THESIS SUBMISSION IN PARTIAL REQUIREMENT FOR THE DEGREE OF DOCTOR OF PHILOSOPHY TO THE UNIVERSITY OF OXFORD

POWER RELATIONS, POWER POLITICS AND THE PERIPHERY OF THE EUROPEAN BANKING UNION

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ABSTRACT

Power Relations, Power Politics and the Periphery of the European Banking Union

The establishment of the European Banking Union marked a significant shift in the supervision of credit institutions within the Eurozone, transferring authority from national competent authorities to the European Central Bank and creating the Single Resolution Board for the recovery and resolution of failing banks. Despite the objective to create a set of uniform rules that would apply to all credit institutions established in the Eurozone, regulatory rules remain inherently incomplete, leaving room for the exercise of *ex post* discretion. While the European Banking Union framework stipulates *ex ante* that the European Central Bank and the Single Resolution Board must act in the interest of the EU as a whole, individual member states have strong incentives to prioritise their domestic interests *ex post*. This dynamic requires an examination of the role of power in shaping, supervising and enforcing financial regulations within the Eurozone. This thesis introduces an analytical framework to categorize power into instrumental, institutional and structural forms, revealing a core-periphery divide where core member states exert greater influence over regulatory practices. The analysis suggests that core states have shaped the European Banking Union to align with their national interests, raising concerns about power imbalances and potential biases that judicial review alone may not fully address due to its inherent limitations in this complex and specialized field. The thesis contends that amending the EBU's institutional framework is essential to ameliorate power disparities among member states, warning that the prevailing dynamics, which favour core states, threaten the EBU's long-term stability in the face of rising Euroscepticism. Nonetheless, it recognises that the legal frameworks within the EBU are deeply embedded in the Eurozone's banking system structure and in major power confrontations, strategic state interests and power capabilities frequently overshadow legal arguments.

ACKNOWLEDGMENTS

This thesis was inspired by the Eurozone sovereign debt crisis, the ensuing negotiations between Eurozone member states and the implementation of EU policies that had significant adverse effects on my home country, Greece. The establishment of the European Banking Union was conceived as a solution to the issues exposed by the Eurozone sovereign debt crisis, yet past experiences and the exercise of power by core member states at the EU level warrant a degree of scepticism.

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Antonios Chatzivasileiadis

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TABLE OF ABBREVIATIONS

ABoR: Administrative Board of Review

BoC: Bank of Cyprus

BPVi: Banca Popolare di Vicenza

BRRD: Bank Recovery and Resolution Directive

BRRD2: Directive (EU) 2019/879

CDC: Caisse des Dépôts et Consignations

CET1: Core Equity Tier 1

CRDV: Capital Requirements Directive V

CRDIV: Capital Requirements Directive IV

CRR: Capital Requirements Regulation

CRR2: Regulation (EU) 2019/876

CJEU: Court of Justice of the European Union

DGSC: Directive (EU) 2014/49

EBA: European Banking Authority

EBU: European Banking Union

ECB: European Central Bank

ECJ: European Court of Justice

EDIS: European Deposit Insurance Scheme

ESM: European Stability Mechanism

ESRB: European Systemic Risk Board

EU: European Union

FROB: Spanish Fund for Orderly Restructuring

FSAP: Financial Services Action Plan

IGA: Intergovernmental Agreement

IRTs: Internal Resolution Teams

ISP: Intesa Sanpaolo

JSTs: Joint Supervisory Teams

LCR: Liquidity Coverage Ratio

MPB: Marfin Popular Bank

MPS: Monte dei Paschi di Siena

NCAs: National Competent Authorities

NRAs: National Resolution Authorities

NSFR: Net Stable Funding Ratio

Sberbank Croatia: Sberbank d.d.

Sberbank Group: Sberbank Europe Group

Sberbank Russia: Sberbank of Russia

Sberbank Slovenia: Sberbank banka d.d.

SSM: Single Supervisory Mechanism

SSM Regulation: Council Regulation (EU) No 1024/2013

SRB: Single Resolution Board

SRF: Single Resolution Fund

SRM: Single Resolution Mechanism

SRM Framework Regulation: Regulation (EU) No 468/2014

TFEU: Treaty on the Functioning of the European Union

TKB: Trasta Komercbanka

VB: Veneto Banca

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1 THE EVOLUTION OF THE EU BANKING MARKET: INTEGRATION, CRISIS AND POWER DYNAMICS

1.1 INTRODUCTION

One of the main objectives of the European Union (the "**EU**") is to integrate its banking sector by establishing a common EU banking market. This initiative forms part of a broader agenda to create a single market, characterized by the unrestricted flow of goods, services, capital and labour.[1] The creation of a single banking market aims to yield several benefits, including expanding and diversifying the availability of capital throughout member states.[2] Furthermore, it aims to reduce the cost of capital for businesses, foster improved risk management practices and contribute to robust economic growth and job creation.[3] This vision is underpinned by a harmonized legal framework, enabling market participants to operate across national boundaries within the EU. The legislative efforts to create a single market in financial services in the EU date back to the 1970s, although the pivotal moment in the development of the EU single market was the Financial Services Action Plan ("**FSAP**") in 1999.[4]

The FSAP consisted of a set of regulatory measures intended to remove legal barriers to cross-border capital raising and the provision of other financial services in the EU. The FSAP radically changed the EU regulatory landscape by harmonising the domestic laws of member states in a number of important areas.[5] In addition to harmonizing regulation, the EU rules also enabled issuers and credit institutions that were authorised in one member state ("**home**") to provide services in another member state without seeking further authorisation ("**host**").[6] These rules proved successful in promoting the integration of the European banking market. An ECB study found that the number and size of EU cross-border

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1 Consolidated Version of the Treaty on the Functioning of the European Union [2012] OJ C326/47 ("**TFEU**"), Articles 3(1)(b) and 26.

2 European Central Bank, *Financial Integration in Europe* (2012), available at: https://www.ecb.europa.eu/pub/pdf/fie/financialintegrationineurope201204en.pdf accessed 11 May 2024, 33.

3 ibid.

4 European Commission, 'Implementing the Framework for Financial Markets: Action Plan' COM (1999) 232.

5 Eilis Ferran, *Building an EU Securities Market* (Cambridge University Press, Cambridge 2004), at 3-4.

6 ibid.

banks increased by 40-45 per cent between 1999 and 2010.[7] Most importantly, the same study concluded that regulatory harmonization was a significant factor in promoting the integration of the European market.[8]

The introduction of the euro gave further impetus to the integration of the Eurozone banking market and increased cross-border banking within the Eurozone.[9] By eliminating exchange rate risk, the euro facilitated rapid credit growth, particularly in capital-scarce and low-income countries of the Eurozone.[10] The common currency brought about a significant drop in interest rates, effectively reducing the burden of public debt and facilitating the flow of capital from richer to poorer countries. For instance, Ireland experienced massive capital inflows following the introduction of the euro in 1999.[11] This influx of capital was particularly noticeable in the years leading up to the Eurozone sovereign debt crisis in 2008, driving real estate and financial sector booms. The lower interest rates and increased borrowing capacity allowed for substantial economic expansion, although it also contributed to later financial vulnerabilities.

The global financial crisis in 2008 was the precipitating event that caused sudden changes in investor sentiment. Eurozone banks suddenly took fright and began worrying about the financial health of all others. Unable to verify which banks had healthy balance sheets and which had not, banks ceased lending to one another. Suddenly, Greece, Portugal, Spain and Ireland found themselves without access to credit and in a crisis for which the founders of the eurozone had not planned.[12] It became apparent that the Eurozone crisis was not a common "sudden stop" crisis similar to those in development countries in previous decades, but that it revealed systemic faults in the Eurozone's design that were not foreseen when the

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7 Sebnem Kalemli, Elias Papaioannou and Jose-Luis Peydro, 'What Lies Beneath the Effect on Financial Integration? Currency Risk, Legal Harmonization, or Trade?', ECB Working Paper No 1216 (June 2010), available at: <https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1216.pdf>, accessed 20 October 2024.

8 ibid, 26.

9 ibid, 17

10 Jean Pisany-Ferry, *The Euro Crisis and its Aftermath* (New York, OUP 2014), 50.

11 ibid., 114.

12 Jean Pisany-Ferry, "The Euro Crisis and the New Impossible Trinity", (bruegel.org, 2012), available at: <https://www.bruegel.org/sites/default/files/wpcontent/uploads/imported/publications/201208_Trinity_MonedayCredito_01.pdf>, accessed 20 October 2024.

rules were first drafted.[13] The Eurozone countries faced a complex challenge described by economists as the "financial trilemma".[14]

This theory suggests that it is impossible to simultaneously achieve financial stability, integrated financial markets and the retention of national financial policies.[15] The intricacies of this trilemma revolve around the inherent trade-offs between these objectives. On the one hand, a nation striving for financial stability and autonomy in its financial regulation may find it necessary to impose barriers to international capital flows, thereby sacrificing the benefits of fully integrated markets. On the other hand, countries that champion open markets and the free movement of capital across their borders often find themselves ceding a portion of their regulatory autonomy to international standards or bodies, in the interest of maintaining stability across a broader integrated financial system.

