safeguards for consultation 'where appropriate' in relation to those rulebooks.[39] Such a development can arguably be considered as relating to – and explained by – the creation of the BU. It could be seen as a potential counterbalancing measure against the BU's powers to issue its own 'internal policies' by ensuring some overall discipline and 'deference' by the SSM to EU-wide harmonisation of supervisory practices – especially given the difficulty to *really* neatly distinguish 'regulation proper' from 'supervision'.

But synergies should ideally also be sought to be explored here too. Indeed, if the power assigned to the EBA to develop a supervisory handbook is to be meaningful at all, it is expected that the ECB will have a big role to play in the development of the supervisory handbook within the auspices of the EBA, allowing for better 'regulatory learning' and dialogue with non-SSM participating supervisory authorities in the European Economic Area.

iii. Other areas

Other parts of the EBA's 'quasi-executive' powers include its coordinating role in relation to the carrying out of stress test exercises in the EU, or to the development of economic analyses of the market, or also to its role regarding supervisory colleges, or the external dimension of regulation and supervision. In these areas again, no formal governance changes resulted from the creation of the BU.

In relation to *stress tests*, the ECB's role has always been crucial in co-developing the scenarios for the test with the EBA. Similarly for the colleges and risk/economic analyses work of the EBA. But again, at a closer look, and with an emphasis on the real interplay of real-world institutional balances, some nuances to the EBA role can be expected as a result of the BU. Thus, for example, the additional influence of the SSM as a supervisor in the stress test discussions; or the EBA's diminished scope of coordination of eurozone-only banking groups,

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[39] Of course, in relation to both the requirement of proportionality, as well as the obligation to consult 'where appropriate', an argument could be made that they did not need to be explicitly mentioned as they are derived from the general principles of EU law and the wider legal framework for the functioning of EU agencies. Their explicit mention, though, seems to confirm the view of a 'hardened' expected nature of such rulebooks.

where EBA colleges got replaced, essentially, by the Joint Supervisory Teams (JSTs) made up of the relevant national competent authorities.

The *risk/economic analyses* aspect perhaps deserves a slightly closer examination, as it relates to the potential role of the EBA as data hub for the EU financial sector. In the history of EU agencies, and in light of the specific institutional limitations for them in the EU context, explained in earlier parts of this article, their role as 'data hubs' was one of the first ever rationales for their creation, aiming at these 'softer' ways of contributing to EU harmonisation.[40] With the ever-increasing relevance of data availability, in a world of higher computational capacity for the handling, analysis and use of that data, the question of who can require supervisory data, who owns it and how this data is shared and used in an interoperable manner around the Union for the benefit of the single market has already been increasing in prominence and will continue to do so.

Indicative of that tendency are the recent discussions that the European Commission began with its data strategy in December 2021[41] and its objective to achieve an integrated reporting for the EU (covering all of supervisory, resolution and statistical reporting). The EBA has already been contributing its views in terms of limiting the cost of compliance with supervisory reporting[42] and also via its feasibility study for how such an integrated reporting might be achieved.[43]

This is an area where the EBA-ECB interplay might become more prominent in the future, taking into account also the need to encompass reporting relating to the ECB's main, monetary role. The legislators' mandate to the EBA to carry out that feasibility study and the Commission's data strategy, seem to suggest that there is a need to achieve greater efficiency in the EU financial sector across different types of reporting, so as to ensure the 'define once, report once' – and that includes not just prudential and resolution reporting but also its overlap with the statistical reporting that the ECB collects and uses under its monetary tasks. It remains to be seen how the Commission will achieve its data strategy there: while it can propose Level 1 legislative proposals guiding/obliging the ESAs to rationalise their reporting (which is already underway), there are more difficulties with taking a similar approach vis-a-vis the ECB: its mandate for statistical reporting is based on a different legal basis;[44] it has a longer tradition than the supervisory reporting; and it relates to the ECB's monetary role involving different constituencies of national authorities collecting that information including statistical institutes.

