THE EUROPEAN SINGLE SUPERVISORY MECHANISM

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The European Banking Union needs a single supervisor. Therefore, the establishment of the Single Supervisory Mechanism (SSM) is the first fundamental step in centralising powers over the banking sector within the Euro Area. This article examines the significant legal issues raised by the creation of the SSM as reflected in the legislative proposals put forward by the Commission and the Council, in the light of policy considerations and political pressures. In particular, the article analyses the role of the ECB as prudential supervisor, including its scope and powers, its interaction with national supervisory authorities, governance arrangements, independence and accountability. The article also considers the implications for the non-Euro Area Member States which opt into the SSM, the Member States which choose not to participate (in particular the UK), the European Banking Authority and the European Systemic Risk Board. The article concludes by attempting a first evaluation of the emerging SSM, taking into account that many details remain to be refined. The short term challenge for the SSM will be to build up its institutional capacity. In the longer term, the SSM's performance could be affected by its own institutional design (forged under legal constraints and political compromise) and by the arduous process of completing the single regulatory rulebook for the European Union.

Keywords: Single Supervisory Mechanism; Banking Union; ECB; Euro Area; EU single market; European Banking Authority; European Systemic Risk Board

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I. Introduction

Euro Area banks need credible financial backstops.[1] The European Stability Mechanism (ESM) could contribute to the performance of this function but common, high quality prudential supervision has been made a pre-condition to the direct recapitalization of Euro Area banks from this source.[2] In the aftermath of the financial crisis, central bank direct involvement in prudential supervision is an approach to the institutional organisation of oversight of financial markets that has come back strongly into favour. The Treaty on the Functioning of the European Union (TFEU) already caters for the possibility of the ECB conducting supervisory task with respect to banks.[3] This alignment between current trends in the organisation of supervision and EU law is fortuitous because it means there is an appropriate institution already in place that can be empowered to assume prudential supervision functions with respect to Euro Area banks, without stirring up the political controversies that would surround a proposed Treaty change.

These, then, are the steps in the underlying logic that leads to the Council Regulation conferring on the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions (ECB Regulation).[4] It is a logic that has been driven by pragmatism and realpolitik rather than abstract principle. In theory, there was an alternative, namely the conferral of banking supervision powers on an expanded European Banking Authority (EBA); but, despite early support from senior European Commission officials and from some Members of the European Parliament, that model, which runs counter to the trend of putting central banks back in charge of prudential supervision and which would have required ingenious 'variable geometry' structures to fit an EU27 single market body to the needs of the EU17 Euro Area Member States, was always destined to founder on the rocks of political division and legal complexity.[5]

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[1] This support can come in a variety of forms. Since 2008 onwards, the ECB has progressively expanded its liquidity provision for Euro Area banks through short and longer-term refinancing operations (MROs and LTROs) and other measures: http://www.ecb.int/mopo/implement/omo/html/index.en.html. The ECB has sought also to address distortions in government bond markets through its programme of Outright Monetary Transactions (OMT, formally launched mid-September 2012) in secondary markets for sovereign bonds. The OMT programme steers around the prohibition on central bank financing of governments by restricting interventions to the secondary market. As of end-January 2013, OMT existed on paper only and had not been actively deployed; however, there are indications that Ireland and Portugal may become the first Member States to benefit from this programme: J Neuger, 'ECB Buying Ireland, Portugal Bonds Weighed to Smooth Crisis Exit', Bloomberg, 22 January 2013, http://www.bloomberg.com/news/2013-01-22/rehn-sees-option-of-ecb-bond-buying-for-ireland-portugal.html.

[2] Euro Area Summit Statement, 29 June 2012. The Treaty Establishing the ESM, which entered into force in September 2012 emphasises strict conditionality.

[3] TFEU, art 127(6); ECB Statute art 25(2).

[4] COM(2012) 511 sets out the Commission's proposal for the ECB Regulation. In this paper, unless clearly otherwise indicated, references to the ECB Regulation relate to the Commission text but the numbering of articles, as well as some of their content, may change in the final version. The Council's proposal was published on 14 December 2012: Council of the EU, 'Proposal for a Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions' [2012] Document 17812/12, 14 December 2012, http://register.consilium.europa.eu/pdf/en/12/st17/st17812.en12.pdf ("ECB Regulation (Council text, December 2012)").

[5] One significant political obstacle is that for the Euro Area banking industry to be supervised by a body located in London would not work for members of the EU17 group but keeping it in London has for the UK become a 'red line' in its negotiating position. A major legal hurdle to the direct empowerment of the EBA as a full-

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As a matter of EU law, it was thus easier to confer responsibility for prudential supervision on the ECB than to pursue other possibilities, such as the expansion of the EBA or the establishment of an entirely new Euro Area body.[6] However, the advantages were relative rather than absolute: just because it was the best option realistically available does not mean that equipping the ECB with the legal authority to act as a prudential supervisor has been a straightforward task. Compromises have had to be made, leading to a system that in certain respects does not conform to the precepts of good supervisory design according to post financial crisis thinking, and in which some unresolved tensions remain. Any evaluation of this new system must taken careful account of the boundaries of the legal space within which institutional progress was possible, and give credit for the legal ingenuity deployed. Nevertheless, these compromises provide reasons for unease as to the likely effectiveness of the new system.

This article therefore explores the significant legal issues that were presented by the 'first step' towards banking union – the establishment of a single supervisory mechanism (SSM) in which the ultimate authority and responsibility for specific supervisory tasks related to the safety and stability of all Euro Area banks will sit with the ECB. This exploration is conducted by reference to the evolution of the legislative process from the European Commission's two formal proposals for the taking of this first step, which were published in September 2012, the political reaction to those proposals at the European Council Summit in October 2012, and subsequent events though to the two texts proposed by the Council of the European Union in mid-December 2012. Whilst the urgency of the matter might have been expected to reinforce the Commission's considerable 'first mover' advantages with respect to the form and content of EU legislative proposals, the high political priority of the issues that surround banking union has in fact meant that there has been intense, top-level scrutiny of the proposals and a number of important changes have been made. These changes have been underpinned by different legal interpretations of the Treaty framework pertaining to the ECB. Moreover, at the political level, the way in which events have unfolded have supported Paul Craig's argument that when reality kicks in, broad level recognition of the need for tighter controls still gives way to resistance by individual Member States to the detailed regime that would make such controls a reality.[7]

II. The ECB as a Prudential Supervisor

1. *Legal basis and timing*

The Council Regulation confers specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions. The legal basis for the ECB Regulation is TFEU, article 127(6). Under article 127(6) the Council must act by means

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blown supervisor is that the *Meroni* doctrine in EU law (Case 9/56 *Meroni v High Authority* [1958] ECR 133) restricts delegation of wide discretionary powers to agencies.

[6] Had the idea of an entirely new Euro Area supervisory body been pursued it is possible that this would have encountered similar objections to those directed at the ESM, which has been challenged on grounds relating to its compatibility with key principles of EU law: Case C-370/12 *Thomas Pringle v Republic of Ireland*. In this case the Court ruled that the EU law provisions raised "do not preclude either the conclusion by the Member States whose currency is the euro of an agreement such as the ESM Treaty or the ratification of that treaty by those Member States" (para 182). However, the possibility that a new Euro Area resolution body might in the future be challenged on similar grounds cannot be precluded.

[7] P Craig, 'Two-Speed, Multi-Speed and European Future: A Review of Jean-Claude Piris on the Future of Europe' (2012) 37 European Law Review 800, 804.

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of Regulations and unanimity is required. The European Parliament and the ECB itself only have the right to be consulted under this provision. In spite of its lack of a formal legislative role, the concomitant need for certain adjustments to the EBA Regulation, which is a matter for co-decision by the European Parliament and the Council, has given the Parliament a lever to exert influence over the content of the ECB Regulation.

As originally proposed, the transfer of responsibility to the ECB was to be phased in: 1 January 2013 over any institution at the ECB's discretion, from 1 July 2013 in relation to the most significant institutions, and from January 2014 at the latest for the others. This rather ambitious timetable was always politically contentious: although the parlous state of the Spanish banks during 2012 gave matters a high degree of urgency, views differed on the use of the new arrangements to resolve legacy problems. At the European Council Summit in October 2012 the timetable for agreement on the legislation was confirmed, but it was determined that work on operational implementation should continue during 2013. As of late February 2013, the date for the debate of both Regulations in the Council had been moved to 15 April 2013.[8] More details are awaited, but it now seems that the SSM may not become operational until 2014 and that the ESM may not be available for direct recapitalisation in the meantime.

2. *Scope: sectors and institutions*

The ECB Regulation as initially proposed by the Commission would transfer to the ECB certain responsibilities for the prudential supervision of all Euro Area credit institutions[9] regardless of size or business model.[10] This would mean that on paper the ECB would become responsible for the 6,000 or so deposit-taking banks located in the Euro Area. The Parliament has sided with the Commission, submitting in its proposal that the ECB's remit should cover all banks in the Euro Area.[11]

However, the Council has adopted a different approach, which would reduce the banks subject to direct ECB supervision from 6,000 to approximately 150, representing around 80% of the banking assets in the Euro Area.[12] According to the Council's text, national competent authorities retain primary supervisory responsibility over banks which are 'less significant on a consolidated basis'.[13] A bank is considered 'less significant' (i) if the total value of its assets does not exceed 30 billion euro; or (ii) if the ratio of its total assets over the GDP of the

[8] According to the European Parliament's Legislative Observatory: http://www.europarl.europa.eu/oeil/home/home.do

[9] As defined in Directive 2006/48/EC, article 4(1). This definition covers deposit taking institutions and electronic money institutions. For brevity this article uses the term 'banks' interchangeably with 'credit institutions' to denote the businesses that will come under the ECB. Financial firms that may be treated as 'banks' under national schemes for the organisation of supervisory oversight but which are not within the Directive 2006/48/EC definition will remain under the supervision of national supervisors. ECB Regulation, art 4(1).

[10] ECB Regulation, art 4.

[11] Art 5, European Parliament, 'Report on the proposal for a Council regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions' (COM(2012)0511 – C7-0314/2012 – 2012/0242(CNS)), 3 December 2012, http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A7-2012-0392+0+DOC+PDF+V0//EN ('ECB Regulation (Parliament text, December 2012)')

[12] V Constâncio, 'Establishment of the Single Supervisory Mechanism – the first pillar of the Banking Union' [2013] Keynote presentation at the 11th Annual European Financial Services Conference 'Reshaping Europe's financial markets', 31 January 2013

[13] ECB Regulation (Council text, December 2012), art 5.

participating home Member State does not exceed 20% (unless the total value of its assets is below 5 billion euro). But even if a bank's size falls below the quantitative criteria, national competent authorities can notify the ECB that they consider a bank to be of significant relevance with regard to the domestic economy, in which case the ECB is responsible to confirm the bank's significance, after conducting a comprehensive assessment. The ECB may also designate a bank as significant on its own initiative, if the bank has banking subsidiaries in more than one participating Member States and its cross-border assets or liabilities represent a significant part of its total assets or liabilities. Banks for which public financial assistance has been requested or received directly from the EFSF or the ESM are automatically considered significant, and therefore fall under the ECB's direct supervision. Finally, the ECB is also responsible for the three most significant credit institutions in each of the participating Member States, 'unless justified by particular circumstances'. However, as discussed in the following section [II.3], even with regard to 'less significant' banks which according to the Council's text remain under the remit of national authorities, the ECB retains some significant supervisory tasks, as well as the general oversight of the system.