In the Eurozone, the financial trilemma was further complicated by the introduction of a fourth element: the role of a lender of last resort coupled with fiscal constraints.[16] As member states adopted a common currency, they effectively relinquished individual control over monetary policy to the ECB. This centralization was meant to improve financial stability and market integration, but it also had a downside: national governments could no longer use monetary policy tools on their own to bail-out banks in trouble, a role that the lender of last resort usually played.[17] The ECB's mandate focused on price stability and was designed to handle situations affecting the Eurozone as a whole and not individual countries.[18] More importantly, the Treaty expressly stipulated that the ECB could not finance budget deficits by extending credit or by purchasing bonds on the primary market.[19]

In addition, the EU fiscal rules restricted the fiscal policies of member states, preventing them from spending more than they earned to boost economies or help struggling

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13 ibid.

14 Dirk Schoenmaker, 'The Financial Trilemma' (2011) 111 Economics letters 111 57, 57-59.

15 ibid.

16 David Howarth and Lucia Quaglia, 'The Political Economy of the Single Supervisory Mechanism: Squaring the 'Inconsistent Quartet' (aei.pitt.edu, 2015), available at: < https://aei.pitt.edu/79340/1/Howarth.Quaglia.pdf> accessed on 20 October 2024.

17 ibid, 6.

18 Pisany-Ferry (n 10), 5.

19 TFEU, Article 123(1).

institutions. The EU fiscal rules requiring that member states limit their budget deficits to 3% of GDP and national debt to 60% of GDP not only prevented the Eurozone periphery from responding to the downturn but created a built-in mechanism for deepening it.[20] As GDP went down, these rules forced indebted member states to cut back expenditures or to raise tax rates, which destabilised crisis-hit economies even further. Ironically, although EU fiscal rules were intended to help the Eurozone member states converge and the austerity imposed was intended to reduce the fiscal deficit, the effects were just the opposite.[21]

To make matters worse, the crisis-hit member states faced strong opposition to debt restructuring from the ECB and other euro-area governments.[22] One of the main reasons for this opposition was the fear of contagion.[23] At the end of the first quarter of 2010, French banks had a €780.4bn exposure to Greece, Ireland, Italy, Portugal and Spain. German banks a €557.8bn exposure. Spanish banks a €134.5bn exposure, primarily to Portugal. Italian banks a €66.3bn exposure. Other Eurozone banks a €396.2bn exposure.[24] A May 2011 assessment of the consequences of a Greek default by the rating agency Moody's concluded that "a confirmation that the euro area was willing to let one of its members default would inevitably cause investors to reassess the limits of the euro area support…could result in…perhaps stronger countries such as Spain and even Italy and Belgium, finding market access considerably more expensive."[25]

The crisis highlighted the need for a more unified approach to prevent the destabilization of the banking system and to safeguard the Eurozone's financial integrity. In response, the Eurozone member states decided to establish the European Banking Union ("**EBU**"), centralizing bank supervision and resolution at the EU level. The EBU represented a significant shift in the regulatory framework for credit institutions, designed to make sure that banks in the euro area are well-regulated and supervised, can be effectively and securely resolved if they fail and to shield the euro area from the fiscal consequences of bank failures.

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[20] Joseph Stiglitz, *The Euro and its Threat to the Future of Europe* (New York, Allen Lane 2016), 96.

[21] ibid.

[22] Pisany-Ferry (n. 10), 90.

[23] ibid, 91.

[24] Philippe Legrain, *European Spring: Why Our Economies and Politics are in a Mess – and How to Put Them Right* (New York, CB Books 2014), 67.

[25] Moody's Investor Service "Assessing the Effect of a potential Greek Default" (2011) Special comment, 24 May 2011.

The EBU shifted responsibility for the supervision of the Eurozone's most significant credit institutions from national competent authorities ("**NCAs**") to the ECB.[26] The ECB assumed responsibility for monitoring the compliance of credit institutions falling within its scope with a set of harmonized rules across the EU (the "**Single Rulebook**"). To carry out its tasks, the ECB also adopted a single supervisory handbook that harmonized practices and articulated a common supervisory approach across the Eurozone banking market.[27] In addition, the EBU transferred responsibility for the recovery and resolution of credit institutions supervised by the ECB from NCAs to a newly established European agency, the Single Resolution Board ("**SRB**").[28] The SRB was endowed with a wide range of powers and tools that enable it to restructure and wind down failing credit institutions under the oversight of the Council and the European Commission. The same agency has access to a €78bn single resolution fund ("**SRF**") capitalized by contributions from the banking industry and intended to provide interim support until the resolution procedure is complete.[29] Under strong conditionality, the SRB can also use the European Stability Mechanism ("**ESM**"), the European fund that was created to fund rescue operations for euro area member states, in order to directly recapitalize failing credit institutions.[30]

1.2 THE STRUCTURE OF THE THESIS

The establishment of the EBU was a significant achievement. However, its design and operation were the result of heated negotiations among member states, each promoting their

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[26] Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions) (15 October 2013) OJ L287/63 (the "**SSM Regulation**")

[27] European Central Bank, 'Guide to Banking Supervision' (banking.supervision.europa.eu, 2014) available at: <Guide to banking supervision (europa.eu)> accessed 5 December 2021.

[28] Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firm in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 [2014] OJ L225/1 (the "**SRM Regulation**").

[29] The target size of the SRF is set at 1% of covered deposits by the end of 2023, i.e. €70 billion, see Single Resolution Board, "Single Resolution Fund grows by €10.4 billion to reach €52 billion" (srb.europa.eu, 2014) available at: <Single Resolution Fund grows by €10.4 billion to reach €52 billion | Single Resolution Board (europa.eu)> accessed 28 February 2024.

[30] Treaty Establishing the European Stability Mechanism, [2012] available at: < https://www.esm.europa.eu/sites/default/files/20150203_-_esm_treaty_-_en.pdf> (the "**ESM Treaty**"), accessed 20 October 2024. The ESM effectively replaced the earlier European Financial Stability Fund.

own agendas and protecting their domestic markets. This thesis argues that despite the aim to create a set of uniform rules applicable to all credit institutions within the Eurozone, regulatory rules remain inherently incomplete, allowing room for the exercise of *ex post* discretion. While the European Banking Union regime provides that the European Central Bank and the Single Resolution Board act in the interests of the EU as a whole, individual member states have strong incentives to prioritise their domestic interests *ex post*. It is important, therefore, to consider the role of power in the creation, supervision and enforcement of financial regulation in the Eurozone and to determine whether all member states face similar constraints in their ability to influence policy outcomes in their favour under the EBU framework.

To this end, this thesis introduces an analytical framework that categorizes power into three forms: *instrumental power*, which invokes the influence of actors to cause changes in others' actions, *institutional power*, a reflection of how certain procedural norms and objectives systematically favour specific actors and *structural power*, which emanates from the positions that actors occupy within an organization, shaping their capacities and interests. These forms are not perceived as competing concepts, but different manifestations of power influencing the way credit institutions are supervised in the context of EBU. This tripartite framework of power suggests that member states within the EBU can be categorized as 'core' and 'periphery,' with core states generally possessing greater influence over regulatory practices and decision-making processes. By applying this power framework to the EBU, the analysis reveals that, in constructing the EBU, core member states have effectively established an institutional framework that enables them to exercise power in ways that are congruent with their national interests.

While judicial review is a fundamental mechanism for legal accountability, ensuring that EBU institutions operate within their delegated competences, it has limitations in addressing power imbalances between core and periphery states. Such imbalances may not always result in explicit legal breaches but could manifest as nuanced biases in decision-making and norm-setting that favour core states. The complexity of legal challenges and the technical nature of banking supervision and resolution decisions can cause the judiciary to refrain from intervening in these specialized and politically charged domains. This deference can effectively leave periphery states with limited recourse through judicial review to counter the disproportionate influence of core states within the EBU framework.

The thesis argues that reforms to the EBU institutional framework are necessary to address power imbalances among member states, as the current dynamics favouring core states could undermine the EBU's long-term stability amidst growing euroscepticism. However, it acknowledges that the legal constructs under the EBU are intricately intertwined with the structure of the Eurozone banking system. In significant power struggles, legal arguments often take a backseat to the power capabilities and strategic interests of the involved states.