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40 See among many M. Everson, E. Vos, *European Agencies: What about the Institutional Balance?*, (2014) Maastricht Faculty of Law Working Papers No. 4, 6.

41 European Commission, Strategy on supervisory data in EU financial services (Communication), COM(2021) 798 final.

42 European Banking Authority, *Study of the cost of compliance with supervisory reporting requirements* (EBA/Rep/2021/15, 2021).

43 European Banking Authority, *EBA's view of a feasible integrated reporting system* (2021).

44 Council Regulation (EC) No. 2533/98 of 23 November 1998 concerning the collection of statistical information by the European Central Bank [1998] OJ L 318/8.

The question arises whether the European Commission will seek to use a wider legal basis to require the ECB to comply with the EU public interest necessitating a higher degree of cooperation with not just the EBA but indeed also the other ESAs. Of course, the ECB's exclusive competence to set the monetary policy is safeguarded in the Treaties, and as a result of that, the ECB retains the privilege to set out its reporting needs in order to carry out this monetary task; arguably, though, it should be possible to ensure some 'co-ordination' or 'reconciliation' of such statistical reporting with other reporting requirements in the Union.[45] This would ensure economies of scale and cost savings for the European banking industry.

Finally, the quasi-executive tasks and role of the EBA can be seen as affected by the BU also in terms of external relations, given the ECB's increased relevance, following the establishment of the BU, in international supervisory *fora*.[46] This constitutes yet another expression of the effects of 'bigness' discussed in previous sections. And, again, while some of these aspects relate to the ECB, and not its supervisory arm the SSM, it is rather the combined SSM-ECB status that is at play here, rather than a purely 'BU'-induced change in the institutional balance.

4. Conclusions

Following a decade since the creation of the first pieces of the puzzle that sometimes appears to be the BU, during which the focus has been largely on reviewing the BU from a substantive banking regulatory viewpoint, this article has aimed to contribute to that other part of the literature that looks at the wider institutional design and which seeks to examine the effects of the creation of the BU on the functioning and the role of the EBA.

The article examined this question from both a formal/legal approach (with a view to taking a more classical, 'law in books' approach), as well as from a more practical 'law in context' approach, that seeks to unveil underlying institutional dynamics in the real-life application of the rules. From the formal point of view, potential inefficiencies in the functioning of the EBA had been identified from the genesis of the BU project: essentially longer and more cumbersome decision-making procedures, where small blocking minorities could end up influencing decision-making in controversial areas. From the more practical viewpoint, the analysis revealed some further 'real-world' effects on

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45 Arguably the ECB could 'coordinate' better the statistical reporting it requires by considering other types of reporting during its impact assessment of the reporting needs. And, subsequently, in practice, such 'coordination' could be achieved e.g. via developing commonly agreed data dictionaries for supervisory, resolution and statistical reporting so that data is 'defined once' – while, ideally (at least in the future) data could also just be reported once.

46 As well as regulatory ones – indeed, in the *continuum* of the different types of EBA tasks, this external dimension could also be explored under the 'quasi-regulatory' heading, having in mind the ECB's international regulatory 'dialogues' with US authorities and more recently with a 'new' but 'familiar' counterpart: the Bank of England; it should also be noted that the ECB also has an observer role in the Basel Committee for Banking Supervision (BCBS).

the EBA's functions and tasks and wider 'competitive' institutional tensions between the EBA and the ECB. In summary, it would be fair to suggest that the effects of the BU on the EBA have been (and are expected to continue to be) quite profound and multi-faceted in nature, even though not always in obvious ways. This realisation, combined with the provision of Article 81a EBA Regulation that requires a revision of the BU when the number of non-participating states reaches four, and the wider 'power imbalance' between the ECB and the EBA could create doubts about the EBA's continuing relevance.[47]

Nevertheless, in this author's view, there are also multiple reasons for which it is expected that the EBA will retain its relevance in the EU financial architecture as the 'glue' binding together different pieces of the EU multi-level governance (given the latter's complexity tending to exacerbate the already difficult regulatory institutional dilemmas present in the financial regulation realm). This is not just because the BU itself is still incomplete and the EBA is contributing to its completion by using its quasi-regulatory role to harmonise the underlying substantive law, including on deposit guarantee schemes. The complexity of the institutional framework should be further and carefully examined. For one, it remains to be seen whether, how and when the eurozone (EZ) will expand enough to coincide with the EU single market. Even if/when it does, a natural limit will be represented by the EFTA countries participating in the EEA market whose nature as non-Member States of the EU means they have not transferred any sovereignty to the EU, and hence cannot constitutionally acquiesce to the supervision of institutions in their territory by an EU institution without effecting a constitutional change domestically.