It remains to be seen how the scope of the ECB's remit will be defined in the final text of the ECB Regulation. The issue carries considerable political significance, and has become one of the points of friction between Parliament and Council.[14] However, the difference between the two approaches might not be as large as it initially seems. As discussed below in section II.4, even under the Commission's (and the Parliament's) approach, the ECB would focus its direct supervision on the largest and more important banks, relying on national authorities for the day-to-day supervision of smaller banks.

The ECB's initial remit will not extend to insurers, investment firms, central counterparties, other market infrastructure providers or entities engaged in 'shadow banking' activities,[15] notwithstanding that it is now firmly recognised that it is not only banks that can pose a threat to the stability of the financial system. Against the background of a political environment inimical to the possibility of Treaty change, this delineation has been driven in part by the limited scope of TFEU, article 127(6), which allows for the conferral on the ECB of tasks relating to credit institutions and other financial institutions[16] only, with insurance undertakings specifically excluded. The urgency of the need to break the vicious circle between banks and sovereigns is another factor that has contributed to the exclusive focus on banks.

The limited sectoral/institutional scope of the ECB's remit does not necessarily make the design of the SSM sub-optimal from the start. Nevertheless, it is plausible to suggest that something may have been lost in the design process by reason of the fact that because of

[14] See J Kirwin, 'European Union Conflicts Bog Down Bank Oversight, Resolution, Capital Reforms' [2013] Bloomberg Law, 14 February 2013.

[15] Such entities may however, be touched by the ECB's responsibilities for consolidated supervision of groups containing credit institutions (art 4(1)(i)) or its participation in the supplementary supervision of financial conglomerates including credit institutions (art 4(1)(j)).

[16] Under Directive 2006/48/EC, art 4(5) a financial institution means an undertaking other than a credit institution whose principal activity is to acquire holdings or to carry on one or more of a number of specified activities (lending, financial leasing, money transmission services, issuing and administering means of payment, guarantees and commitments, trading for own account or for account of customers in specified instruments, participation in securities issues and the provision of services related to such issues, advice to undertakings on capital structure, industrial strategy and related questions, money broking, portfolio management and advice, and safekeeping and administration of securities). Directive 2006/48/EC extends cross-border passporting rights to financial institutions that are subsidiaries of credit institutions.

Treaty constraints there could not occur at EU level the kind of far-reaching debate about scope that has, for example, taken place in the UK with respect to the boundary line between those firms (not just banks) that are to be prudentially supervised by the Prudential Regulation Authority (PRA) and those (less systemically important firms) that are to be prudentially supervised by the Financial Conduct Authority (FCA). Furthermore, the same constraint means that the SSM will not have the flexibility found in both the United States and the UK systems for non-banks to be brought within the purview of the ECB if they are deemed to be systemically significant.[17]

3. *ECB prudential supervisory tasks*

Article 127(6) permits the conferral on the ECB of *specific* tasks concerning *prudential supervision* (emphasis added). This raises questions about how far it is possible to stretch the concept of prudential supervision. In the EU context the answer to this question must be determined by reference to the forthcoming 'CRD IV' package – that is the Capital Requirements Directive IV, which governs access to deposit taking business, the exercise of freedom of establishment and free movement of services, prudential supervision, capital buffers, corporate governance and sanctions; and the Capital Requirements Regulation (CRR), which sets out a single set of EU-wide harmonized prudential rules on capital, liquidity, leverage and counterparty credit risk, adapting the Basel III Capital Accord to suit the EU context.

The ECB Regulation as proposed by the Commission would confer 'exclusive competence' on the ECB for a specific list of key supervisory tasks contemplated by the CRD IV package, including the authorisation and licensing of credit institutions, the assessment of acquisitions and disposals of holdings in credit institutions, ensuring compliance with EU capital, liquidity and related requirements and, in particular cases, setting higher or additional requirements, applying capital buffers, overseeing robust and sound internal governance, internal assessment and risk management arrangements, strategies, processes and mechanisms, carrying out stress tests, conducting consolidated supervision, participating in supplementary supervision of financial conglomerates, and carrying out supervisory tasks in relation to early intervention (in coordination with resolution authorities).[18] Under the Commission's proposal, the ECB's list of 'exclusive competences' would also extend to coordinating and expressing a common position of the competent authorities of participating Member States in EBA decision-making contexts for issues relating to the tasks conferred on the ECB.[19]

The Council's proposal is that the ECB's supervisory tasks will be limited to the significant banks which fall under its direct supervision. However, even with regard to 'less significant' banks which remain under the remit of national authorities, the ECB has the overall control and 'oversight over the functioning of the system'. The ECB issues regulations, guidelines and general instructions guiding the supervision by national authorities. Further, the ECB retains some direct supervisory powers with regard to 'less significant' banks. These include

[17] One of the key functions of the US Financial Stability Oversight Council is to designate systemically important nonbank financial firms and financial market utilities for supervision by the Federal Reserve under enhanced prudential standards. The first designations under this system were of eight financial market utilities in July 2012. In the UK, the new framework put in place by the Financial Services Act 2012, inserting Financial Services and Markets Act 2000, section 22A provides for regulations (The Financial Services and Markets Act 2000 (PRA-regulated Activities) Order 2013) under which the PRA can designate certain firms with permission to 'deal in investments as principal' for prudential supervision by the PRA.
[18] ECB Regulation, art 4(1)(a)-(k).
[19] ECB Regulation, art 4(1)(l).

bank authorisation and withdrawal of authorisation, assessment of acquisitions and disposals of holdings,[20] the possibility to exercise directly any supervisory power 'when necessary to ensure consistent application of high supervisory standards', as well as powers to request information and conduct investigations.

There are also differences between the Commission and the Council drafts with regard to the list of tasks entrusted to the ECB. Notably, under the Council's proposal, it is national authorities (not the ECB) that have the power to apply capital buffers and other macro-prudential tools.[21] The Council's rationale for leaving macro-prudential tools with national authorities is probably that the latter are in a better position to assess the specific circumstances of the local financial system. However, national authorities are required to 'duly consider' any objections from the ECB. Further, if necessary, the ECB has the power to apply higher capital buffers and more stringent macro-prudential measures than these applied by national authorities.

An important point is that, under the Council's proposal, the ECB would no longer be coordinating a common position for the competent authorities of participating Member States in the EBA.[22] This change is a response to concerns (discussed further in section IV.2 of the article) about the emergence of a caucus with EBA decision making processes that could leave non-participating Member State effectively sidelined.

With regard to group supervision, the ECB will participate in consolidated and supplementary supervision, including in colleges of supervisors for cross-border groups headed by parents based in non-participating Member States, and it will take on host State tasks with respect to the branches of banks from non-participating Member States that are located within its domain.[23] For groups established only in participating Member States, the ECB will take over the supervisory tasks of both the home and the host supervisor.[24] The ECB is empowered to develop contacts and administrative arrangements with the supervisors and the administrations in third countries, and with international organisations.[25] It is equipped with a range of supervisory, investigatory and sanctioning powers.[26]

Whilst it is a given in the post-crisis world that prudential supervision embraces oversight of banks' recovery plans, involvement in resolution planning, and responsibilities with respect to preventative and early intervention steps,[27] the concept of prudential supervision cannot be

[20] ECB Regulation (Council text, December 2012), art 5 (4)
[21] ECB Regulation (Council text, December 2012), art 4a
[22] ECB Regulation (Council text, December 2012), art 4(1)(l) – deleted.
[23] ECB Regulation, art 4(1)(i)-(j) and 4(2).
[24] ECB Regulation, art 14(1). Concerns that eliminating multiple watchdogs could impair the ability to identify risks at group level could be offset to a great extent by the significant advantages of a centralised supervisory structure in the group context, including better information flows, increased technical capacity and expertise and –importantly- elimination of home-host supervisory disputes.
[25] ECB Regulation, art 7.
[26] ECB Regulation, arts 8-15. The ECB can impose sanctions on credit institutions, financial holding companies and mixed financial holding companies for the purposes of carrying out its supervisory tasks but only in respect of intentional or negligent breaches of requirements under directly applicable Union acts in relation to which administrative pecuniary sanctions are available to competent authorities under Union law. In other cases the ECB must look to national supervisors for enforcement: art 15.
[27] European Commission, 'Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms' [2012] COM(2012) 280/3 (Recovery and Resolution Directive Commission Proposal), arts 5-8, 9-15 and 23-25.

extended as far as the actual management of the resolution of a failing institution.[28] Thus, the debate on the merits and drawbacks of locating responsibilities for resolution within the organisational entity or group that also is responsible for supervision is again forestalled by the Treaty. Both approaches can be found in operation around the world: for example, under the new regime in the UK from April 2013 onwards, responsibility for prudential supervision and for resolution will both come under the umbrella of the Bank of England but in the United States, the resolution authority, the Federal Deposit Insurance Corporation (FDIC) is distinct from the supervisory authorities. Whichever model is adopted, the crucial thing is to ensure that there is a clear allocation of responsibilities so that the transition from supervision to resolution is seamless and that there is absolutely no doubt about the location of decision-making powers in situations that, by their very nature, will demand quick and decisive action.

On this matter, the ECB Regulation may fall short. The ECB has the ultimate weapon – that of withdrawing a banking licence – at its disposal,[29] and it is also specifically empowered to carry out supervisory tasks in relation to early intervention.[30] Otherwise, things are left quite open: 'pending the conferral of resolution powers on a European body, the ECB should moreover coordinate appropriately with the national authorities concerned to ensure a common understanding about respective responsibilities in cases of crises'.[31] The lack of granularity with regard to the location of specific decision-making power is a source of concern,[32] especially given that there are potential overlaps between the tasks of early intervention and the early stages of resolution.[33]

And it should not be too lightly assumed that these problems will disappear when the single resolution mechanism (SRM) is established in stage two of the steps towards banking union.[34] For the SRM to follow on after the SSM could mean that the interface of the two mechanisms is less smooth than it would have been if they had been designed together as mutually-interdependent and reinforcing elements of a composite structure. In particular, the legacy effects of any lack of certainty and predictability in the crisis management arrangements that are established on a temporary basis between the ECB and national resolution authorities in the interim period could infect the ECB-SRM relationship from the very start.

An even more fundamental point that has been made by the Chair and Vice-Chairs of the Advisory Scientific Committee of the European Systemic Risk Board is that the SSM without

[28] For the purposes of EU law this is clear from the Recovery and Resolution Directive Commission Proposal, art 3 on the designation of authorities responsible for resolution, which is unambiguous in regarding supervision and resolution as separate functions.

[29] ECB Regulation, art 4(1)(a) and art 13.

[30] ECB Regulation, art 4(1)(k). The Council's text adds art 13b, which specifies the ECB's early intervention powers. These early intervention powers reflect the early intervention powers under the proposed CRD IV package and the Recovery and Resolution Directive.