This thesis comprises eight chapters that explore themes surrounding the incompleteness of regulatory rules, the dynamics of power, the limitations of judicial review, proposed reforms to the current EBU framework and the constraints of law in addressing power imbalances. *Chapter 2 (Regulatory Challenges Arising from the National Division of Bank Supervisory Responsibilities in the EU*) delves into the regulatory difficulties encountered by NCAs prior to the Eurozone sovereign debt crisis. It highlights the systemic issues and regulatory shortfalls that exacerbated the financial turmoil, setting the stage for a deeper understanding of why the EBU was deemed necessary. *Chapter 3 (The Heated Negotiations Over the EBU*) sheds light on the intense negotiations that led to the formation of the EBU. It details the differing negotiating positions of member states, each seeking to safeguard their domestic banking interests. This chapter provides insight into the political and economic dynamics that shaped the final structure of the EBU. In this chapter the inherent incompleteness of regulatory frameworks, specifically focusing on the EBU, is discussed. It explores how these gaps necessitate the exercise of *ex post* discretion by regulators, raising questions about the predictability and consistency of regulatory enforcement under the EBU regime. Chapter 4 *(The Power Framework*) establishes a comprehensive understanding of power and its application within the context of EU financial regulations. It explores the concept of power and how it manifests in regulatory practices, categorising power into three distinct forms: instrumental, institutional and structural. Building on these classifications, the chapter then categorises Eurozone member states into two groups: core and periphery. Chapter 5 (*Application of the Power Framework to the EBU Institutions*) applies the established power framework to the EBU institutions. It provides a detailed analysis of how power manifests itself within the EBU, illustrating the mechanisms through which core member states can exert influence and enforce their policy preferences on other member states under the EBU regime. This in-depth examination highlights the dynamics within EBU institutions, revealing the ways in which core member states leverage instrumental, institutional and structural power to shape regulatory outcomes. Chapter 6 (*Bank Resolution*

Cases In Practice Under the EBU) examines the most significant resolution cases of failing banks within the EBU through the lens of the power framework. Through the examination of the first resolutions handled under the EBU, this chapter reveals the political biases embedded within the regime. This chapter challenges the notion that the EBU operates independent of political influence, as asserted by some scholars, by showing how political considerations have shaped its implementation. Chapter 7 (*The Limits of Administrative and Judicial Review in the EBU framework*) critically assesses the constraints of judicial review in protecting the interests of periphery member states. It argues that existing administrative and judicial mechanisms are inadequate to address power imbalances within the EBU. Finally, chapter 8 (*Making the EBU work for all Member States*) proposes potential reforms aimed at ameliorating the power asymmetries between member states within the EBU. Despite the political and legal obstacles to implementing these reforms, they remain beneficial to the core Eurozone member states in the long term, particularly in light of the increasing rise of Euroscepticism. Nevertheless, the chapter concludes that the role of law in inter-state relations should not be overestimated. It asserts that any meaningful change will necessitate profound economic, political and ideological transformations.

2 REGULATORY CHALLENGES ARISING FROM THE NATIONAL DIVISION OF BANK SUPERVISORY RESPONSIBILITIES IN THE EU

2.1 INTRODUCTION

This chapter examines the regulatory challenges faced by the Eurozone member states during the Eurozone sovereign debt crisis emanating from the fragmented supervision of credit institutions within the Eurozone. The analysis identifies three primary issues. The first issue was the considerable diversity of banking regulations among member states. This resulted largely from EU banking laws being open to different interpretations by NCAs, who often engaged in a kind of regulatory competition to attract more business. Furthermore, there was a lack of consistency in domestic resolution frameworks, which caused fragmented resolution actions by various national authorities. The second issue related to the split of supervisory duties along national lines. Home and host country supervisors often had divergent goals, severely undermining the efficiency of cross-border supervision and crisis management. The third and perhaps most crucial issue exposed by the European sovereign debt crisis was the damaging 'feedback loop' between the fiscal situations of member states and the stability of financial institutions located within them. This loop reflected the interlinked vulnerabilities of sovereigns and their respective banking sectors.

The chapter subsequently describes the institutions backing the EBU, introduced to address the above issues. The EBU aimed to standardize EU banking regulations through a unified set of rules and supervisory practices overseen by the ECB. Furthermore, a newly established central authority, the SRB, is responsible for resolving major credit institutions within the Eurozone, ensuring uniform application of resolution tools and maintaining a fair competitive environment among member states. Lastly, the SRF will provide the financial support for these resolutions, ensuring that differences in the fiscal capacities of member states do not impact competition in the Eurozone banking sector.

2.2 CHALLENGES ARISING FROM THE DIVISION OF SUPERVISORY RESPONSIBILITIES IN THE PRE-EBU PERIOD

As noted in Chapter 1 (*The Evolution of the EU Banking Market: Integration, Crisis and Power Dynamics*), the integration of the EU market aimed to establish an economic area where financial services and capital could move freely among member states. This harmonisation aimed to promote competition, drive innovation and stimulate economic growth by eliminating barriers and standardising regulatory frameworks. A key element of this integration was the EU passport mechanism for financial institutions, which permitted a bank or financial institution licensed in one member state to operate throughout the entire EU without requiring separate authorisations for each country.[31] The institution initially received authorisation from its home country, complying with all relevant legal and regulatory standards. It then notified its home regulator of its intentions to expand within the EU, prompting the home regulator to inform the host countries where the institution planned to either establish branches or offer services directly. Although the institution had to adhere to certain local regulations in the host countries, it remained primarily supervised by its home state regulator, ensuring a streamlined regulatory process.[32]

In the years preceding the Eurozone sovereign debt crisis, European banks took the form of integrated groups, conducting their foreign operations through branches and subsidiaries.[33] Branches have no separate legal personality from their head office, provide services using the same capital as their parent and face joint liability.[34] Subsidiaries, in contrast, are separate legal personalities incorporated under national law and face liabilities separate and apart from their parent.[35]

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[31] Passporting, however, required sending a notification to the relevant regulators which, unless exceptional circumstances applied, had to accept the notification and not impose any additional prudential requirements (in particular cases, some local investor protection rules could apply).

[32] Guido Ferrarini and Filippo Chiodini, "National Fragmented Supervision over Multinational Banks as a Source of Global Systemic Risks: A Critical Analysis of Recent EU Reforms" in Eddy Wymeersch, Klaus J. Hopt and Guido Ferrarini, *Financial Regulation and Supervision: A Post Crisis Analysis* (OUP 2012).

[33] Luigi Chiarella, 'The Single Supervisory Mechanism: the Building Pillar of the European Banking Union' (2016) 1(1) University of Bologna Law Review 34, 41.

[34] ibid.

[35] ibid.

This distinction was important for the allocation of supervisory responsibilities between NCAs within the European banking market. In the EU, mutual recognition and the single passport enabled credit institutions to establish branches in other member states in order to provide services under the prudential regulation and supervision of the home country.[36] Subsidiaries, in contrast, fell within the scope of the regulatory and oversight responsibilities of the host country.[37] As a result, the host supervisor did not have powers over the whole group, which was subject to fragmented national regulation and supervision. Adding to the complexity and despite a large body of EU banking regulations, there was a clear variation among banking rules in different member states.[38]

To enhance coordination between national supervisors, EU rules required the supervisor of the parent company to establish colleges of supervisors, comprised of the home consolidating supervisor and the host supervisors.[39] The establishment of colleges of supervisors was mandatory for all credit institutions established in a member state that had subsidiaries or significant branches in other member states. Home and host supervisors were obliged to coordinate their supervisory actions by exchanging information with each other and reaching joint decisions on matters relating to the adequacy of a cross-border banking group's capital and liquidity.[40] Where home and host supervisors failed to reach a joint

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[36] Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) available at: <http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:177:0001:0001:EN:PDF> accessed 5 December 2021, Recital 21.

[37] Guido Ferrarini and Luigi Chiarella, 'Common Banking Supervision in the Eurozone: Strengths and Weaknesses' Law Working Paper No 223/2013 (August 2013) available at: < https://www.ecgi.global/sites/default/files/working_papers/documents/SSRN-id2309897.pdf > accessed 5 December 2021.

[38] Eddy Wymeersch, 'The Single Supervisory Mechanism or "SSM", Part One of the Banking Union' Law Working Paper No 240/2014 (February 2014) available at: <The Single Supervisory Mechanism or 'SSM', Part One of the Banking Union by Eddy Wymeersch: SSRN> accessed 5 December 2021, 7.

[39] Directive 2013/36/EU of the European Parliament and Council on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (26 June 2013), Articles 51 and 116.

[40] ibid. Articles 112, 113, 114 and 117. See also European Banking Authority, Draft Regulatory Technical Standards on General Conditions of the functioning of colleges of supervisors in accordance with Article 51(4). and Article 116(4) of the Directive 2013/36/EU (3 July 2014).

decision, however, the consolidated home supervisor was responsible for making a decision unilaterally after taking into consideration the risk assessments of host supervisors.[41]

The weaknesses stemming from the mismatch between the scope of cross-border groups and national supervision were exposed by the Eurozone sovereign debt crisis. The mandates of some NCAs required them to contribute to the development of their domestic systems as financial centres.[42] This resulted in competition among such NCAs to reduce the rigour of their regulatory and oversight responsibilities in order to promote the expansion of their domestic financial services industries into other jurisdictions.[43] Home supervisors were only accountable to domestic constituencies and showed little concern for the potential negative impact of expansion strategies of institutions in other jurisdictions on the financial systems of other member states.[44]

The fragmented supervisory architecture also had a negative impact on crisis prevention. The objectives of NCAs included safeguarding their domestic banking systems and reducing the fiscal costs of potential bank recapitalizations for domestic taxpayers.[45] As a result, NCAs failed to take precautionary measures in response to the build-up of risks, because they wanted to avoid taking actions that would jeopardize the expansion of their domestic banking groups. To conceal risks, home supervisors withheld, manipulated or delayed reporting information to the host supervisor, resulting in issues with regard to the timeliness and relevance of information shared in a college.[46] The delays in identifying and resolving stresses resulted in the exacerbation of the eventual costs of the crisis.

