

- The ECB cannot apply national procedural laws which raises the question what procedural law should be applied.
- The ECB does not have a legal basis to apply substantive provisions of national law which are not based on European law but it can instruct national competent authorities to apply national law.
- Realistically, national competent authorities and the ECB are likely to act together and co-operate to overcome legal difficulties.

Authors Mathias Hanten and Kate Heljula

# The ECB as the new regulator: a lawyer's perspective

In this article we share views from a recent conference in Frankfurt, shortly before the launch of the ECB's Single Supervisory Mechanism (SSM) on 4 November 2014 and provide an update on the concerns raised. The conference featured speakers from the ECB, the University of Liechtenstein, Switzerland, DLA Piper and KPMG with the purpose of providing the audience with as broad as possible a view about what the new European Regulator might mean from internal, external, legal, academic and accounting perspectives.<sup>1</sup>

A few months on, and the SSM is now fully operational. We can now observe how the SSM works in practice, which reduces the need for theorizing and increases the need for observation, analysis, assessment and consideration of jurisprudence. However, until the SSM has established itself, the thoughts, concerns and hopes for the SSM that were expressed at the Frankfurt conference remain current, at least for now. In this article, we will therefore try to summarise the lawyer's view of the the SSM and what this might mean for European Banking regulation.

## THE NEED FOR A NEW REGULATOR

After the unprecedented financial crisis that started in 2007 and which effects are still being felt, EU Financial Reform was put high on the political agenda at Brussels. Something was needed to restore confidence in the European banks and to put an end to "too big to fail banks". The SSM was conceived in order to ensure as far as possible on an EU-wide basis, safer and transparent financial markets in which other banking economies could have faith. Restoring confidence was key.

One function of the SSM was to carry out stress tests of those banks identified by the ECB as significant enough to be supervised by it, and to publish those results ahead of the SSM's launch. Overall there were 25 banks that failed the stress tests, which required banks to show that they

had sufficient capital to survive a crisis that would cause Europe's economy to fall 7 per cent below forecasts with a rise in unemployment and collapse in house prices. According to Vitor Constancio, Vice President of the ECB, "This unprecedented in-depth review of the largest banks' positions will boost public confidence in the banking sector." From an external perspective, the effect of the stress-tests is that it has leveled the European Banking playing field.

One very important outcome of the stress-testing is in fact to identify nations where their banks appear less robust. It must be right that in applying a unified regulatory body to oversee the banks in those nations, that the bar is seen to be raised such that investors can now have confidence where they could not before. Also from the point of view of ongoing regulation, these banks are likely to be subject to greater scrutiny and will be a greater cause of concern than those banks which have not failed the test.

For the ECB, one of its biggest challenges must be how to regulate institutions that have been brought up in such differing regulatory environments. The UK which has traditionally had one of the most robust regulatory environments can say that, whilst it has opted out of the SSM, it nonetheless had all its banks pass the ECB stress-tests.<sup>2</sup>

## THE REGULATORY FRAMEWORK

In order to consider and contextualise legal themes relating to the SSM,<sup>3</sup> it is useful to have an understanding of the underlying legislation.

### Institutional and Procedural Side<sup>4</sup>

The SSM is based on three legislative pillars; (i) Art 127 para 6 of the Treaty on the Functioning of the European Union (TFEU), which confers regulatory power on the ECB;<sup>5</sup> (ii) the SSM Regulation (SSMR), which confers certain regulatory tasks to the ECB; and (iii) the SSM Framework Regulation (SSMFR), which regulates the co-operation between the ECB and the National Competent Authorities (NCAs).

While it is the SSMFR which regulates co-operation between the ECB and the NCAs, the theme of co-operation is pervasive also in the SSMR.<sup>6</sup> And it is clear that co-operation within the new regime is going to be key to its success. That is perhaps why the SSMFR has enshrined a duty contained within Art 20 of the SSMFR to co-operate in good faith, and an obligation to exchange information. This obligation is mirrored in Art 6(2) of the SSMR.

It is important to note that it is the SSMR which determines the significance of Capital Requirements Regulation (CRR) Institutions and therefore governs the question of which regulator, ECB or NCA, will supervise the CRR Institution. This very significant question is governed by Art 6(4) of the SSMR, whereas the determination as to whether or not an entity is considered to be significant is contained in Part IV of the SSMFR.

It is perhaps of interest that the SSMFR only provides for some basic procedural law, for example, under Art 22 SSMFR; the ECB cannot apply national procedural laws. This

raises a concerning question, whether the ECB can adhere to the Rule of Law and to the Principle of Legal Certainty if in its dealings with banks in Member States it is unable to apply their national procedural laws. And further raises the question as to what procedural law is applied?

## MATERIAL SIDE: THE RELEVANT UNION LAW UNDER ART 4(3) OF THE SSMR

The applicable substantive law under the Capital Requirements Directive IV (CRD IV) consists of the CRR which is directly applicable to institutions within the EU and the Capital Requirements Directive (CRD) which is implemented through national laws. CRD IV is the package put together in response to Basel III.<sup>7</sup>

## LEGAL ISSUES

Clearly the ECB is competent to apply European law. The ECB does not, however, have any legal basis to apply provisions under national laws, which are not based on European law. This raises an interesting theoretical question; there are potentially areas where European law does not apply and where the national law is not based on European law. How does the ECB act in those circumstances? It would appear that the NCAs would need to step in and apply national laws. This could hold true, eg for Liquidity Ratios before the Delegated Regulation (EU) 2015/61 enters into force, the remuneration rules under CRD IV, which have been transposed under national laws and for matters which are simply governed by the national laws, eg rules on the commercial register. Under Art 9(1) of the SSM the ECB has the power to direct that NCAs apply their national laws. Realistically, the NCAs and the ECB are likely to act together, and co-operate if and when these issues arise.