[31] ECB Regulation, rec 21.

[32] J Carmassi, C DiNoia, and S Micossi, *Banking Union: A Federal Model for the European Union with prompt corrective action* (CEPS Policy Brief, No 282, 18 September 2012).

[33] For instance, one of the conditions for resolution is that the competent authority *or* the resolution authority determine that the institution is failing or likely to fail (Recovery and Resolution Directive Commission Proposal, art 27).

[34] Notably, mindful of the need to ensure coordination between supervision and resolution, the Council proposed that 'the Chair of the European Resolution Authority, once established, should participate as observer in the meetings of the Supervisory Board' (ECB Regulation, Council text, December 2012, rec 36b).

the SRM as part of the same single package could struggle for effectiveness and credibility.[35] To be clear, no-one has seriously challenged the expediency of the two-stage approach. The political obstacles to a SRM are formidable because of the burden-sharing obligations that it must inevitably entail. There are also difficult questions about the legal basis for the SRM and its compatibility with key principles of European law that still need to be worked through.[36] The EU did not have the luxury of being able to wait for the opening up of a smooth path right the way through to the ultimate endpoint. Nevertheless, in a weighing up of the strengths and weaknesses of the SSM, its potential vulnerability by reason of the fact that it has had to start without the SRM cannot be ignored.

4. *Actual performance of tasks*

It is now envisaged that the ECB will not assume its supervisory tasks until March 2014 at the earliest.[37] Is the ECB expected to transform itself within a year into the Euro Area's 'single' prudential supervisor, with the manpower, technical knowhow, computer systems and other resources to function uniformly across the Euro Area, as well as the ability to operate competently and effectively within 17 national legal systems that remain different in many important respects in spite of harmonization efforts, and to liaise closely with the multiplicity of national authorities that remain responsible for supervisory tasks that are not transferred to the ECB?[38] The question has only to be posed to see that the answer must be no. It is self-evident that a body of such ambitious size and scope could not be created on such an accelerated timetable, and the impossible is not being attempted. What is to put in place is a single supervisory *mechanism* comprising the ECB and the national competent authorities of the participating Member States, not a single supervisory *authority*.[39] The

[35] A Sapir, M Hellwig, and M Pagano, *A Contribution to the Discussion on the European Commission's Banking Union Proposals* (Advisory Scientific Committee Reports, No 2, October 2012); also R Goyal, et al, *A Banking Union for the Euro Area* (SDN/13/01) 12.

[36] A proposal to establish the SRM by means of an inter-governmental Treaty could encounter objections similar to those that were launched against the ESM: Case-370/12, *Thomas Pringle v Republic of Ireland* (see above note 6). It is not clear, moreover, how that approach would accommodate Member States which are not part of the Euro Area but which may wish to opt into the SSM (assuming that, in time, participation in the SRM would be required of participants in the SSM). The use of TFEU, art 114 for this purpose would be problematic because art 114 is not limited to the Euro Area. The use of the enhanced cooperation procedure (TEU, art 20 and TFEU, arts 326-334) is another possibility that could be explored. Or, alternatively, TFEU art 352 which allows for measures to be adopted by the Council acting unanimously and with the consent of the European Parliament which allows for necessary action to be taken within the framework of the policies defined in the Treaties, to attain one of the objectives set out in the Treaties, and the Treaties have not provided the necessary powers.

[37] ECB Regulation (Council text, December 2012) art 27.

[38] ECB Regulation, art 4(4); moved to art 1, subpara 4 in the Council's text. The number here will be well in excess of 17 because Member States may divide responsibilities for various aspects of financial services supervision between several different bodies.

[39] ECB Regulation, art 5. The Commission's version of this article is not expressly limited to participating Member States only but must be read in that way if the logic of the Commission's proposal is followed through. Other Member States that choose to opt in have a "close cooperation" arrangement but under the Commission's proposal technically they are not part of the SSM (nor are they defined as 'participating Member States' under art 2(1)). However, the case is different under the Council's proposal. According to art 5 of the Council's proposal, the SSM is composed of the ECB and of national competent authorities. National competent authorities are defined as the authorities 'designated by participating Member States', which according to the Council's text include non-euro Member States with a close cooperation relationship (ECB Regulation (Council text, December 2012) art 2(1)-(2)). Therefore under the Council's proposal the non-euro Member States with a close cooperation are considered to be part of the SSM. This interpretation of the Council's proposal is confirmed by the deletion of para 3 in art 6 (which becomes redundant if non-euro participating Member States are automatically represented in the Supervisory Council).

distinction is quite subtle but nevertheless of considerable importance: a single supervisory mechanism comprising the ECB and national authorities has the advantage of shielding the ECB from the inevitability of failure by reason of having taken on too much but, at the same time, it exposes it to the risk of failure by reason of continuing supervisory fragmentation.

To evaluate the seriousness of this risk it is necessary to go deeper into the operation of the mechanism, playing close attention to the differences in approach as between the Commission and the Council texts. The legal text adopted by the Commission requires the national competent authorities to assist the ECB in the areas in which it has exclusive competence[40] and provides that national supervisors must obey the ECB's instructions.[41] It contemplates that considerable use will be made by the ECB of local expertise and experience[42] but mostly leaves it to the ECB to organise the practical modalities of implementation.[43] Provision is made for the ECB to define the framework and conditions under which supervision is to be conducted at national level[44] and to adopt regulations, recommendations and decisions to the extent needed to carry out its tasks.[45] The ECB may arrange for the exchange and secondment of staff with and among national competent authorities.[46] The ECB is required to devote the necessary resources to supervisory tasks and to budget and account separately for them.[47] It is empowered to levy proportionate fees on credit institutions.[48]

Further flesh was put on the bones of the intended working relationship between the ECB and national supervisors at the October 2012 European Council Summit, by which point it had already become clear that direct supervision by the ECB was likely to be the exception rather than the norm (at least in the early days), with 'differentiated' supervision being the preferred model. By differentiated supervision it is meant that the ECB would set out the required approach to supervision in a supervisory handbook and other pronouncements, apply that approach directly in the case of a small number of systemically significant banks, oversee its implementation by national supervisors in other cases, and retain the right to call other banks into direct supervision where, as has been seen with the Spanish cajas, they are giving rise to problems of potentially systemic proportions.

This model is formally endorsed in the Council's proposal of December 2012. As previously discussed, the Council's text transfers to the ECB competence over 'significant' banks, and leaves most supervisory tasks for 'less significant' banks to national authorities, over which the ECB has the general oversight.[49] According to the Council's proposals, the ECB, in consultation with national authorities, will develop a framework for the practical modalities of this arrangement.[50] The framework will include a specific methodology for the assessment of the criteria which designate a bank as significant. The framework will also define procedures and time limits for the relation between ECB and national authorities. Notably, even for banks which are designated as significant (and, hence, subject to direct supervision

[40] Ibid.
[41] ECB Regulation, art 5(3)-(4).
[42] ECB Regulation, rec 28.
[43] ECB Regulation, art 5(3).
[44] ECB Regulation, art 5(3).
[45] ECB Regulation, art 4(3).
[46] ECB Regulation, art 25.
[47] ECB Regulation, arts 22-23.
[48] ECB Regulation, art 24.
[49] ECB Regulation (Council text, December 2012), art 5
[50] ECB Regulation (Council text, December 2012), art 5(7)

by the ECB), there is scope for national authorities to prepare draft decisions to be sent to the ECB for consideration.[51]

This division of responsibilities could be sensible. Although the ECB has had a longstanding interest in prudential supervision born of its established statutory responsibility to contribute to the smooth conduct of policies pursued by national authorities relating to prudential supervision and financial stability,[52] it has no track record as a direct supervisor and must build capacities and resources in the area. Since it is untested, there is absolutely no guarantee that the ECB will do a better job in supervision than many national supervisors but it must at least be given a fair chance to prove its worth. It would have been suicidal to have overwhelmed it from the start. But the approach is certainly not risk-free. A major concern is that the allocation of supervision of less significant banks to national authorities or the outsourcing of labour from the ECB to national authorities may not afford the ECB with sufficient visibility of emerging problems quickly enough for timely intervention. The elimination of the home bias that can lead to supervisory forbearance, which would be one of the principal benefits of effective ECB prudential supervision, may thus not occur.[53] A very prescriptive supervisory handbook to supplement the EU harmonized 'single rulebook', in which little room is left for local supervisory discretion, may go some way towards mitigating this problem, albeit at the price of leaving little room for a judgment-led style of supervision. These are also other concerns. For instance, there can be no doubt as to the ability of the ECB to outsource labour; but can it allow national supervisors formally to retain any supervisory decision-making powers on banks which fall under the ECB's direct supervision? The thorny issue of delegation of discretionary powers under EU law raises its head here.[54] If it is the case that at a formal level all supervisory decisions for banks which fall under the ECB's direct supervision must be taken by the ECB itself, the mechanics of the ECB sign-off process will be need to be settled, and thought must also be given to the strain that this volume of work for the ECB could place on mechanisms for the review of supervisory decisions. The Council's proposal to limit the ECB's direct supervision to significant banks has the advantage of reducing considerably the burden of work which falls on the ECB, but its workload could still be considerable nevertheless.

Lack of clarity on other key aspects of the system for the allocation of responsibilities between the ECB and national authorities could give rise to further problems. For example, the distinction between prudential supervision and conduct supervision may not be straightforward for all Member States, especially Member States where both functions are

[51] ECB Regulation (Council text, December 2012), art 5(7)(ab).

[52] TFEU, art 127(5) and ECB Statute, art 3(3). See also ECB, *The Role of Central Banks in Prudential Supervision* (2001). The main thrust of this paper was that arguments in favour of a separation of prudential supervision and central banking lost most of their force in the Eurosystem. It contemplated this being a role mostly for national central banks but also hinted at ECB involvement in its call for reinforced co-operation at an area-wide level in order to tackle the changes triggered by the introduction of the euro.

[53] On forbearance, see Advisory Scientific Committee, *Forbearance, Resolution and Deposit Insurance* (ASC Reports, no 1, July 2012).

[54] C-301/02 P *Tralli v ECB* [2005] ECR I-4071, considering the application of Case 9/56 *Meroni v High Authority* [1958] ECR 133 to the ECB. The Court held that a Community institution or body must be entitled to lay down a body of measures of an organisational nature, delegating powers to its own internal decision-making bodies [at para 42]. It held also that Community institutions and bodies enjoy powers of internal organisation whereby their collegiate bodies may delegate to one or more of their members the power to adopt staff management decisions of an individual nature in a context which has already been the subject of general rules adopted by the collegiate body concerned [paras 59-60]. The SSM does not appear merge the national supervisors into the ECB and, on that basis, to leave decisions with national supervisors would seem to involve external delegation rather than simply being a matter of internal organisation.

carried out in the same supervisory authority. In addition, the powers of national supervisors under national law, including sanctions, accountability, early intervention, continue to exist in parallel with the powers conferred to the ECB. Overlaps and/ or duplication of tasks between the ECB and national authorities are almost certain to arise. While these issues can be expected gradually to give way as increasing coordination within the SSM builds up, the transition process could be long and far from easy.