But it appears that there will also be other dynamics at play; the ever-increasing regulatory complexity unfolding in recent years is already giving indications of those dynamics. This is illustrated by a multiplicity of new pieces of legislation in the EU in the areas of anti-money laundering/countering the financing of terrorism (AML/CFT), digital operational resilience (with the Digital Operational Resilience Act – DORA[48]), crypto-assets (with the Markets in Crypto-assets Regulation – MiCA[49]), sustainable finance; and other longer-term plans such as the Commission's strategy on integrated reporting in the EU. These suggest increasing inter-connectedness of regulatory subject-matter with difficult trade-offs among regulatory objectives that render regulatory design choices even more challenging: achieving a balance between financial stability and prudential soundness while enabling and facilitating precious innovation for

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47 For example, see E. Ferrán, *The Existential Search of the European Banking Authority*, (2016) 17 European Business Organization Law Review, 285.

48 Regulation (EU) 2022/2554 of the European Parliament and of the Council of 14 December 2022 on digital operational resilience for the financial sector and amending Regulations (EC) No. 1060/2009, (EU) No. 648/2012, (EU) No. 600/2014, (EU) No. 909/2014 and (EU) 2016/1011 (OJ, L 333, 27.12.2022, 1).

49 Regulation (EU) 2023/1114 of the European Parliament and of the Council of 31 May 2023 on markets in crypto-assets, and amending Regulations (EU) No. 1093/2010 and (EU) No. 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937 (OJ L 150, 9.6.2023, 40).

the EU market which can be achieved in a sustainable fashion, sounds like a Herculean task!

The area of AML/CFT, for example, is one where the SSM does not have any formal competences, hence one would not expect it to feature in an analysis of the BU effects on the EBA. Nevertheless, a different picture appears when one takes into account the need for close cooperation between prudential supervisors and AML/CFT authorities, and the SSM's footprint as a prudential supervisor. This has represented yet another area of SSM influence on the work of the EBA, which, since 2020, was competent in the area of AML/CFT with a scope covering all three financial sectors (albeit coupled with the obligation to consult as appropriate the other two ESAs). Nevertheless, the institutional setting in this area is now changing again: as a result of the newly adopted 'AML legislative package',[50] *all* EBA AML/CFT-related competences (and not just the ones relating to financial market participants and operators) are to be transferred to a new authority (AML authority or AMLA).[51] While this decision probably echoes reactions to the EBA's perceived weakness in its ability to discipline the Danish financial supervisor (as mentioned earlier), a wider 'institutional lens' reading would suggest this design marks the re-uniting of regulation and supervision in the subject matter area of AML/CFT – which can have a rather wide-reaching 'horizontal' effect on all financial regulation and supervision, permeating and underlying it.

In the area of digital finance, further similar dynamics appear to come into play. These are expected to enrich further the institutional picture, requiring to go much beyond the binary of SSM-EBA relations. MiCA entrusts the EBA with the power to supervise issuers of significant asset reference tokens and issuers of significant e-money tokens that are e-money issuers. So, at least with regard to the supervision of the former, the final version of the text represents a settling of a debate that, for a while, considered assigning such powers to the SSM instead, given linkages with prudential supervision and payments, among others. The MiCA design also brings into the picture interactions with other parts of the ESFS, such as with ESMA, which has also been entrusted with some powers of a supervisory nature.