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41 ibid., Article 113.

42 Eddy Wymeersch (n 38), 5-6.

43 Rishi Goyal, Petya Koeva Brooks, Mahmood Pradhan, Thierry Tressel, Giovanni Dell'Ariccia, Ross Leckow and Geyla Pazarbasiogly, 'A Banking Union for the Euro Area', (2013) International Monetary Fund (IMF) Staff Discussion Note 13/01, available at: <https://www.imf.org/external/pubs/ft/sdn/2013/sdn1301.pdf >, accessed 20 October 2024,t 7.

44 Wymeersch (n 38), 6.

45 SRM Regulation, recital 9.

46 Karia D' Hulster, 'Cross-border Banking Supervision: Incentive Conflicts in Supervisory Information Sharing Between Home and Host Supervisors' (2011) World Bank Policy Research Working Paper No. 5871, available at: < https://documents1.worldbank.org/curated/en/172321468325263744/pdf/WPS5871.pdf>, accessed 20 October 2024.

When the risks from financial expansion materialized, supervisory colleges proved ineffective in coordinating their cross-border resolution actions.[47] The resolution of EU financial institutions engaged in cross-border activities was subject to differing national legislations.[48] National laws did not encourage NCAs to share information with their peers and constrained the imposition of recovery measures on domestic branches. Indeed, domestic resolution frameworks differed in key areas related to the triggers for the commencement of resolution proceedings or the powers available to the supervisors to deal with an insolvent bank.[49]

Importantly, when faced with a bank failure in their territory, NCAs prioritized the interests of their domestic constituencies. In case of a failure of a bank, national priorities were translated into a "ring-fencing" of the assets of domestic branches or subsidiaries for the benefit of local creditors, domestic depositors and ultimately, taxpayers.[50] Given their concerns over the impact of a bank's failure on domestic financial stability and public finances, NCAs were reluctant to surrender control over resolution decisions to other authorities.[51] The resolution of Fortis group, a Belgian/Dutch financial conglomerate, illustrates the tension between the cross-border nature of a group and the domestic focus of national frameworks and responsibilities for crisis management. The group was initially supported by the injection of €11.2 billion by the governments of Belgium, the Netherlands and Luxembourg.[52] The rescue subsequently fell apart because disputes arose over burden sharing, with the Netherlands nationalizing the Dutch operations of the financial

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47 Goyal et al (n. 43), 10-11.

48 Martin Cihak and Erlend Nier, 'The Need for Special Resolution Regimes for Financial Institutions – the Case of the European Union' (2009) International Monetary Fund (IMF) Working Paper WP/09/200, 9-10.

49 National specificities still exist despite the adoption of the BRRD, see European Commission 'Study on the Differences Between Bank Insolvency Laws and on Their Potential Harmonization' (2019) available at: < Study on the differences between bank insolvency laws and on their potential harmonisation - Final report (europa.eu)> accessed 28 February 2022.

50 Katla D'Hulster and Inci Otker Robe, 'Ring-fencing cross-border banks: an effective supervisory response?' (2018) 5(1) The Journal of Financial Perspectives 1, 6.

51 ibid.

52 Rosalind Z. Wiggins, Natalia Tente and Andrew Metrick, 'European Banking Union C: Cross-Border Resolution – Fortis Group' (2019) available at: <European Banking Union C: Cross-Border Resolution–Fortis Group by Rosalind Wiggins, Natalia Tente, Andrew Metrick: SSRN> accessed 5 December 2021.

conglomerate and Belgium and Luxembourg selling the remaining operations to BNP Paribas.[53]

In addition to the above weaknesses related to the supervisory architecture of the European banking market, the crisis also demonstrated the existence of a feedback loop between the financial health of credit institutions and the fiscal health of the member states in which they were established.[54] The failure of a banking group can have catastrophic social and economic impacts due to the increased risk of contagion to other parts of the financial system, the potential loss of access to payment systems and of lending capacity to the real economy.[55] The Eurozone sovereign debt crisis demonstrated that EU policy makers viewed the costs of protection of large credit institutions as smaller than the benefits that resulted when they prevented instability in the banking system from occurring and potentially spilling over to the rest of the Eurozone economy.[56] The decision to provide individual government support to failing banks in the Eurozone was taken by the European Council to "ensure the proper financing of the Eurozone economy" and "avoid the failure of relevant financial institutions."[57]

However, this decision imposed intense pressure on member states' public finances. Ireland stands out as an obvious example of the fiscal constraints faced by member states in the context of the Eurozone sovereign-debt crisis. As Ireland's crisis began in 2008, the Irish government announced its decision to provide a two-year guarantee covering nearly all liabilities of Irish banks. Ultimately, the direct cost to Irish taxpayers of bailing out the failing banks was €64 billion, around half of the value of everything Irish that residents produced in 2011.[58] The bailout caused Ireland's debt-to-GDP ratio to rise from 24 per cent

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53 ibid.

54 Dirk Schoenmaker and Arjen Siegmann, 'Efficiency Gains of a European Banking Union', Duisberg School of Finance – Tinbergen Institute Discussion Paper TI 13026/IV/DSF51 (31 January 2013).

55 For a general overview of the risks associated with the failure of systemic banks, see Gary H. Stern and Ron Feldman, *Too Big To Bail – the Hazards of Bank Bailouts* (Brookings Institution Press, Washington DC, 2009).

56 European Council, "Declaration on a concerted European Action Plan of the Euro Area Countries" (October 2008) 14239/08, available at: < https://data.consilium.europa.eu/doc/document/ST-14239-2008-INIT/en/pdf> accessed 6 March 2022.

57 ibid.

58 Legrain (n 24), 20.

in 2007 to 95.2 per cent in 2015.[59] Although there is some debate about whether Ireland would have assumed some of these debts without intervention, but there is hardly any doubt that Ireland's government had no other option but to ask for the bailout because the ECB required it as a prerequisite for receiving liquidity assistance.[60] The decision was based on the consideration, which was shared among EU authorities, that banks across the euro area should be prevented from defaulting in order to avoid the kind of panic that had followed the demise of Lehman Brothers a fortnight earlier.[61]

In turn, the deterioration of states' public finances and plummeting sovereign debt ratings fed back into the financial system. Domestic financial firms were exposed to the value of government bonds, both through their direct holdings of sovereign debt and the value of explicit or implicit government guarantees.[62] In general, when a state's finances are in good shape and the size of the financial system is not disproportionately large in relation to its GDP, creditors expect to be compensated by the state if their bank is in danger of becoming insolvent. This expectation is then translated into an ability of the bank established in this state to refinance at more favourable terms. Conversely, when a state has limited fiscal capacity, creditors charge a premium for the absence of a credible fiscal backstop and the corresponding increase in the probability of bank insolvency.

The differences in the systemic significance that banks had for the Eurozone as a whole and the differences between member states in terms of resources available for state interventions created significant market distortions and undermined the internal market. Large credit institutions, which were typically established in more creditworthy member states and whose failure would have very adverse economic effects, had access to capital at considerably lower rates than their smaller competitors in less creditworthy member states. These distortions undermined the global competitiveness of banks established in less creditworthy member states, which reduced these banks' profitability and resilience to

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[59] Stiglitz (n. 20) 156.

[60] ibid.; Stephen Castle, 'ECB Threatened to End Funding Unless Ireland Took Bailout, Letter Show' (nytimes.com, 2014) available at: <https://www.nytimes.com/2014/11/07/business/international/ecb-threatened-to-end-funding-unless-ireland-took-bailout-letters-show.html> accessed 21 January 2022.

[61] Patrizia Baudino, Diarmuid Murphy and Jean-Philippe Svoronos 'The banking crisis in Ireland" (bis.org, 2020) FSI Crisis Management Series No 2 available at: < https://www.bis.org/fsi/fsicms2.pdf> accessed 21 January 2022.

[62] Adrian Alter and Yves Schuler, 'Credit Spread Interdependencies of European States and Banks During the Financial Crisis' (2012) 36 Journal of Banking and Finance 3444.

shocks and so increased the probability that their host states would be called upon to support their domestic banking systems. This resulted in a "vicious circle" between banks and sovereigns: the deterioration of bank balance sheets put pressure on the fiscal resources of member states and the deterioration of member states' finances undermined the health and competitiveness of their domestic banking systems.[63]

The divergence in national banking laws, the perverse incentives of NCAs to promote domestic interests in times of crisis and the "vicious circle" between banks and sovereigns provided the impetus for EU reforms to deal with the Eurozone sovereign debt crisis. On 8 October 2012, the states of the Eurozone announced the establishment of the ESM to help Eurozone countries in financial distress. The ESM is an intergovernmental institution, established under public international law, whose purpose is to provide stability support, conditional on the implementation of policy measures, to Eurozone countries experiencing financial distress. The ESM is funded by subscriptions from member states. Its capital structure comprises €80.5 billion paid-in capital, supplemented by €624.3 billion in additional capital commitments callable upon the unanimous authorization of the ESM member states.[64] The ESM is also authorized to issue debt on international capital markets. It has a maximum lending capacity of €500billion, which it can use to grant loans and temporary credit lines to member states and to purchase sovereign bonds in the primary and secondary markets.[65]

EU policy makers hoped that they would dampen the circle between sovereigns and banks by pooling the fiscal resources of ESM member states and providing support to those experiencing financial distress.[66] However, the prospect of financial assistance could induce NCAs established in less fiscally responsible member states to relax their supervision, thereby giving rise to an acute moral hazard problem: that is, the ESM could provide

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63 Christian Scheinert, "Vicious Circles: The Interplay Between Europe's Financial and Sovereign Debt Crises" (2016) European Parliament Briefing available at: <https://www.europarl.europa.eu/thinktank/en/document/EPRS_BRI(2016)583806> accessed 20 October 2024.