5. *Supervisory governance*

The potential for conflicts between monetary policy and financial supervisory policy is one of the well known drawbacks (at least in theory) of combining these functions within a central bank; the need for structural arrangements to guard against cross-contamination is widely acknowledged.[55] Unfortunately, whilst the need for the functions to be separated has never been in doubt in the context of the SSM, the legal framework governing the ECB has not made it easy to put the principle of separation into practical operation.

Some matters are relatively straightforward. One uncontroversial passage in the legal text explicitly requires the ECB to ensure due separation between the supervisory and monetary policy functions.[56] There is also an obligation on the ECB to pursue only the objectives set by the Regulation in carrying out supervisory tasks, those objectives being stated to be the promotion of the safety and soundness of credit institutions and the stability of the financial system, with due regard for the unity and integrity of the internal market.[57] A clear statement of objectives is recognised to be a valuable part of a statutory mandate for a financial supervisor.[58] There appears to be no doubt that TFEU, article 127(6) allow for these objectives to be specified in the ECB Regulation notwithstanding that the 'primary' objective for the ECB mentioned in TFEU and the ECB Statute relates to price stability.[59] The logic here is that since a new function is being conferred on the ECB, new objectives can be set as conditions for the exercise of this function.[60] In any event, by promoting safety, soundness and stability the ECB will be providing the essential underpinning for sustainable and balanced economic progress, thereby advancing the additional objective that applies to it in its monetary policy role of supporting the general economic policies in the Union with a view to contributing to the objectives of the Union.[61]

Whether the logic of 'new functions, new conditions for exercise' can be stretched to the internal organizational structure of the ECB is more doubtful, however. On this front, the European Commission took a relatively cautious approach.[62] It proposed the establishment of

[55] C Goodhart and D Schoenmaker, 'Should the Functions of Monetary Policy and Banking Supervision be Separated?' Oxford Economic Papers 47, 539-560

[56] ECB Regulation, rec 35 and art 18(2).

[57] ECB Regulation, arts 1 and 18(1). ECB Regulation, rec 23 envisages that furthering these objectives will thereby ensure also the protection of depositors.

[58] Discussing the importance of statutory mandates in the UK domestic context: E Ferran, 'The New Mandate for the Supervision of Financial Services Conduct' (2012) 65 Current Legal Problems 411.

[59] TFEU, arts 127(1) and 282(2).

[60] E Wymeerch, 'The European Banking Union, a first analysis' (2012) Financial Law Institute Working Paper 2012-07, uses this logic to explain a number of features of the SSM.

[61] TFEU, arts 127(1) and 282(2). The general objectives of the European Union are set out in TEU, art 3. They include the sustainable development of Europe based on balanced economic growth and price stability.

[62] However, it should be noted that in a not-publicly disclosed but in late 2012 widely reported Legal Opinion the Council legal services apparently took the view that even the Commission's approach went too far by allowing for the delegation to the Supervisory Board clearly defined tasks and *related decisions* (emphasis added).

a 'Supervisory Board' within the ECB.[63] The membership of the Supervisory Board was to comprise four representatives of the ECB, one representative of each of the participating (ie the Euro Area) Member States' supervisory authorities, and a Chair and Vice-Chair elected by the ECB Governing Council. The Chair of the EBA and a member of the European Commission were to have observer status.

The Council's text would result in a different composition for the Supervisory Board: the Council extends the definition of 'participating Member State' to include non-euro Member States with close cooperation agreements, which appears to open up the way for non-euro Member States to be represented in the Supervisory Board.[64] The Council's proposal also introduces significant changes to the appointment of members of the Supervisory Board,[65] which are intended to increase its independence from the Governing Council and from national competent authorities.[66] More precisely, according to the Council's proposals, the Chair and Vice-Chair of the Supervisory Board would be appointed by the Council itself.[67] The Chair of the Supervisory Board should not be a member of the ECB Governing Council (contrary to the Commission's proposal).[68] The four ECB representatives on the Supervisory Board should not perform duties directly related to the monetary function of the ECB. Another amendment introduced by the Council is that representatives of participating Member States where the central bank is not the supervisory authority are allowed to bring a central bank representative to the ECB Supervisory Board. Observers to the Supervisory Board can only attend by invitation, and it is not clear whether the EBA can participate as an observer.[69]

The role of the Supervisory Board, according to the Commission's proposals, is to plan and execute the supervisory tasks conferred on the ECB. The Commission draft envisages that the Governing Council of the ECB, which is also responsible for monetary policy, would remain formally responsible for making decisions prepared by the Supervisory Board, subject to the possibility of the delegation to the Supervisory Board of 'clearly defined supervisory tasks and related decisions' about an individual institution or set of institutions, such delegation being subject to the oversight and responsibility of the Governing Council.[70]

The Council's December 2012 proposal retains broadly the same division of tasks between the Supervisory Board and the Governing Council: the former carries out preparatory supervisory tasks and proposes draft decisions, which are formally adopted by the latter.[71] The Council's proposal specifies elements of the procedure for formal adoption of draft decisions proposed by the Supervisory Board.[72] For instance, draft decisions are deemed adopted unless the Governing Council objects within a certain period. Any objections of the

[63] ECB Regulation, art 19.
[64] ECB Regulation (Council text, December 2012) art 1(1) and 19(1). This reading of the Council's proposal is reinforced by the deletion of para 3 in art 6 of the Commission's proposal.
[65] ECB Regulation (Council text, December 2012) art 19.
[66] ECB Regulation (Council text, December 2012) rec 36a.
[67]On the basis of qualified majority, not including votes of non-participating Member States (ECB Regulation (Council text, December 2012) art 19(2)).
[68] According to the Commission's proposal, the Chair of the Supervisory Board would be member of the ECB's Executive Board, whose members are also members of the Governing Council (ECB Regulation art 19(2)).
[69] ECB Regulation (Council text, December 2012), art 19(6) deletes the reference to the EBA; however recital 36b provides that the EBA can be invited as an observer to the Supervisory Board.
[70] ECB Regulation, rec 36 and art 19.
[71] ECB Regulation (Council text, December 2012), art 19.
[72] ECB Regulation (Council text, December 2012), art 19 (3).

Governing Council to the Supervisory Board's draft decision must be justified in writing, stating in particular monetary policy concerns. Specific disagreement procedures against the Supervisory Board's draft decision, or the Governing Council's objections (or amendments) to the draft decision are envisaged for non-euro Member States which opt into close cooperation with the SSM.[73] Contrary to the Commission's proposal, the Council's text does not provide for any delegation of tasks and related decisions concerning specific institutions from the Governing Council to the Supervisory Board.

The details of the approach followed in both the Commission and the Council's proposals are potentially troubling from a supervisory institutional design perspective because the requirement for matters to be elevated up to the Governing Council for decision appears to breach the ring-fence that should be maintained between supervision and monetary policy. Moreover, they disregard issues relating to the impracticality of having multiple layers of governance arrangements, and the location of supervisory expertise: the Member State members of the Governing Council are central bank governors, who may or may not be experienced in supervision depending on their domestic set up. (As discussed further below, the structure suggested by the Commission is also problematic as regards non-Euro Area Member States that might consider opting into the SSM, an issue which the Council's proposal attempts to address to a certain extent.)

The complexities here are rooted in the interpretation of the ECB's statutory framework. The TFEU and ECB Statute provide that the Governing Council and the Executive Board are *the* ECB's decision-making bodies responsible for the governance of the European System of Central Banks (emphasis added).[74] The division of responsibilities under the Statute is that the Governing Council is responsible for the formulation of monetary policy and the Executive Board is responsible for its execution.[75] The legal framework sets out the division of responsibilities in some detail: the Governing Council must take the decisions necessary to ensure the performance of the tasks entrusted to the ESCB under the Treaties and the Statute;[76] in addition to its role in the implementation of monetary policy, the Executive Board may have certain powers delegated to it where the Governing Council so decides;[77] and the Executive Board is responsible for the current business of the ECB.[78]

However, whilst the TFEU and the ECB Statute contemplate the possibility of the ECB being given responsibility for prudential supervision, the legal framework does not provide explicitly for an accompanying dedicated institutional structure equivalent to that for the conduct of monetary policy. In other words, the legal framework does not cater explicitly for the possibility of a Supervisory Board with extensive decisional autonomy. Of course, the ECB already has considerable latitude with respect to the organization of its internal affairs – no organization could function effectively without this room for manoeuvre – and this includes the establishment of advisory committees to help with particular tasks[79] and the

[73] These provisions are discussed in more detail later in this article, in section III.
[74] TFEU, art 129(1) and ECB Statute, art 9(3). The General Council of the ECB, which brings in the governors of the central banks of all 27 Member States is a third decision-making body of the ECB (TFEU, art 141) but this so-called 'transitional' body (i.e.in place only because not all Member States have adopted the euro, but looking increasingly permanent as opposition to ever joining the euro hardens in Member States such as the UK) need not be considered further in this paper.
[75] ECB Statute, art 12.
[76] ECB Statute, art 12(1).
[77] ECB Statute, art 12(1).
[78] ECB Statute, art 11(6); Rules of Procedure of the European Central Bank, art 10.
[79] Rules of Procedure of the European Central Bank, art 9.

ability to delegate responsibility for management decisions of an individual nature in the context of general rules adopted by its decision-making bodies.[80] Many of the internal organizational changes that are needed in order for the supervision function to be performed effectively should fall within the scope of these existing powers. However, the establishment of a new Board with wide discretionary decision-making powers can reasonably be considered to be a step beyond the modalities of internal organization. That the space for institutional creativity does not extend that far appears to be the reasoning behind the approach followed by the Commission and the Council; indeed the Council has been more conservative in its views than the Commission, because its text does not allow for the delegation of specifically defined supervisory tasks.

Is there room for improvement? A bolder approach would be to say that the logic of 'new functions, new conditions for the exercise of those functions' extends even to the ECB's internal decision-making apparatus, with the consequence that TFEU, article 127(6) could then be used to establish a full-capacity Supervisory Board. However, this approach is hard to square with EU primary law on the internal structure of the ECB.[81] Expediency must have its limits, and care must be taken not to undermine the rule of law. Examining the issues through the lens of good supervisory design versus the EU Treaty framework, the balance of the argument would be clear, and little further would need to be said. In accepting an arrangement in which the Supervisory Board is limited to doing preparatory work (potentially subject to relatively narrow exceptions), and the Governing Council remains formally responsible for most of the decisions that are required, comfort could be drawn from the views of those who contend that the so-called conflicts of interest between monetary policy and supervisory functions that are identified in the literature may rest on a misunderstanding or exaggeration of the risks involved.[82]

However, there is another facet to the debate around the SSM internal organizational structure - that of the position of the Member States that do not use the euro who may wish to opt into the single supervisory mechanism. Membership of the ECB Governing Council is confined to the central banks of the Euro Area Member States and, so, an arrangement in which the Governing Council is the key forum for important decisions is one in which the opting-in Member States are seemingly condemned to a secondary role. The political and legal delicacy of this question is immense and the considerable effort that has gone into seeking to find an answer that is widely accepted is addressed separately in section III of this article.