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50 Regulation (EU) 2024/1620 of the European Parliament and of the Council of 31 May 2024 establishing the Authority for Anti-Money Laundering and Countering the Financing of Terrorism and amending Regulations (EU) No. 1093/2010, (EU) No. 1094/2010 and (EU) No. 1095/2010 (OJ L, 19.6.2024) – 'AMLA Regulation'; Directive (EU) 2024/1640 of the European Parliament and of the Council of 31 May 2024 on the mechanisms to be put in place by Member States for the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Directive (EU) 2019/1937, and amending and repealing Directive (EU) 2015/849 (OJ L, 19.6.2024) – 'AMLA Directive'; Regulation (EU) 2024/1624 of the European Parliament and of the Council of 31 May 2024 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (OJ L, 19.6.2024) – 'AML Regulation'.

51 EBA might still in practice have some inputs into AMLA's work and/or help implement AMLA rules in the EU financial context (see e.g. Article 11 AMLA Regulation, or Article 21 AML Regulation, or Article 49 AML Directive covering, among others, in its paragraph 12, aspects of cooperation of AMLA colleges with prudential supervisors).

DORA, on the face of it, seems to be an area that is neither affected by, nor affecting the, BU. Nevertheless, the new legislative act assigns some oversight tasks to the ESAs and seem to indicate a return to an institutional model where the distinction between significant and less significant institutions is retained (as it appears to have been working well in balancing EU and national supervisory powers for now), but where there are also large efforts to avoid sectoral silos by establishing one of the ESAs as 'lead overseer' (LO) and requiring strong cross-sectoral cooperation.[52] It is also indicating a return to the re-coupling of regulation and supervision in the ESAs rather than its separation, although the non-regulated nature of the relevant entities means that the competences of the LO will be limited – hence in practice the enforcement of any oversight guidance deriving from the LO would have to be done via prudential supervisors, and therefore of course also the SSM.[53]

All of the above envisaged developments, coupled with the analysis of the current institutional panorama that preceded, call for a rationalisation of the regulatory landscape, to the extent this is possible, given the particularities of the EU multi-level governance and the participatory values this represents. One option, at least from the point of view of the EBA and the ESAs more in general, would be to seek to take advantage of their unique position among different constituencies of regulatory/supervisory authorities in different but related and interconnected supervisory realms in order to enable them to achieve further efficiencies. Comfort, in terms of legal feasibility, is provided from the updated reading of *Meroni* in recent Court jurisprudence, such as the ESMA short selling case regarding agencies' quasi-executive powers, or even the more recent decision on the EBA's guidelines on product oversight governance, regarding the ESAs' quasi-regulatory powers;[54] and the EBA has also argued elsewhere about further practical solutions and their legal feasibility.[55] An additional requirement, but also difficulty in light of current economic and political climate, would be to ensure that relevant institutions, and especially the ESAs, given their different nature from the ECB, are assigned adequate resources to fulfil their potential. This is definitely an area of continued challenges and 'one to watch' for both academics and practitioners.

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52 Although one should avoid tilting the scale too much towards the opposite direction, given that this is only an 'oversight' regime, given the non-regulated nature of the entities involved. Therefore, one needs to ensure some procedural care to avoid hampering the overall effectiveness of the regime.

53 As an example of the ECB's relevance in this area one can look to the ECB's TIBER-EU framework for cyber-resilience testing, whose existence preceded the DORA and arguably influenced the discussions on some of its content in this area.

54 Case C-911/19 *Fédération bancaire française (FBF) v Autorité de contrôle prudentiel et de résolution (ACPR)* [2021] ECLI:EU:C:2021:599.

55 See European Banking Authority, *Opinion of the European Banking Authority on improving the decision - making framework for supervisory reporting requirements under Regulation (EU) No. 575/2013* (EBA/Op/2017/03, 7 March 2017). This argues in favour of replacing the legal instrument via which the EU supervisory reporting framework is developed, from the current use of implementing technical standards (ITS) with EBA decisions. The legal aspects of this Decision are further discussed in D. Chatzimanoli, *The ESA's Technical Standards* (forthcoming), cit.

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