Under the rules of the SSMR and SSMFR, the ECB is the responsible authority to assess whether CRR Institutions qualify as Less Significant Undertakings and which therefore do not fall to be regulated by the ECB.<sup>8</sup> However, the scope of Art 6(4) is uncertain. Article 6(4) of the SSMR provides for a threshold

of €30bn, above which CRR Institutions do not qualify as Less Significant Undertakings and there is then no question of who is their regulator. The SSMR provides for exemptions however, under which CRR Institutions, which cross the quantity threshold, may nevertheless be exempt and revert to regulation by their NCA. The principles behind any exemption have not been elaborated upon yet. Some institutions which have met the criteria for ECB supervision have requested exemption so that they continue to be supervised by their NCA, but been unsuccessful in obtaining a re-classification.

The Administrative Board of Review under Art 24 of the SSMR is a new agency, independent of the ECB and responsible for deciding on administrative review of decisions of the ECB.<sup>9</sup> In the event that matters proceed to court, the competent court for the judicial control of ECB regulatory decisions is the European Court under Art 256 TFEU and not the European Court of Justice. The ECB has, with Art 9 ff. of the SSMR not yet set up a full set of procedural rules or regulations. This fact may limit the level of control which may be exercised either by the European Court or by the national courts and is something that should be addressed as soon as possible.

Redress through courts is fairly uncommon in areas of financial regulation. However, the sanctions have increased significantly under Art 18 of the SSMR and relevant institutions may face fines significantly above fines at national level (up to twice the amount of the profits gained or losses avoided because of the breach, or up to 10 per cent of the total annual turnover). This may lead to more challenges in a European context than has previously been the case at national level. Institutions have tended not to challenge regulators in courts for a number of reasons, including an inherent reluctance or fear of taking on the regulatory powers. However, the commercial significance of fines issued by the ECB and the new political dimension of challenging the ECB may give rise to supervised entities taking action in court.<sup>10</sup>

Finally, the ECB faces some real challenges in its constitution. The fact that it has representatives from all NCAs on the supervisory board makes it an unwieldy formula for decision making. Drawing on such diversity has its advantages however. According to Sabine Lautenschlaeger, Vice Chair of the Supervisory Board, "European supervision [...] provides a new paradigm that incorporates the best elements of [a] nation's approach" and it is to be hoped that this is in fact the case.

## WILL THE SSM LIVE UP TO EXPECTATIONS?

When the SSM is described as the Regulator of the Regulators there is a real question mark over how the ECB will achieve this role. As referred to above, the key to the SSM functioning properly will be co-operation and a willingness to drive the process forward to ensure that any issues which arise are dealt with promptly, and to put in place an ever more comprehensive regulatory framework which will stand up to criticism.

Overall, the aim and purpose of the SSM is laudable. Unfortunately, the pace at which the SSM has come into existence has been significantly behind regulation in the US, for example. It therefore has a lot to prove going forward, and perhaps will only be able to show its worth when its competence is expanded through further regulation. No one will doubt that an effective European Regulator is necessary and a good thing in the banking sector to keep up with the rest of the world. ■

- 1 <http://www.ilf-frankfurt.de/Conference-Materials.450.0.html> The new Regulator.
- 2 This is in no small part due to the regulation of banks in the UK by the Prudential Regulatory Authority, which carries out its own stress-tests on a periodic basis.
- 3 The SSM is one of three pillars of the banking union. See Single Resolution Mechanism (SRM) and European Stability Mechanism (ESM), cf. Ligere, *The Banking Law Journal*. An Ever Closer Banking Union in the EU? February 2015, p 81 ff.
- 4 For general questions, cf. Ohler, *Bankenaufsicht und Geldpolitik in der Währungsunion*, § 5.

**Biog box**

Dr Mathias Hanten is a Partner and head of the Financial Services Regulatory team in the Frankfurt office at DLA Piper. Kate Heljula is a Legal Director in the London office of DLA Piper. Email: [mathias.hanten@dlapiper.com](mailto:mathias.hanten@dlapiper.com) and [kate.heljula@dlapiper.com](mailto:kate.heljula@dlapiper.com)

- 5** The question, whether Art 127 para 6 of the TFEU is a sufficient legal basis to confer the supervisory task to the ECB is under academic discussion, eg during the historic discussion, H James, Making of the European Monetary Union, 2012, p 313 ff.; Thiele, Krise der Europäischen Integration? Die Bankenunion als Beleg für die Handlungsfähigkeit der Union, will be published shortly, p 12.
- 6** In particular Arts 3, 6 and 7 of the SSM directly address co-operation.
- 7** Basel III is a set of reform measures in

banking prudential supervision developed by the Basel Committee and endorsed by the G20. A summary of interplay between Basel III and CRD IV can be found at Hanten: in Reischauer/Kleinhans, Das CRD IV Paket.

- 8** For a further introduction to this specific topic cf, Lackhoff, JIBLR 2013, 454.
- 9** Decision ECB/2014/16; a good overview at Thiele, (will be published shortly manuscript available) and Ohler, Bankenaufsicht und Geldpolitik in der Währungsunion, 2015, p 227 f.
- 10** Action has been taken by at least one bank

in Germany against the decision by the ECB that the bank falls under ECB supervision. The claim is in the General Court under File Number T-122/15.

**Further Reading**

- Banking Union: are we nearly there yet? [2014] 7 JIBFL 427.
- Banking Union: story of the emperor's new clothes? [2013] 2 JIBFL 67.
- Lexis PSL: Financial Services: The Single Supervisory Mechanism.