Irrespective of the outcome of the debate about the nature of the Supervisory Board's role, it will still be necessary to determine rules of procedure for its operation. The Commission text places this responsibility in the hands of the ECB Governing Council.[83] On the contrary, the Council's text provides that the Supervisory Board itself will adopt its rules of procedure.[84]

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[80] *ECB v Tralli*.

[81] TFEU, article 129(3) provides a streamlined amendment procedure for particular articles of the ECB Statute (none of the articles governed by this procedure is relevant here). But for these provisions, changes to the ECB Statute require a Treaty amendment.

[82] V Constâncio, 'Establishment of the Single Supervisory Mechanism – the first pillar of the Banking Union' (n __).

[83] ECB Regulation, art 19(7).

[84] Which should 'ensure equal treatment of all participating member states': ECB Regulation (Council text, December 2012) art 19(7).

The Commission's proposal does not make specific provisions for voting modalities for the Supervisory Board. The Council's text adds details on this issue. According to the Council's proposal, decisions of the Supervisory Board would be taken by simple majority, and each member would have one vote (including the four representatives of the ECB),[85] with a casting vote for the Chair in case of draw.[86] A one member-one-vote system has the advantage of being both inclusive and straightforward but recalling that the Supervisory Board will have at least 23 full members,[87] issues of technocratic efficiency suggest that a more streamlined process could have been preferable.

There are also questions about whether votes should be weighted in some way to take account of financial market size.[88] Parallels can be drawn with the debate about voting modalities within the ECB Governing Council, where in a one-member-one-vote system provision has been made (but not yet brought into force) for rotational voting using a complicated formula system that takes account of Euro Area Member States' economic and financial weights.[89]

6. *Independence and accountability*

Operational independence is recognised globally as a core principle of effective bank supervision.[90] It is thus in one sense quite unremarkable that the ECB will be required to act independently in its role as supervisor – nothing else could ever have been envisaged. Moreover, the ECB Regulation broadly reinforces the minimum guarantee of independence that the ECB is already afforded by TFEU, article 130.[91] Yet whilst the ECB already enjoys a high degree of independence, it is clear that even in its monetary policy role, this independence is not untrammelled and that it operates within the framework of EU law.[92] It should not be assumed that 'independence' in the supervisory context is identical to monetary policy independence. The essential purpose of ECB independence is 'to shield the ECB from political pressure in order to order it effective to pursue the objectives attributed to its tasks.'[93] The particular objectives that the ECB must serve in its new supervisory capacity serve as the determinant of its independence in performing those functions. Independence is not an end in itself.

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[85] ECB Regulation (Council text, December 2012) art 19(2a)

[86] ECB Regulation (Council text, December 2012) art 19(2ab). The Council's proposal provides an exception from the general voting rules for regulations adopted by the ECB in order to organise or specify the modalities for the exercise of its supervisory tasks: these regulations are to be adopted on the basis of qualified majority voting, and the ECB Representatives have a vote equal to the median vote of the other members (ECB Regulation (Council text, December 2012) art 19(2b)).

[87] The Chair, the Vice-Chair, the four ECB representatives and the representatives of the EU 17 national supervisors. The number could rise, depending on how uncertainties about the position of non-Euro Area Member States that may wish to join the SSM are resolved. If the Council's proposal is followed in the final regulation, non-Euro Area Member States would also be represented on the Supervisory Board (see note 39 above).

[88] For example, Germany argued in favour of voting weights to reflect the larger size of its banking sector: A Barker, P Spiegel, and M Johnson, 'Germany demands more power on banking' [2012] Financial Times, 9 October 2012.

[89] ECB Statute, art 10(2).

[90] Basel Committee on Banking Supervision, *Core Principles for Effective Banking Supervision* (September 2012) principle 2.

[91] ECB Regulation, art 16. See also TFEU, art 282(3).

[92] Case-11/00 *Commission of the European Communities v ECB*. Noted O Odudu, (2004) 41 Common Market Law Review 1073. Cf C Zilioli and M Selmays, 'Recent Developments in the Law of the European Central Bank' (2006) 25(1) *Yearbook of European Law* 1-89.

[93] Case-11/00, para 134.

It is also universally accepted globally as a maxim of effective supervision that bank supervisors must be accountable for the discharge of their duties and use of their resources.[94] Independence and accountability must thus be kept in balance, again bearing in mind that the relevant considerations in the supervisory context are not necessarily the same as those that arise in relation to accountability for monetary policy. It has been said of the framework governing ECB accountability for monetary policy that it is 'exceptionally weak in terms of having to justify or explain its conduct or face the consequences of its mistakes'.[95] Weak constraints are unacceptable in the supervisory context because a financial supervisor has the power to affect in profound ways the interests of individual financial institutions, of financial consumers, and even of nation states; the accountability framework must be commensurate with the nature and extent of those powers.

The Commission's approach with respect to accountability, which largely tracks the accountability framework for the ECB in its monetary authority role, (albeit taking account of some ways in which practice in the monetary policy context has evolved beyond the Treaty framework),[96] could be a matter of concern. In this respect, the Council's approach, which introduces more rigorous procedures for accountability and reporting with regard to the ECB's supervisory role, is a welcome development.[97] The common ground of both proposals (Commission and Council) is accountability to the European Parliament and to the Council, annual reporting to the Parliament, Council, Commission and the Eurogroup,[98] the ability for the European Parliament committees to require the Chair of the Supervisory Board to appear before them, and an obligation on the ECB to reply to questions put to it by the European Parliament or by the Eurogroup.[99] These are important elements of an accountability framework but they are not necessarily sufficient. The Council's proposal makes additional provisions which include reporting requirements for the evolution of supervisory fees,[100] the ability for the Eurogroup to request the Chair of the Supervisory Board to appear in front of the Eurogroup and the representatives of non-euro participating Member States,[101] and a requirement for the European Court of Auditors to take into account the supervisory tasks conferred upon the ECB when examining the operational efficiency of the management of the ECB.[102]

One significant gap in the Commission's proposal is with respect to accountability at national level. This point was alluded to in the October Summit Conclusions which referred to the need for accountability 'at the level at which decisions are taken *and implemented*'. It would go too far to expect ECB officials to appear periodically before all the national Parliaments to explain their actions; apart from being grossly inefficient that model could be counterproductive by introducing 'too many masters' for any effective discipline to be

[94] Basel Committee on Banking Supervision, *Core Principles for Effective Banking Supervision* (September 2012) principle 2.
[95] D Chalmers, G Davies and G Monti, *European Union Law* (CUP, 2nd edn, 2010) 732. And also at p 734 describing an extensive study by Amtenbrink of accountability mechanisms for central banks in which the arrangements in the ESCB were found to be uniquely feeble.
[96] TFEU, art 284(3). This does not provide for the ECB to be obliged to respond to written questions, although in practice it does so. TFEU, art 284(3) also does not provide specifically for accountability to the Eurogroup.
[97] ECB Regulation (Council text, December 2012) arts 17, 17aa, 17a, 17b.
[98] ECB Regulation, arts 17 and 21.
[99] ECB Regulation, art 21.
[100] ECB Regulation (Council text, December 2012) art 17(2).
[101] ECB Regulation (Council text, December 2012) art 17(4).
[102] Under the ECB Statute, art 27(2): ECB Regulation (Council text, December 2012) art 17 (8).

exerted. However, a mechanism whereby a national Parliament could call upon the ECB to appear in particular circumstances could be useful.

The Council's proposal addresses this point by providing a new procedure for accountability of the ECB in front of national parliaments.[103] In particular, under the Council's proposal, the ECB is required to forward the annual reports to national parliaments of participating member states. National parliaments can address reasoned observations to the ECB and request the ECB to reply in writing. Further, a national parliament may invite the Chair or a member of the Supervisory Board to participate in an 'exchange of views' together with a representative of the national competent authority.[104] For the sake of clarity, the Council's proposal emphasises that, for supervisory tasks which rest with national authorities according to the allocation of tasks within the SSM, national authorities are accountable to national parliaments under national legislation.[105]

General public accountability can be enhanced by hardwiring transparency obligations more fully into the institutional framework. For example, the recently adopted Financial Services Act 2012 in the United Kingdom, specifically requires the UK's new regulators, the Prudential Regulation Authority and the Financial Conduct Authority, to exercise their functions 'as transparently as possible'.[106] The Commission's proposal notes that the ECB should be bound by Union rules and general principles on due process and transparency[107] but it includes only a limited number of specific publication requirements.[108] The Council's proposal improves on this by adding a considerable number of transparency provisions: for instance, under the Council's proposal, publishable documents include the practical modalities of allocation of tasks between the ECB and national authorities,[109] the Governing Council's internal rules for its relation with the Supervisory Board, [110] the Supervisory Board's rules of procedure,[111] and internal rules for the separation and interaction between monetary policy and supervision.[112]

The Commission proposal does not provide specifically for administrative or judicial accountability. There is, of course, already Treaty provision for the actions and omissions of the ECB to be judicially reviewed and interpreted by the Court of Justice of the EU,[113] and as a matter of course the ECB would be expected to respect fundamental civil rights and obligations in its own internal rules of procedure to govern the handling of supervisory disputes.[114] Nevertheless, the Commission's proposal could have been fuller for example, on

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[103] ECB Regulation (Council text, December 2012) art 17aa.
[104] ECB Regulation (Council text, December 2012) art 17aa(3).
[105] ECB Regulation (Council text, December 2012) art 17aa(4).
[106] Financial Services Act 2012, s 3B(h)
[107] ECB Regulation, art 33.
[108] For instance, ECB Regulation, art 15(6) obliges the ECB to publish details of sanctions, including the identity of the parties involved unless naming them would cause disproportionate damage. Publication may be withheld if it would seriously jeopardise market stability. Further, the ECB is required to publish on the Official Journal its decision to establish or terminate close cooperation with a non-euro Member State (ECB Regulation, art 6).
[109] ECB Regulation (Council text, December 2012) art 5(7).
[110] ECB Regulation (Council text, December 2012) art 19(7).
[111] Ibid.
[112] ECB Regulation (Council text, December 2012) art 18(3).
[113] TFEU, art 263-266 and ECB Statute, art 35.
[114] See ECB Regulation, rec 33 (right to be heard) and 46 (respect for fundamental rights).

matters of proper process for the ECB's supervisory tasks or on how banks supervised by the ECB could seek an internal review of its decisions.[115]

In this respect, the Council's proposal, which is a lot more prescriptive in these areas, appears to be a positive step forward. The Council proposed due process requirements for the adoption of supervisory decisions.[116] According to the Council's proposal, the ECB's supervisory decisions should be justified. The ECB should give the persons concerned the opportunity to be heard prior to making its decision,[117] and may not base its decisions on objections on which the parties concerned have not been able to comment. The persons concerned are entitled to have access to the ECB's file, except for confidential information where legitimate interests of third parties are at stake.[118]