64 ESM Treaty (n 30), Articles 4(3), 5(6)(c), 8 and 9. Any losses experienced by the ESM will be absorbed first by any reserves, then by paid-in capital and, finally, by any callable capital; ibid. Article 25.

65 ibid., Articles 14-18.

66 Euro Area Summit Statement (29 June 2012) available at < https://www.consilium.europa.eu/media/21400/20120629-euro-area-summit-statement-en.pdf >, accessed 28 February 2022.

incentives for risky behaviour by banks and sovereigns in less creditworthy member states.[67] As chapter 2 (*Heated Negotiations over the EBU*) demonstrates below, the more creditworthy Eurozone member states directly linked the set-up of the ESM to the establishment of an independent third-party supervisor who would be responsible for the supervision of the most important Eurozone credit institutions. The EBU can, thus, be understood as an essential precondition to striking a balance between the necessity of providing a common Eurozone fiscal backstop and constraining the moral hazard this backstop inevitably created.

2.3 THE EUROPEAN BANKING UNION

To this point, this thesis has analysed the main issues stemming from the fragmented pre-EBU supervisory system that were identified during the Eurozone sovereign debt crisis. The first problem was that banking rules diverged significantly between member states. EU banking legislation was subject to diverging interpretations by member states, which engaged in regulatory competition to attract more businesses. Similarly, domestic resolution frameworks largely differed, resulting in resolution actions taken by multiple authorities along national lines. The second problem stemmed from the fragmentation of supervisory responsibilities along national lines. Home and host supervisors often possessed radically divergent incentives, which caused a significant undermining of cross-border supervision and crisis response. Third, the European sovereign debt crisis demonstrated a pernicious 'feedback loop' between the fiscal health of member states and the financial health of credit institutions in which these institutions were established.

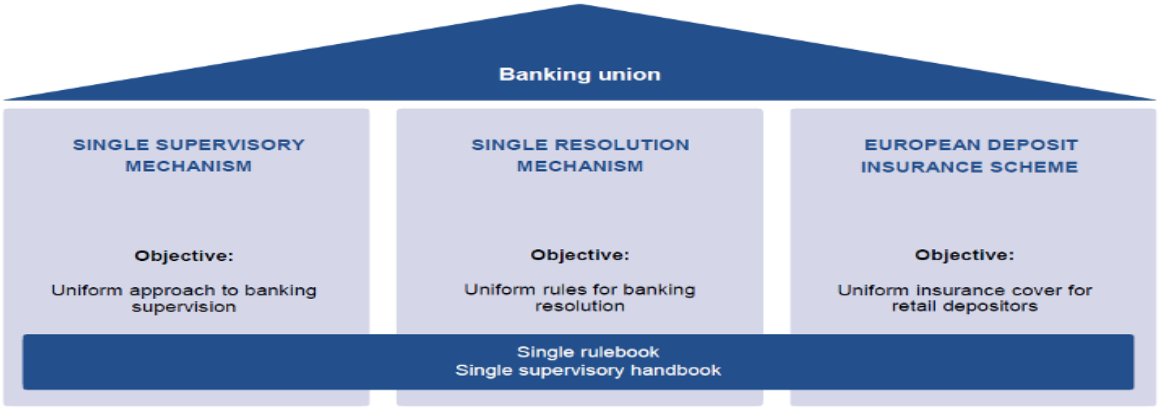
The EBU was the main policy response to these identified problems. Figure 1 shows the four core pillars of the EBU and their main objectives: the Single Rulebook, the Single Supervisory Mechanism ("**SSM**"), the Single Resolution Mechanism ("**SRM**") and the European Deposit Insurance Scheme ("**EDIS**"). Each of these pillars is currently at a different stage of legal and operational implementation. This section describes the legal frameworks establishing these pillars. It provides the foundation of the subsequent

[67] Concerns for moral hazard were expressed particularly by the German government, see David Howarth and Lucia Quaglia, 'The Steep Road to the European Banking Union: Constructing the Single Resolution Mechanism' (2014) 5 Journal of Common Market Studies 125.

examination of the incompleteness of rules and the role of actors' power in influencing policy outcomes when rules are incomplete.

Figure 1. The main pillars of the EBU and their main objectives*: The main pillars of the EBU include (a) the Single Rulebook, (b) the SSM, (c) the SRM (d) the EDIS. The Single Rulebook is the name for the EU laws that collectively govern the financial sector across the entire EU. It is supplemented by the Single Supervisory Handbook developed by the EU banking regulatory agency, the European Banking Authority (the "**EBA**") and aimed at harmonizing supervisory practices acreoss the EU area. The SSM and the SRM transfer the responsibilty for the supervision and resolution of the largest Eurozone credit institutions from NCAs to the ECB and the SRB respectively. The EDIS whose aim was to create uniform insurance cover for all eligible deposits in the Eurozone was dropeed off the Commission's agenda due to political disagreements between member states.*

Source:https://www.oenb.at/en/



2.3.1 The Single Rulebook

The Single Rulebook was adopted in order to establish a uniform set of rules that would close the regulatory gaps that became apparent during the Eurozone sovereign debt crisis. It comprises the CRDIV package, the Bank Recovery and Resolution Directive ("**BRRD**")[68] and the recast Deposit Guarantee Schemes Directive ("**DGSC**").[69] The CRDIV package consists of the Capital Requirements Directive ("**CRDIV**")[70] and the Capital Requirements

[68] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, [2014] OJ L 173 ("**BRRD**").

[69] Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes Text with EEA relevance [2014] OJ L 173 ("**DGSC**").

[70] Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms [2013] OJ L 176/338 ("**CRDIV**").

Regulation ("**CRR**").[71] The aim of the CRDIV Package was to introduce in EU law the agreed international standards to strengthen financial institutions' loss-absorbing capacity, to improve risk management and governance and to increase transparency for market participants. The CRDIV regulates who can engage in banking activity and sets prudential rules for credit institutions and investment firms. It covers rules on corporate governance, powers and responsibilities of competent authorities and measures to reduce systemic risks. The CRR, on the other hand, aims to standardize prudential requirements across the EU and establishes rules for determining the proportion between debt and equity on the balance sheets of the banks. It also sets requirements on reporting and liquidity. The CRR applies directly, whereas the CRDIV is transposed into national legislation in domestic jurisdictions.

The BRRD was established to give national authorities a complete framework for handling banks that are failing and to improve cross-border cooperation between national authorities.[72] Its goal is to equip domestic authorities with a minimum set of tools and powers to ensure a smooth resolution of credit institutions without affecting the financial system and with minimal costs for the taxpayers. The BRRD covers four main areas: (a) the preparation and prevention of resolution through recovery and resolution planning, (b) early intervention measures by supervisors, (c) the use of resolution tools when a bank failure actually occurs and (d) cooperation between national authorities. It also obliges member states to create national resolution funds to deal with failing credit institutions. The BRRD is a minimum harmonization directive which means that member states may adopt additional rules at national level, as long as they are in line with the resolution objectives and principles under the BRRD and EU state aid rules.[73]

Building upon the foundational regulatory measures established by the original CRDIV and BRRD, the European banking sector's regulatory framework was further amended by the

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[71] Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms [2013] OJ L 176/1 ("**CRR**").

[72] World Bank, 'Understanding Bank Recovery and Resolution in the EU: A Guide to the BRRD' (2017) available at: <https://documents1.worldbank.org/curated/en/100781485375368909/pdf/112266-REVISED-PUBLIC-0317-FinSAC-BRRD-Guidebook.pdf> accessed 1 March 2022.

[73] BRRD, recital 10.

introduction of a new Capital Requirements Directive[74] ("**CRDV**") and Capital Requirements Regulation[75] ("**CRR2**" and together with CRDV, the "**CRDV package**") and a new Bank Recovery and Resolution Directive[76] ("**BRRD2**"). The CRDV package introduced a new market risk and liquidity regime that incorporated the Fundamental Review of the Trading Book[77] into European law, with the goal of standardizing market risk capital calculations and increasing risk sensitivity across banks. This initiative sought to prevent excessive risk-taking that could lead to market instability. The package also strengthened liquidity requirements by enhancing the Liquidity Coverage Ratio ("**LCR**") and introducing the Net Stable Funding Ratio ("**NSFR**"). The LCR requires that banks hold enough high-quality liquid assets to survive short-term liquidity shocks, while the NSFR ensures a stable funding profile over a longer-term horizon, taking into account the characteristics of assets and off-balance sheet activities.