The Council's proposal also envisages a procedure for internal review of the ECB's decisions.[119] For this purpose, the Council's proposal establishes an independent Panel of Review, composed by members nominated by the Supervisory Board and appointed by the Governing Council, which should ensure an appropriate representation of stakeholders across the participating Member States.[120] The Panel of Review is responsible for the internal review of the procedural and substantive legality of supervisory decisions taken by the ECB. Supervisory decisions of the ECB can be brought to the Panel of Review by the addressee, or any person to which the decision is of 'direct and individual concern',[121] within a certain period,[122] and the review may be given a suspensive effect.[123] The Panel of Review can remit the ECB's decision to the Supervisory Board. The Supervisory Board is required to take into account the Panel's opinion, but it can re-issue the same draft decision which was challenged in front of the Panel.[124] This raises concerns as to how potent the internal review process can be. However, once a decision has been remitted by the Panel, the Supervisory Board would need to justify its insistence on the initial decision.[125] In any case, the internal review process is without prejudice to the right to challenge decisions before the Court of Justice of the European Union.[126]

III. The 'Pre-ins': the non-euro Member States that may wish to join the SSM

Among the Member States that do not use the Euro, the UK and (less predictably) the Czech Republic have indicated firm opposition to becoming part of the SSM. Other Member States,

[115] A comparison can be made with the legal frameworks governing the European Supervisory Authorities, which do regulate decision-making procedures and provide for an appeal mechanism in addition to the possibility of an action before the Court of Justice: using the EBA's founding instrument as the example, Regulation (EU) No 1093/2010, arts 39 and 58-61.
[116] ECB Regulation (Council text, December 2012) art 17a and recs 34b, 34e, 34f.
[117] Except in cases where 'urgent action is needed in order to prevent significant damage to the financial system', when the ECB may adopt a provisional decision and give the persons concerned the opportunity to be heard as soon as possible after taking its decision.
[118] When restricting access to the file, the ECB should respect the fundamental rights and observe the principles recognised in the Charter of Fundamental Rights of the European Union, notably the right to an effective remedy and to a fair trial: ECB Regulation (Council text, December 2012) rec 34e.
[119] ECB Regulation (Council text, December 2012) art 17b.
[120] ECB Regulation (Council text, December 2012) rec 34f.
[121] ECB Regulation (Council text, December 2012) art 17b(6).
[122] ECB Regulation (Council text, December 2012) art 17b(7).
[123] ECB Regulation (Council text, December 2012) art 17b(8).
[124] ECB Regulation (Council text, December 2012) art 17b(9).
[125] ECB Regulation (Council text, December 2012) art 17b(10).
[126] ECB Regulation (Council text, December 2012) art 17b(11).

such as Poland and Sweden, have also expressed concerns but not as firmly as the UK. The 'Pre-ins' therefore constitute a large and important group. For the Pre-ins to join the SSM would promote the cause of integrated financial supervision in Europe. It could also, in time, build momentum for more Member States to adopt the Euro as their national currency. There are, therefore, many compelling reasons to ensure that opting in is an attractive option. However, again, the EU Treaty framework is not entirely conductive to the achievement of this goal.

The Commission's proposal provides for non-euro Member States to be able to opt into a 'close cooperation' arrangement with the ECB.[127] The opting-in Member State has to accept a number of conditions including undertaking to abide by guidelines and requests issued by the ECB, and agreeing to adopt national legal acts to ensure that its bank prudential supervisor will be obliged to adopt any measure in relation to credit institutions requested by the ECB. The ECB can decide to terminate the close cooperation but there is no reciprocal right in favour of the Member State. The proposal envisages that when a close cooperation arrangement is in place, the ECB would carry out its supervisory tasks in relation to credit institutions established in that Member State. The proposal stipulates that a representative of the relevant Member State's competent authority would be entitled to take part in the activities of the ECB Supervisory Board but does not spell out in precise terms the nature and extent of this participation.

Unsurprisingly, this scheme, which in effect amounts to condemning opting-in States to the status of second class citizens in the banking union, did not find political favour. It was rejected at the October 2012 European Council meeting, the conclusions of which called for 'the equitable treatment and representation of both euro and non-euro area Member States participating in the SSM'. There were even suggestions that the Commission's proposals were at odds with EU law by infringing principles of equality of treatment.

The Council's December 2012 proposal put the 'Pre-ins' in a much better position (at least compared to the Commission's proposal). The Council's text extends the definition of 'participating Member States' to include non-euro Member States which opt into the SSM,[128] and grants the 'Pre-ins' participation in the Supervisory Board, through the representatives of their national authorities.[129] Further, 'the rules of procedure of the supervisory board shall ensure equal treatment of all participating Member States.'[130] The ECB can only terminate a Member State's close cooperation if it first issues a warning to the relevant Member State regarding failure to comply with its obligations under the close cooperation, and the Member State fails to take decisive corrective action within 15 days.[131] Instead of terminating the close cooperation, the ECB may also suspend it.[132] Further, non-euro participating Member

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[127] ECB Regulation, art 6.
[128] ECB Regulation (Council text, December 2012) art 2(1).
[129] The Supervisory Board includes representatives of national competent authorities, which are defined as the competent authorities of participating Member States, the definition of which includes non-euro participating Member States (ECB Regulation (Council text, December 2012) arts 19(1), 2(1)-(2)). The deletion of art 6(3) from the Commission's text supports this interpretation.
[130] ECB Regulation (Council text, December 2012) art 19(7).
[131] ECB Regulation (Council text, December 2012) art 6(6).
[132] ibid

States also have the right to terminate themselves the close cooperation at any time after three years of its establishment, by submitting a request to the ECB.[133]

In order to deal with the fact that non-euro participating Member States are not present in the ECB Governing Council, the Council proposes additional safeguards in ECB's supervisory decision making process.[134] However, these safeguards are envisaged to be used only in 'duly justified, exceptional cases'.[135] In particular, if a non-euro participating Member State disagrees with the Governing Council's objection (or amendments) to a draft decision of the Supervisory Board, the Member State can invite the Governing Council to give a reasoned opinion.[136] If the Governing Council insists on its objection, the Member State concerned can notify the ECB that it will not be bound by any amendments to the Supervisory Board's decision made by the Governing Council.[137] Further, if a non-euro participating Member State disagrees with a draft decision of the Supervisory Board, the Member State can refer the case to the Governing Council, which decides on the matter; ultimately, the Member State which disagrees can request the ECB to terminate the close cooperation with immediate effect and will not be bound by the relevant decision. [138]

Finally, the fact that according to the Council's proposal non-euro Member States with close cooperation are under the definition of participating Member States gives them equal status to Euro Area Member States with regard to a range of issues in the ECB Regulation, including accountability of the ECB and the Supervisory Board in front of national parliaments, and participation in the Panel of Review.[139]

To what extent do the above arrangements ensure that non-Euro Area Member States that want to opt in are on an equal footing with Euro Area Member States? A fact which cannot be disregarded is that non-Euro Area Member States cannot be represented on the Governing Council. This issue directs the discussion back to the internal governance of the ECB and to the possibility of adding to the existing formal decision making structure without the need for a Treaty change. As indicated earlier in this article, this is a highly problematic proposition. The goal of full and equal involvement of opting in Member States cannot be achieved under an institutional arrangement in which the Governing Council of the ECB is the principal decision-making body for supervision because it is clear that only the governors of the national central banks of the Member States whose currency is the euro can be members of the Governing Council.[140] So, instead, any serious pursuit of this aim would need to come back to the idea of an ECB Supervisory Board with wide decision-making powers, now also adding the further twist of opted-in Member States having full voting rights alongside the

[133] ECB Regulation (Council text, December 2012) art 6(6a). If a Member State terminates the close cooperation, it cannot re-enter close cooperation for a period of three years: ECB Regulation (Council text, December 2012) art 6(6b).
[134] ECB Regulation (Council text, December 2012) rec 29aa.
[135] ECB Regulation (Council text, December 2012) rec 29aa.
[136] ECB Regulation (Council text, December 2012) art 6(6ab) and art 19(3). For this reason, the Council's proposal envisages that the Governing Council should invite the representatives from non-euro area participating Member States when it contemplates to object to a draft decision prepared by the Supervisory Board: ECB Regulation (Council text, December 2012) rec 36c.
[137] In which case the ECB will consider the possible suspension or termination of the close cooperation agreement with the Member State: ECB Regulation (Council text, December 2012 art 6 (6ab)).
[138] ECB Regulation (Council text, December 2012), art 19 (3) and art 6 (6abb).
[139] Notably, when appointing the members of the Panel of Review, the Governing Council is called to have regard to the "appropriate geographical and gender balance and representation of stakeholders across the participating Member States." (ECB Regulation (Council text, December 2012) rec 34f)
[140] ECB Statute, art 10(1).

Euro Area countries. TFEU, article 127(6) would be a remarkably insecure foundation for a development of such magnitude. Adding to the doubts about using article 127(6) to modify the internal governance of the ECB, Wymeersch argues that it simply cannot be applied to non-Euro Area Member States.[141] Wymeersch raises the prospect of recourse to TFEU, article 352, which caters for possibility of necessary action if the Treaties have not provided the necessary powers. Yet the only truly satisfactory answer to the question in the longer term must be an amendment of TFEU 127(6). This prospect has been acknowledged both by the Council and the Commission.[142] However, the absence of a Treaty change at the time when the foundations of the SSM are being set could have troubling long-term legacy effects on the architecture and functioning of the banking union.

Many complex questions will remain to be worked through. Will full membership of the SSM carry with it an obligation, explicit or implicit, also to be a full member of the single resolution mechanism and, in due course, the single deposit guarantee scheme? What will be the legal basis for those arrangements? How will these arrangements involving, perhaps, up to 25 or even 26 Member States, Euro Area and non-Euro Area, fit with the ESM, which is established by an inter-governmental Treaty of the 17 Euro Area Member States? Will the ECB be able to function well with two different domains, ie the Euro Area for its monetary policy function, and the Euro Area plus opted-in Member States for its supervisory functions? Cumulatively these arrangements could pose a major test to the ability of the EU's constitutional framework to cope with differentiated integration.

IV. The 'Outs' and Others – the UK, the EBA and the ESRB

1. *The UK and the single market in financial services*

EU27 needs a strong EU17. But measures to strengthen EU17 could undermine the integrity of EU27. This is a core conundrum. It has particular resonance for the UK, which before long could find itself in the position of being one of a very small number of 'Outs', ie non-Euro Area Member States that choose not to join the SSM. As the location for almost 50 per cent of EU financial services business, the UK's national interests are closely tied up with preserving the integrity of the single market because of the crucial importance of cross-border freedoms to the way that much financial services business is now conducted. Of course, the arguments can be turned the other way: even if EU17 becomes EU25 or 26 for banking union purposes, single market prosperity will still depend greatly on the contribution of the UK or, putting it another way, the UK will simply be too big to marginalise. On both sides, therefore, there are hard-nosed pragmatic considerations as well as genuine high-minded principles that lie behind the emphasis that has been placed on avoiding fragmentation of the internal market following the establishment of the SSM.[143] Nevertheless, the potential for cleavages to open up is considerable.

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[141] E Wymeersch, 'The European Banking Union, a first analysis' [2012] Financial Law Institute Working Paper Series WP 2012-07 http://ssrn.com/abstract=2171785. However, this view is not uncontested: see for example J Carmassi, C DiNoia, and S Micossi, 'Banking union : A federal model for the European Union with prompt corrective action' [2012] CEPS Policy Brief No 282.

[142] ECB Regulation (Council text, December 2012) rec 45a, referring to the Commission Communication of 28 November 2012 on a Blueprint for a deep and genuine economic and monetary union (COM(2012) 777 final).

[143] Notably, the Council's proposal sets out the general principle that "no action, proposal or policy of the ECB shall, directly or indirectly, discriminate against *any Member State* or group of Member States as a venue for the provision of banking or financial services *in any currency*" (emphasis added)(ECB Regulation (Council text, December 2012) art 1).

2. *The European Banking Authority*

The European Banking Authority could play an important role in holding things together. The EBA, which is based in London and which has been in operation only since January 2011, brings together the bank supervisors of the Member States, who are the voting members of the EBA's Board of Supervisors. The EBA's powers include:[144] to develop binding technical standards; to ensure compliance with EU law; to take certain action in the event of an emergency situation; and to settle cross-border disputes between supervisors by imposing a binding decision. Other areas in which the EBA has responsibilities include writing non-binding guidelines and recommendations, conducting peer reviews, mediating disputes between supervisors on a non-binding basis, promoting supervisory cooperation, convergence and coordination, facilitating home/host MS relations, and providing opinions to the Union Institutions.[145] The EBA is meant to be at the heart of the hub and spoke system of financial regulation in the EU and the ECB is not meant to replace it in this role. However, more clarity is needed as to the allocation of responsibilities between the ECB and the EBA, both in rule-making and in supervision.

With regard to rule-making, the proposals for the ECB Regulation envisage that the ECB should not replace the tasks of the EBA to develop draft technical standards and guidelines and recommendations.[146] However the ECB has its own rule-making powers to adopt regulations under TFEU article 132. The relationship between EBA and ECB in rule-making should be refined. The Commission proposed that the ECB should exercise its rule-making powers when the EBA's technical standards are not adequately detailed to cater for the ECB's functions.[147] However such generally framed provisions could open the way for the ECB to encroach upon the EBA's rule-making mandate. With regard to supervision, the ECB is to develop a 'supervisory manual' for national authorities under its remit. The relation between the ECB's manual and the single supervisory handbook which the EBA is to develop for the entire Union should also be specified. Unavoidably, the larger degree of supervisory convergence within the SSM will call for different arrangements than those applying at EU27 level. The possibility of overlaps and/ or conflicts between the two sets of supervisory rules cannot be excluded.

Yet even if detailed aspects of the ECB-EBA interface are improved, the emergence of the ECB as a powerful coordinating force in supervision could still have disturbing implications for the EBA in the longer term. Rather than being a crucial single market cohesion mechanism, the EBA could itself become marginalized. Unlike the UK, the EBA does not have the ballast of its own economic might and a long track record of engagement with financial market issues to call upon as a defence against being condemned to irrelevance. To protect the EBA against this possible fate and to enable it to continue to operate effectively in an environment in which the interests of those Member States that are participating in the SSM may diverge from those that are not, certain changes to its organizational and decision-making structures are to be made. An IMF Staff Note observes that accommodating the concerns of the non Euro Area Member States 'will augur well for consistency with the EU single market'.[148] Yet the controversy that has surrounded the changes to the EBA to address these matters serves to indicate the acute sensitivity of the underlying issues.

[144] Regulation (EU) 1093/2010, art 8.
[145] ibid
[146] ECB Regulation rec 26; ECB Regulation (Council text, December 2012) rec 26.
[147] This is explicitly provided for in the Commission's proposal: ECB Regulation rec 26.
[148] R Goyal, et al, *A Banking Union for the Euro Area* (SDN/13/01) 4.

The Commission determined that certain targeted amendments to the EBA Regulation were needed in order to take account of the conferral of supervisory tasks on the ECB and to ensure that the EBA could continue to pursue its functions to protect the integrity, efficiency and orderly functioning of the internal market and the stability of the financial system in the internal market. The perceived need for the first set of changes arose from the strong protection for ECB independence under the EU Treaties.[149] The Commission took the view that the prohibitions on the ECB taking instructions from Union agencies collided with the EBA's power in certain circumstances to impose binding decisions on national competent authorities.[150] The EBA Amendment Regulation, as proposed by the Commission, therefore inserts amendments whereby the EBA can merely 'request' the ECB to follow its decisions; the ECB then either has to comply or seek to explain non-compliance.[151] Other competent authorities, including the UK Prudential Regulation Authority, would remain subject to the possibility of being bound by EBA decisions. The Commission's proposal thus creates another odd asymmetry and again raises difficult questions about principles of equality of treatment that are enshrined in EU law.

It is possible that the Commission could have taken a more robust view with regard to the interpretation of 'independence' in this context and determined that the possibility of the imposition of a binding decision on the ECB by the EBA would not pose any real threat to the ability of the ECB to pursue its supervisory objectives free from interference. This view appears to be the explanation behind the Council's proposal, which provides that the ECB in its supervisory capacity would be obliged to follow the EBA's decisions.[152] However, the Council's approach is not necessarily uncontroversial. The circumstances in which the ECB can be bound by EU secondary legislation are not straightforward and there are, moreover, some sensitivities about the EBA's own independence from political influence from the Commission. Against this background, the Commission's decision to adopt a conservative approach can probably be justified. Another alternative in order to correct the asymmetry and achieve equality between the ECB (in its supervisory function) and national competent authorities, could be to remove generally the EBA's ability to impose decisions on supervisors. This would be a modest step back from the 'improvements' that were put in place when the EBA was established, but the power to address a decision directly to a financial institution in certain circumstances would remain and the effect of this reversal of policy would therefore be contained. An approach along these lines is followed in the Parliament's proposal for the EBA Amendment Regulation.[153] According to the Parliament's proposal, the EBA can address decisions to supervisory authorities (the ECB and national authorities), which function on a comply-or-explain basis. If the relevant authority (ECB or

[149] TFEU art 130; ECB Statute, art 7. See also ECB Regulation, art 16(2).

[150] Regulation (EU) 1093/2010, arts 18- 19.

[151] European Commission, 'Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority)' COM(2012) 512 ('EBA Amendment Regulation'), art 1(2)-1(3) amending art 18(1) and inserting art 18(3a) (action in emergency situations) and art 19(3) (cross border disputes) into Regulation (EU) 1093/2010.

[152] Council of the EU, 'Proposal for a regulation amending regulation (EC) No 1093/2010 - General approach' [2012] Document 17813/12, 14 December 2012 ('EBA Amendment Regulation (Council text, December 2012)') art 1(2) removed the amendments to Regulation (EU) 1093/ 2010 which were proposed by the European Commission.

[153] European Parliament, 'Report on the 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), Document A7-0393/2012, 3 December 2012 ('EBA Amendment Regulation (Parliament text, December 2012)').

national authority) does not comply, the EBA has the power to address a decision directly to financial institutions (under certain conditions).[154]

The second set of changes proposed by the Commission relates to decision-making within the EBA and seeks to address the risk of non-participating Member States being outvoted by the participating Member States. EBA decisions on regulatory matters (the development of binding technical standards, the issuance of guidance) are made on the basis of qualified majority voting (QMV) in the Board of Supervisors.[155] The Commission does not propose changes to the voting modalities on matters requiring QMV. EBA decisions on supervisory matters (including breaches of Union law, actions in emergency situations, and settlement of disagreements between competent authorities in cross-border situations) are, under the EBA's original founding instrument, generally taken by a simple majority vote in the Board of Supervisors.[156] In the case of settlement of cross-border disputes, there is an arrangement for an independent panel from within the Board of Supervisors to propose the decision for final adoption by the Board. These procedures are changed by the EBA Amendment Regulation, as proposed by the Commission.[157] The requirement for an independent panel in dispute resolution is broadened, and that mechanism is extended to breaches of Union law as well; the three-person panel must include at least one member from a non-participating Member State; and the decision proposed by the panel shall be considered as adopted by the Board of Supervisors unless it is rejected by a simple majority, which must include at least three votes from Member States that are participating in the SSM and at least three votes from Member States that are not participating in the SSM.[158] The thinking here is that the revised approach both strengthens the position of the independent panel and prevents the participating Member State caucusing in order to block the adoption of a decision that goes against them.

The Council's proposal follows a different approach with regard to voting procedures in the EBA. EBA decisions on regulatory matters are still to be made on the basis of QMV, but this must include at least a simple majority from members of participating Member States[159] and a simple majority from members of non-participating Member States.[160] Decisions on supervisory matters are still to be taken on simple majority basis, but with additional layers. In the case of action in emergency situations, decisions require a simple majority from participating Member States and a simple majority from non-participating Member States. In cases of breaches of Union law as well as settlement of disputes, the decision proposed by the independent panel must be adopted by a simple majority from participating Member States, and a simple majority from non-participating Member States.[161] Broadly, the Parliament's proposal follows the same approach as the Council with regard to voting modalities in the EBA.[162]

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[154] EBA Amendment Regulation (Parliament text, December 2012) art 1(2), amending Regulation (EU) 1093/2010, art 18.
[155] Regulation (EU) 1093/2010, art 44.
[156] Regulation (EU) 1093/2010, art 44.
[157] Regulation (EU) 1093/2010, art 41.
[158] EBA Amendment Regulation, art 1(5)-(7), amending Regulation (EU) 1093/2010, arts 41-44.
[159] In accordance with the ECB Regulation, non-euro participating Member States would be included.
[160] EBA Amendment Regulation (Council text, December 2012) art 1(7) amending Regulation (EU) 1093/2010 art 44.
[161] Ibid.
[162] EBA Amendment Regulation (Parliament text, December 2012) art 1(7) amending art 44 of Regulation (EU) 1093/2010. As discussed in the following footnote, the Parliament proposes a different composition for the independent panel.

The Council also puts forward different rules for the composition of the independent panel: this would consist of seven members who are not representatives of the authorities concerned and do not have any interest in the case; but (contrary to the Commission's proposal) there is no requirement for a minimum number of panel members to come from non-participating Member States.[163] Finally, the Council's proposal introduces a new provision that 'notwithstanding the voting arrangements for EBA set out in this Regulation, the Board of Supervisors of EBA shall strive for consensus when taking its decisions.'[164]

Which approach to voting modalities is preferable? So far as decisions on supervisory matters are concerned, the Commission's proposal appears to put non-participating Member States in an invidious position because they must secure the support of at least four participating Member States to block a supervisory decision that goes against them,[165] yet participating Member States are to be corralled into a common position expressed by the ECB for issues relating to the supervisory tasks conferred on the ECB.[166] On the other hand, the Council's (and the Parliament's) proposal is not without problems either because requiring each group to vote positively in favour of a decision for it to be adopted could be tantamount to giving a veto to UK and any other State that remains with it in the Out camp. In the ordinary course of events, the special mechanisms for voting on supervisory matters may not come to be tested very often - if one postulates, for example, the two behemoths of EU supervision, the PRA, as a subsidiary of the Bank of England, and the ECB, being in dispute with each other on a matter of cross-border prudential supervision, it is not easy to envisage the EBA ever reaching the point of coming a formal decision that favours one over the other; it seems far more likely that the EBA will rely on 'soft' mediation and conciliation tools to help bring the dispute to an end. Yet to rely on the hope that identified weaknesses in voting mechanisms will not matter much in practice because of under-utilization is a potentially dangerous way to proceed. The projected review of the voting mechanism when the number of non-participating Member States reaches four reflects the underlying unease.[167]

Furthermore, the issue of the practical operation of the voting modalities cannot be ducked as regards the EBA's rule making powers. It is this part of the EBA's mission that arguably is most critical to the interests of the single market and where the greatest dangers of marginalization or fragmentation may arise. In the aftermath of the financial crisis, Member States coalesced around the view that 'more Europe' – meaning more harmonization, with increased use of directly-applicable Regulations containing 'maximum harmonization' requirements that Member States cannot deviate from or add to, and also multiple layers of secondary regulation including binding technical standards prepared by the ESAs – was essential. Intensely detailed regulatory harmonization is the 'common foundation' on which the stability and integrity of the single market now rest.[168] It is vital, therefore, that the establishment of the SSM does not undermine the regulatory function.