Another key aspect of the CRDV package was the adoption of new capital rules for derivatives and secured financing transactions. These rules aimed to improve counterparty credit risk management and reduce the systemic impacts of derivatives and securities financing activities. Modifications to the leverage ratio and the creation of a leverage ratio buffer for globally systemically important banks forced these banks to maintain higher capital levels against their exposures.

Along with the CRDV package, the revised BRRD2 focused on improving the EU's crisis management framework for banks, paying special attention to the Financial Stability

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[74] Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures [2019] OJ L 150 ("**CRDV**").

[75] Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012 [2019] OJ L 150 ("**CRR2**").

[76] Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019 amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC [2019] OJ L 150 ("**BRRD2**").

[77] The Fundamental Review of the Trading Book is a comprehensive suite of capital rules developed by the Basel Committee on Banking Supervision (BCBS) as part of Basel III, intended to be applied to banks' wholesale trading activities. For further information, see https://www.bis.org/publ/bcbs265.htm.

Board's total loss-absorbing capacity standard.[78] It was designed to ensure that systemic banks held sufficient equity and bail-in-able debt to absorb losses, thereby avoiding the risk of systemic failures. By clarifying the bail-in mechanism and establishing a clear hierarchy of creditor claims in bank resolutions, BRRD2 aimed to shift the burden of bank failures from taxpayers to the institution's shareholders and creditors. Moreover, BRRD2 emphasized the need for thorough resolution planning and preparation. It required that banks meet a minimum requirement for own funds and eligible liabilities to enable an orderly resolution without public funds. These provisions were intended to increase the readiness of banks for possible financial distress, thus enhancing the stability of the European banking sector.

2.3.2 The SSM

The weaknesses of the fragmented supervisory architecture that became apparent during the Eurozone sovereign debt crisis provided the impetus for institutional reforms to enhance coordination of supervisory actions. To this end, the SSM Regulation aims to intensify the integration of banking supervision in the euro area and to ensure a consistent application of prudential rules in all member states by establishing a centralised supervisor distant from national lobbies and with stronger incentives to identify and monitor the build-up of potential sources of cross-border contagion.[79] The SSM applies automatically to all credit institutions established in a member state that uses the Euro as its national currency.

The SSM operates a differentiated supervisory system. The ECB has become responsible for the supervision of "significant"[80] credit institutions in the Eurozone.[81] For less significant credit institutions, the ECB's role is restricted to overseeing the consistent application of the single rulebook by NCAs, which maintain day-to-day supervisory

[78] Total Loss-Absorbing Capacity Standard requirements are regulatory standards established by the Financial Stability Board to ensure that globally systemic banks have sufficient resources to absorb losses during a financial crisis.

[79] Wymeersch (n 38).

[80] The criteria for determining whether banks are considered significant include: (a) the total value of the bank's assets; (b) the bank's economic importance for a specific member state or the EU economy as a whole; (c) the size of the bank's cross-border operations; (d) the receipt by the credit institution of ESM assistance; and (e) whether the bank is one of the three most significant banks established in a particular member state, see table 1 on page 17 below.

[81] SSM Regulation, Article 6(5)(a).

responsibility.[82] Simultaneously, however, the SSM contemplates that the ECB may subsequently assume direct supervisory responsibility for these less significant credit institutions in certain circumstances. For example, the ECB may unilaterally deem a credit institution to be of systemic significance when it has established a banking subsidiary in two or more participating member states and its cross-border assets or liabilities represent a significant portion of its total assets.[83] Moreover, the ECB may, after consulting with NCAs, assume direct supervisory responsibilities for less-significant credit institutions when it deems it necessary to do so in order to ensure the consistent application of supervisory standards.[84]

The criteria for determining whether banks are considered significant - and therefore under the ECB's direct supervision - are set out in the SSM Regulation. Banks that fulfil at least one of the criteria listed in Table 1 below are automatically deemed significant. These are institutions whose total value of assets exceeds €30 billion; institutions whose total assets exceed €5 billion and the ratio of its cross-border assets/liabilities in more than one member state to its total assets/liabilities is above 20%; the three most significant institutions in each participating member state; institutions for which public financial assistance has been requested or received from the ESM; and institutions that NCAs consider to be important for the domestic economy.[85] Under the SSM, the ECB has become responsible for the supervision of 120 banking groups deemed to be significant which represent approximately 80% by assets of the Eurozone banking sector.[86]

[82] ibid., Articles 6(5) and 6(6).

[83] ibid., Article 6(4).

[84] ibid., Article 6(5)(b).

[85] ibid., Article 6(4).

[86] European Central Bank, 'ECB assumes responsibility for euro area banking supervision) (2014), available at: < ECB assumes responsibility for euro area banking supervision (europa.eu)> accessed 1 March 2022.

Table 1: Criteria for determining the significance of a credit institution: A bank is deemed significant if (a) the total value of its assets exceeds 30 billion; (b) it is important for the economy of a specific country or the EU economy as a whole; (c) the total value of its assets exceeds €5 billion and the ratio of its cross-border assets/liabilities in more than one member states to its total assets/liabilities is above 20%; (d) it has received or requested ESM assistance; and (e) it is one of the three largest banks established in a particular country. *Source: the ECB website: What makes a bank significant? (europa.eu)*

Significance criteria	
Size	the total value of its assets exceeds €30 billion
Economic importance	for the specific country or the EU economy as a whole
Cross-border activities	the total value of its assets exceeds €5 billion and the ratio of its cross-border assets/liabilities in more than one other participating Member State to its total assets/liabilities is above 20%
Direct public financial assistance	it has requested or received funding from the European Stability Mechanism or the European Financial Stability Facility

A supervised bank can also be considered significant if it is one of the three most significant banks established in a particular country.

The SSM grants the ECB exclusive competency to perform a number of specific tasks relating to the prudential supervision of credit institutions established in the Eurozone and other participating member states. These tasks include authorizing and withdrawing the licenses of credit institutions;[87] evaluating the acquisition and disposal of certain 'qualifying holdings' in credit institutions;[88] monitoring compliance with the Single Rulebook and imposing capital, liquidity, leverage, risk management, remuneration and other prudential requirements;[89] conducting supervisory reviews including, where appropriate, stress tests to determine whether credit institutions have adequate loss-absorbing capacity and other 'arrangements, strategies, processes and mechanisms' for managing risk;[90] carrying out supervisory tasks in relation to recovery plans.[91]

In order to ensure that the ECB is able effectively to carry out its new supervisory responsibilities vis-à-vis significant credit institutions, the SSM grants it a number of

[87] SSM Regulation, Article 4(1).

[88] Pursuant to Article 4(1)(36) of CRR the term 'qualifying holding' means a direct or indirect holding in a credit institution which represents 10 per cent. or more of the capital or voting rights which makes it possible to exercise significant influence over the management of that institution.

[89] SSM Regulation, Articles 4(1)(d) and 4(1)(e).

[90] ibid., Article 4(1)(f).

[91] ibid., Article 4(1)(i).

specific powers. First, the SSM gives the ECB the power to request information from, conduct on-site inspections of and impose administrative penalties on, credit institutions.[92] When necessary to carry out its tasks, the ECB may also instruct NCAs to make use of the powers conferred to them under national law.[93] Second, on the basis of its supervisory reviews, the ECB has the power to impose additional capital, liquidity, reporting and other requirements on credit institutions.[94] It can also adopt early intervention measures in cases where a credit institution is, or is likely to find itself, in breach of prudential requirements.[95] Third, where explicitly permitted by European law, the ECB is empowered to impose structural requirements, i.e., 'ring-fencing,'[96] measures on credit institutions and to request the limitation or cessation of certain activities or changes to their legal or operational structure.[97] Fourth, at the macroprudential level, the SSM gives the ECB the power to apply more stringent countercyclical and other capital buffers than those imposed by member states. Finally, the ECB has some rule-making powers, as it can adopt regulations, after initiating public consultations, but only to the extent necessary to organise arrangements for the carrying out of its tasks.[98]

It is worth emphasising that, notwithstanding the transfer of responsibility to the ECB, the NCAs remain heavily involved in the supervision of significant banks. Ongoing supervision of the significant banks is carried out by Joint Supervisory Teams ("**JSTs**") comprising staff from both the ECB and NCAs.[99] Each JST is led by a coordinator at the ECB who is responsible for the implementation of supervisory tasks and activities for each individual significant credit institution.[100] Each NCA appoints a sub-coordinator and staff members

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[92] ibid., Articles 9-13 and 18.

[93] ibid., Articles 9(1).

[94] ibid., Articles 4(1)(f) and 16(2).

[95] ibid., 4(1)(i) and 16(1).

[96] For more information, see UK Independent Commission on Banking, *Final Report and Recommendations* (September 2011) available at: < https://www.gov.uk/government/news/independent-commission-on-banking-final-report> accessed 20 October 2024 and High-level Expert Group on Reforming the Structure of the EU Banking Sector, *Final Report* (2 October 2012) available at: <https://finance.ec.europa.eu/system/files/2016-10/liikanen-report-02102012_en.pdf> accessed 20 October 2024.