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[163] EBA Amendment Regulation (Council text, December 2012) art 1(5) amending Regulation (EU) 1093/2010 art 41. Notably, the Parliament requires a different composition for the independent panel with regard to settlement of disputes, including at least one member from a non-participating Member State when the dispute involves the ECB and a supervisory authority from a non-participating Member State: EBA Amendment Regulation (Parliament text, December 2012) art 1(5) amending art 41 of Regulation (EU) 1093/2010.
[164] EBA Amendment Regulation (Council text, December 2012) art 1(7a) amending Regulation (EU) 1093/2010 art 44(1).
[165] That is to achieve the required overall majority of 14/27.
[166] ECB Regulation, art 4(1)(l).
[167] EBA Amendment Regulation (Council text, December 2012), art 81a.
[168] European Commission, *A Roadmap towards Banking Union* (COM(2012) 510).

As discussed, within the EBA, decisions on technical standards will continue to be made by QMV. In this sphere the formal position appears to be that the ECB would not formally coordinate and express a common position.[169] Nevertheless, chances are that the EU17 national authorities will increasingly coalesce around a common position as the ECB puts its stamp on Euro Area supervisory practices, procedures, policies and philosophies, since this growing uniformity can be expected to spill over into regulatory thinking as well. The non-Euro Area Member States that opt into the SSM and then to other elements of banking union could also move in the same direction. In theory, then, this could in future lead to situations in which the Euro Area Member States plus the other Member States that have opted into the SSM are able to impose their views in EBA decisions on the content of binding standards, with deleterious effects on overall EU27 supervisory relations. The Council's approach, which requires a simple majority from non-participating Member States in the QMV procedure, mitigates this risk; however, this safeguard comes at the cost of giving a potentially small number of non-participating Member States powers to block rule-making which is relevant for the entire Union.

As an ultimate safeguard against regulatory decisions that reflect partisan preferences, the European Commission could always intervene by refusing to endorse or by amending an EBA draft standard because 'the Union's interests so require'[170] but the prospect of stand-offs between the EBA and the Commission is very discouraging if it is recalled that the thinking that animated the design of the technical standing setting procedures was that the technical expertise needed to devise such standards lay mostly with the EBA as 'the actor in close contact with and knowing best the daily functioning of financial markets' supervisors and that Commission departures from its drafts should be 'only in very restricted and extraordinary circumstances'.[171]

Another outcome can be envisaged. This is that the big players on the coming European prudential supervisory landscape – namely the ECB, as coordinator of the SSM national supervisors and the UK Bank of England/PRA - could simply reach a compromise between themselves whereby they agree to draft technical standards at a sufficiently high level of generality to accommodate their differences in approach. This course of events would involve a much reduced threat to the working of the single market, but it would be at the expense of the 'single rulebook' becoming a genuine reality, thus undermining what was thought to be one of the lessons from the crisis. From an institutional perspective, moreover, it would place the EBA in a hopelessly weak position. One of the pieces of the institutional jigsaw still to be put in place is the Memorandum of Understanding between the ECB, the Bank of England/PRA and the competent authorities of the other non-participating Member States;[172] this MoU could play a pivotal role in shaping the EBA's destiny.

3. *European Systemic Risk Board*

[169] As previously mentioned, the Council's proposal has removed the ECB's power to coordinate a common position: ECB Regulation (Council text, December 2012), art 4(1)(l) – deleted. But even under the Commission's proposal, it appears that the ECB would not coordinate national authorities in the context of rule-making, as this is not a 'supervisory' task for which the ECB is responsible.
[170] Regulation (EU) 1093/2010, arts 10 and 15.
[171] Regulation (EU) 1093/2010, rec 23. Draft standards would be subject to amendment 'if they were incompatible with Union law, did not respect the principle of proportionality or ran counter to the fundamental principles of the internal market for financial services as reflected in the acquis of Union financial services legislation'.
[172] ECB Regulation (Council text, December 2012), rec 11a.

The European Systemic Risk Board, which like the EBA was a product of the EU's early reaction to the bank crisis that reached it seminal moment with the collapse of Lehman Brothers in September 2008, also faces an uncertain future.

The ESRB was designed as an EU body responsible for macroprudential policy and systemic risk. The ESRB, among its other tasks, is responsible to monitor systemic risk and issue warnings and recommendations to Member States, the European Supervisory Authorities and national supervisory authorities.[173] The ESRB's warnings or recommendations function on a comply-or-explain basis. The ESRB is responsible to monitor and follow-up its warnings and recommendations; if the ESRB is not satisfied with the response of the authority to which the warning/ recommendation was addressed, it notifies both the relevant authority and the Council. The ESRB may also decide to make warnings and recommendations public.

The ECB has a powerful position within the ESRB. The ESRB's Chair is the President of ECB and the ESRB First Vice-Chair is appointed by the ECB's Governing Council among its members. The ESRB's main decision making body, the General Board, includes among its members the President and Vice-President of the ECB, as well as governors of national central banks. Both the Commission's and the Council's proposal envisaged that the ECB should cooperate closely with the ESRB.[174] Indeed, it can be reasonably expected that the establishment of the SSM will increase the ECB's relative importance within the ESRB. As supervisory convergence within the SSM increases, the governors of national central banks of Member States participating in the SSM are likely to coalesce around the ECB's position when voting in the ESRB's General Board.

On the other hand, the emergence of the ECB as a supervisory authority means that the ECB would also be responsible for the exercise of macro-prudential policy tasks. According to the Commission's proposal, the ECB is responsible to impose capital buffers and other macro-prudential requirements on financial institutions.[175] Even under the Council's proposal, according to which macro-prudential tools are to be applied by national authorities,[176] the ECB retains a significant macro-prudential policy role. According to the Council's text, national authorities notify their decisions with regard to macro-prudential policy tools to the ECB, and should duly consider any objections raised by the ECB. Notably, the ECB has the power to apply directly to institutions more stringent macro-prudential measures than those applied by national authorities.

The ECB, as the Euro Area's central bank, is a suitable candidate for systemic risk monitoring and for the exercise of macro-prudential supervision. However, the fact that the ECB is involved both in the ESRB and in the exercise of macro-prudential tools raises concerns with regard to potential conflicts between these two roles. Combined with the fact that an even more powerful ECB could dominate decision-making within the ESRB, there is a plausible risk that the effectiveness of the ESRB as an EU27 watchdog against systemic risk could be curtailed, and that its agenda could become dominated by banking union concerns. Or the ESRB could become little more than a forum for a dialogue led by the ECB

[173] Regulation (EU) No 1092/2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board.
[174] ECB Regulation, art 3.
[175] ECB Regulation rec 12 and art 4(1)(e)
[176] ECB Regulation (Council text, December 2012) art 4a

and the Bank of England, in which event its elaborate institutional architecture could be superfluous.

V. Evaluation: will the SSM work?

To begin to develop an answer to this question, it is necessary to start by identifying clearly what precisely is expected of the SSM. One set of aims, which have a relatively short term character, is to address the fragility and fragmentation in the Euro Area financial system, to break the bank/sovereign vicious circle, and to restore the proper functioning of ECB monetary policy transmission. The essence of measures to deal with these concerns is that they must restore confidence in the Euro and calm fears about redenomination risk (ie countries exiting the Euro Area). Merely putting arrangements in place can sometimes suffice to send credible confidence-boosting signals even before actual deployment. Recent ECB data showing some improvement in market conditions has provided credibility for claims that policy efforts to 'do everything to save the euro', are starting to have a positive impact.[177] Much of the credit for this has gone to the ECB, in particular for its bold decision to delicate willingness to intervene in secondary sovereign bond markets.[178] Yet, even if the SSM is to some extent riding on the coat tails of ECB intervention to calm the markets, it can be given a tentatively positive assessment as being part of a series of steps that have boosted market confidence that the Euro Area is finally on a path that will produce an suitable institutional architecture for a sustainable monetary union. Of course, that confidence could easily dissipate if progress falters. Even at the purely practical level of staffing and resources there are significant questions that require quick responses. As an IM Staff Discussion Note observes 'the challenge of developing the requisite competence at the ECB and building credibility in supervision should not be underestimated'.[179]

The longer term prospects for the SSM are much more uncertain and at this juncture, while many of the details remain to be settled, it would far too be premature to adopt a definitive position. What can be said with confidence is that the SSM will certainly deviate in many respects from preferred models for financial supervisory design as identified in the literature. That such deviation exists is, in one sense, quite unremarkable: it would be unheard of for the real-world architecture of financial supervision to be governed exclusively by abstract principles since this is a matter that is always prone to being shaped by a complex mix of law, politics, institutional path-dependencies, cultural preferences, resource constraints, and a myriad of other factors. However, in a post-crisis world that has learnt that big banks are not the only source of systemic risk and that the transitions between supervision, early intervention and resolution must be as seamless as possible, the compromises dictated by the limited scope of the Treaty base and by Member States' resistance to bold action, have the potential seriously to undermine the effectiveness of the SSM from the very start.

Another potential threat stems from the state of play with regard to regulatory harmonization The creation of a truly single rulebook is of fundamental importance for the functioning of the SSM. The less comprehensive the legal and regulatory framework at EU level, the more the ECB will have to rely on national authorities to exercise powers that are available to them under national, but not EU, law. This could lead to significant gaps in monitoring and early

[177] Ralph Atkins and Mary Watkins, Eurozone banks start long road back to health, Financial Times 26 October 2012, 21.
[178] M Steen, 'Draghi Expands Role in Fight to Save Euro' Financial Times, 1 November 2012, 9.
[179] R Goyal, et al, *A Banking Union for the Euro Area* (SDN/13/01) 14.

intervention or to enforcement weaknesses. In the EU context bank regulation is usually viewed as harmonized and decentralised supervision has been seen as the main problem. Paradoxically, the SSM potentially entails the opposite risk, ie having a centralised supervisory mechanism, which relies on a partially harmonized rulebook. This risk deserves to be highlighted because recent experience has shown that the adoption of the single rulebook is far from straightforward, and its 'single' element has been watered down significantly in the various stages of negotiations in order to accommodate preferences of Member States.