[97] SSM Regulation, Article 4(1)(i).

[98] ibid, Article 5.

[99] European Central Bank (n. 27), 11.

[100] ibid., 17.

who shall assist the JST coordinator as regards the organisation and coordination of supervisory tasks in the JST.[101]

Both the ECB and NCAs are subject to an express duty of cooperation in good faith, coupled with obligations to consult each other regularly.[102] NCAs remain the main recipients of information by supervised entities and are responsible for performing initial data checks.[103] In addition, they must provide the ECB with the assistance it needs to carry out its supervisory tasks, including, in particular, its ongoing day-to-day supervisory assessments.[104] Indeed, NCAs cooperate in numerous dedicated projects by actively participating in ad-hoc working groups as well as in on-site inspection missions. More importantly, the SSM requires the ECB to apply all relevant EU law, but when EU law requires a member state to adopt national legislation to transpose EU law into domestic jurisdictions, the ECB shall apply the national legislation.[105]

The transfer of supervisory responsibilities and the potential conflicts of interest between the SSM and the ECB's monetary policy mandates, necessitated a number of changes to the internal governance structure of the ECB. The planning and execution of tasks conferred upon the ECB under the SSM became the responsibility of a newly created Supervisory Board, comprised of a Chair, Vice-Chair, four representatives of the ECB and one representative of each participating member state.[106]

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[101] ibid.

[102] SSM Regulation, Article 6(1).

[103] SSM Regulation, Article 6(7)(b); Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) [2014] ("**SSM Framework Regulation**") OJ L 141, Article 115(2).

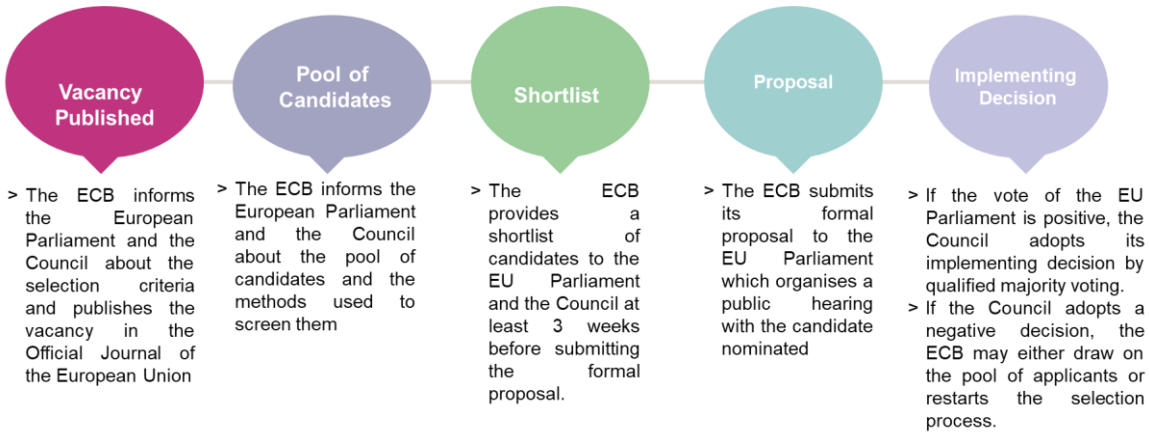
[104] ibid., Articles 6(2) and 6(3).

[105] ibid., Article 4(3).

[106] ibid., Article 26(1).

The process of appointing the Chair of the Supervisory Board has two phases: selection and approval.[107] The procedure is illustrated in Figure 2 below.[108] In the first phase, the ECB decides on the *selection criteria*, keeping the European Parliament and the Council informed. As soon as the selection criteria are decided between the above institutions, the vacancy is published in the Official Journal of the European Union. At all stages, the ECB keeps the Parliament and the Council informed of the pool of applicants and the method used to screen them. After the deadline for applications expires, the ECB conducts a pre-selection, identifying a shortlist of at least two candidates, which is then communicated to the European Parliament and the Council. The Governing Council then makes a formal proposal, which it submits to the European Parliament for approval.

***Figure 2*: The Appointment Process:** *This figure shows the appointment process for the selection of the Chair and the Vice Chair of the Supervisory Board. The procedure starts with the ECB informing the European Parliament and the Council of the selection criteria and publishing the vacancy in the Official Journal of the European Union. At all stages the ECB keeps the European Parliament and the Council informed of the pool of candidates before submitting its formal proposal to the European Parliament. Following a positive vote of the European Parliament, the Council adopts its implementing decision by qualified majority voting.*



In the second phase, the European Parliament organises a public hearing with the nominated candidate, after which the voting process begins. If the European Parliament's vote on the nominee produces a positive outcome, then the final step of the process is the appointment of the nominee by the Council by an implementing decision. The Council decides using

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[107] ibid., Article 26(2)-(4).

[108] For an overview of the appointment processes for the Chair and the Vice-Chair, see European Parliament, 'European Central Bank Appointments' (2019, europa.eu) available at: < https://www.europarl.europa.eu/RegData/etudes/STUD/2019/638413/IPOL_STU(2019)638413_EN.pdf > accessed 1 March 2022.

qualified majority voting, excluding Member States that do not participate in the SSM. If the European Parliament or the Council reaches a negative decision on the candidate, the ECB may choose either to draw on the pool of original applicants or to restart the selection process.

The qualified majority voting process requires 55% of member states, representing at least 65% of the EU population, to vote in favour of a candidate.[109] To limit the possibility of larger states joining together to block proposals, a blocking coalition must include at least 4 member states representing at least 35% of the EU's overall population.[110] Table 2 shows the share of votes of Eurozone member states in the Council, depending on the population of member states. Germany and France acting in coalition with either Spain or Italy and an additional member state can block the appointment of any candidate. The voting power that these countries enjoy has enabled them always to be represented in the executive bodies of the ECB.[111] In turn, their representation enables them to influence major EU policy decisions, which are typically made following informal coordination meetings between the top officials of the ECB, the Eurogroup and the European Council.[112] It is not surprising, therefore, that the appointment of the most senior executive officials in the EU institutions has always been subject to heated negotiations between member states.[113]

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[109] TFEU, Article 238.

[110] ibid.

[111] Kathryn M.E. Dominguez, 'The European Central Bank, the Euro and Global Financial Markets' (2006) 20(1) Journal of Economic Perspectives 67, 71.

[112] Uwe Puetter, *The European Council and the Council – New Intergovernmentalism and Institutional Change* (OUP, 2014), 117.

[113] Mariano Rajoy, 'Madrid Hopes ECB Appointment Leads to Wider EU Role' (2018) available at: <Madrid hopes ECB appointment leads to wider EU role | Financial Times (ft.com)>, accessed 1 March 2022.

Table 2 – Qualified Majority Voting: *When the Council decides on the proposal made by the ECB, a qualified majority is reached if two conditions are met: (a) 55% of member states vote in favour and (b) the proposal is supported by member state representing at least 65% of the total EU population. The table below sets out what percentage of the Eurozone population each country represents.*

Countries	% Euro Population
Germany	24.2
France	19.7
Italy	17.9
Spain	14
Netherlands	5.3
Belgium	3.4
Greece	3.3
Portugal	3.1
Austria	2.5
Finland	1.6
Slovakia	1.4
Ireland	0.62
Slovenia	0.61
Latvia	0.4
Estonia	0.26
Luxembourg	0.16
Malta	0.13

The appointment of the Vice-Chair of the Supervisory Board follows a similar approval process to the appointment of the Chair analysed above. The Governing Council selects the candidate among the Executive Board members. The European Parliament then holds a public hearing with the candidate, after which the voting process begins. In case of a positive decision, the Council adopts an implementing decision. If the Parliament's or the Council's decision is negative, the Governing Council should propose another candidate.

The activities of the Supervisory Board are supported by a Steering Committee which prepares the Board's meetings.[114] The Steering Committee is composed of the Chair and Vice-Chair of the Supervisory Board, one ECB representative and five representatives of

[114] SSM Regulation, Article 26(8).

NCAs.[115] The five representatives are appointed by the Supervisory Board for one year, based on a rotation system that ensures representation of countries depending on the size of their domestic banking system.[116] NCAs are allocated to four groups, according to a ranking based on the total consolidated banking assets in the relevant participating member states.

Table 3 shows the group to which each member state is allocated. Germany, France, Italy and Spain will always have a representative in the Steering Committee.[117] Each group shall have as a minimum one member on the Steering Committee. Although the Steering Committee does not have any formal authority to make decisions, it can have a major impact on the way the Supervisory Board views the reality of given situations by determining how and when access to information to the Supervisory Board will be granted and by highlighting or downplaying the importance of specific events occurring elsewhere in the organisation.

Table 3: Rotation System of the Steering Committee: *The representation of NCAs in the Steering Committee follows a rotation system based on which NCAs are allocated to four groups according to a ranking based on the total consolidated banking assets in the relevant participating member state. Each group has a minimum of one member in the Steering Committee. The term of office of each NCAs as members of the Steering Committee shall be one year.*

Group	Member State	Number of seats on the Steering Committee
1	Germany and France	1`
2	Spain, Italy and the Netherlands	1
3	Belgium, Ireland, Greece, Luxembourg, Austria, Portugal and Finland	1
4	Estonia, Cyprus, Latvia, Malta, Slovenia and Slovakia	1

The decision-making process in the SSM is illustrated in Figure 3 below. The process begins with the JSTs, which are responsible for acquiring and assessing supervisory information related to the credit institutions under their supervision. Having assessed that information, the JSTs submit draft decisions to the ECB, either in response to a request by the ECB or on their own initiative.[118] Following the receipt of that information, the Supervisory Board

[115] Rules of procedure of the Supervisory Board of the European Central Bank [2014] OJ L 182.

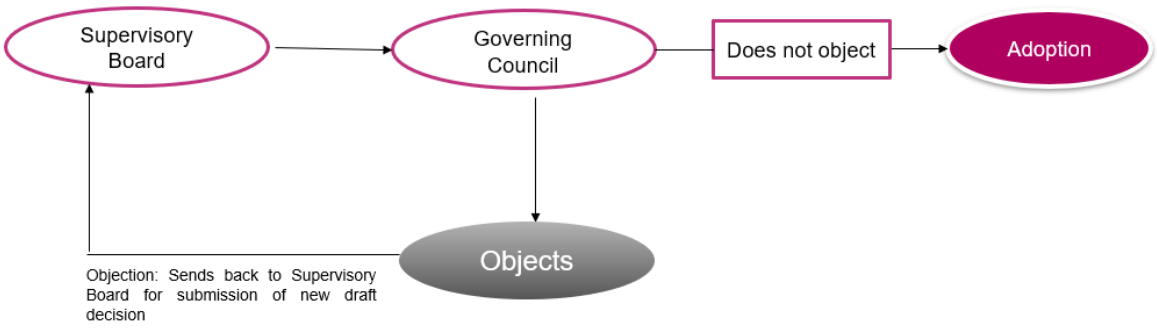
[116] ibid., Article 11.

[117] ibid., Annex.

[118] SSM Framework Regulation, Article 91(1).

reviews the JSTs' submissions and submits its draft decisions to the ECB's Governing Council, which will be deemed to have adopted them unless it objects within a specified timeframe.[119] If the Governing Council objects to a draft decision, it must state its reasons in writing, including, in particular, any monetary concerns and send the draft decision back to the Supervisory Board.[120] Ultimately, the Supervisory Board must comply with the decisions of the Governing Council and submit a new draft decision.

Figure 3 –The SSM decision making process: *This figure illustrates the SSM decision making process. The Supervisory Board submits its draft decisions to the ECB's Governing Council, which will be deemed to have adopted them unless it objects within a specified timeframe. If the Governing Council objects to a draft decision, it sends the draft decision back to the Supervisory Board which must adopt a new decision.*



In case there are differences of views between the Supervisory Board and the Governing Council regarding an objection by the Governing Council to a draft decision of the Supervisory Board, a newly established mediation panel is responsible for resolving them (the "**Mediation Panel**").[121] The Mediation Panel comprises one member per participating country chosen from among the members of the Governing Council or the Supervisory Board.[122]

Lastly, the shift of responsibilities to the ECB has been complemented by the establishment of the Administrative Board of Review ("**ABoR**").[123] The ABoR is comprised of five

[119] SSM Regulation, Article 26(8): This timeframe must not exceed 10 days outside the context of "emergency situations", where the timeframe must not exceed 48 hours.

[120] ibid.

[121] SSM Regulation, Article 25(5).

[122] ibid.

[123] SSM Regulation, Article 24.

members and two alternates, who are all appointed by the ECB's Governing Council after hearing the Supervisory Board.[124] The ABoR carries out internal administrative reviews of the ECB's supervisory decisions. The reviews may be requested by any person or legal entity who are addressees of or are directly affected by an ECB supervisory decision.[125] After such request is made, the ABoR expresses its opinion on the conformity of the decision with the SSM Regulation, while respecting the margin of discretion left to the ECB. The ABoR submits the outcome of its review to the Supervisory Board, proposing that it either abrogate the initial decision or replace it with an identical or amended one for final approval by the Governing Council under the non-objection procedure.[126] The opinion of the ABoR is not binding and the Supervisory Board has the right to choose whether to follow it or not. The person making the request can also choose to challenge an ECB decision directly at the European Court of Justice.[127]

The set-up of the Supervisory Board stems from the European Commission's desire, expressed in the legislative proposal to set up the EBU, to avoid any conflicts of interest that might arise in connection with the ECB's simultaneous pursuit of monetary policy objectives relating to price stability.[128] The SSM seeks to contain any such conflicts in two principal ways.[129] First, the ECB supervisory staff must be organisationally separated from staff involved in carrying out the ECB's other responsibilities.[130] Second, the operation of the Governing Council must be "completely differentiated as regards monetary policy and prudential supervisory functions".[131] This differentiation must include – at a minimum – strictly separated meetings and agendas.[132] Given that it is ultimately the same individuals making decisions relating to both the ECB's supervisory and monetary functions, one might

[124] ibid., Article 24(2).

[125] ibid., Article 24(5).

[126] ibid., Article 24(7).

[127] ibid., Article 24(11).

[128] European Commission, 'Communication from the Commission to the European Parliament and the Council – A Roadmap Towards a Banking Union' (2012) available at: < https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012DC0510&from=EN> accessed 2 March 2022.

[129] SSM Regulation, Article 25(2).

[130] ibid.

[131] ibid., Article 25(4).

[132] ibid.

question whether these requirements will have a substantive impact on the deliberations of the Governing Council.[133] Moreover, as described above, the SSM itself actually contemplates that in certain circumstances the Governing Council will take monetary policy considerations into account when adopting decisions on supervisory matters.[134]

In addition to vertical coordination, the SSM requires horizontal coordination between the ECB and other European institutions, including the European Systemic Risk Board (the "**ESRB**"), the ESM and especially the European Banking Authority ("**EBA**"). Created in 2011, the role of the EBA is to centralise, to some extent at least, rule setting as to resolve technical issues and to develop a set of harmonized prudential rules applicable to all credit institutions established within the EU. A close working relationship between the EBA (as author of the harmonized set of prudential rules across the EU) and the ECB (as promulgator of a common supervisory approach in the Eurozone) is vital to the efficient functioning of the SSM.[135] To this end, the SSM requires the ECB to contribute to the development of technical standards by EBA. In addition, the EBA regulation allows the participation of an ECB representative to the Board of Supervisors.[136] However, unlike national authorities, the ECB representative has no voting rights.[137] The ECB remains subject to the technical standards and guidelines adopted by the EBA along with the EBA's powers to resolve a cross-border disagreement between supervisors and require action in emergency situation. This is particularly important in light of evidence that the EBA's decision making process is dominated by national preferences.[138]

In sum, table 4 below shows the main bodies involved in supervisory decision-making in the SSM, their composition and their respective roles in the organisation. As the table

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[133] For a general overview of the conflicts that might arise in connection with the simultaneous pursuit of monetary policy and supervisory functions, see Thorsten Beck and Daniel Gros, 'Monetary Policy and Banking Supervision: Coordination Instead of Separation' (cesifo.org, 2012) available at: <https://www.cesifo.org/DocDL/forum4-12-focus6.pdf> accessed 2 March 2022.

[134] SSM Regulation, Article 26(8).

[135] SSM Regulation, Article 4(3).

[136] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC [2010] OJ L 331 ('**EBA Regulation'**), Article 40.

[137] ibid; the Board of Supervisors is the decision-making body of the EBA comprised of NCAs and EU officials.

[138] European Commission, The operation of the European Supervisory Authorities (ESAs) and the European System of Financial Supervision (ESFS) COM (2014) 509 final, 9.

illustrates, notwithstanding the transfer of responsibilities to the ECB, NCA stuff still play a vital role in decision-making processes.

Table 4 - The SSM main decision-making bodies: *The main bodies involved in decision-making processes in the context of the EBU are (a) the JSTs, (b) the Steering Committee, (c) the Supervisory Board and (d) the ABoR. These bodies are comprised of both national and EU stuff who are appointed by either domestic or EU authorities. The JSTs are responsible for the day-to-day supervision of significant credit institutions and submitting draft decisions to the Supervisory Board. The Steering Committee is responsible for supporting the activities and preparing the agenda of the meetings of the Supervisory Board. The Supervisory board is responsible for adopting supervisory decisions. The ABoR is responsible for the administrative review of such decisions. National and EU stuff are subject to an express duty of cooperation under the SSM Regulation.*

Body	Composition	Appointment Process	Role in the decision-making process
JSTs	Comprised of both ECB and NCA staff.	The ECB appoints the JST coordinator. NCAs appoint the sub-coordinator and supervisory staff.	JSTs are responsible for day-to-day supervision. They review and assess supervisory information. They submit draft decisions to the Supervisory Board.
Steering Committee	Chair of the Supervisory Board (appointed for a non-renewable term of five years), Vice-Chair of the Supervisory Board (chosen from among the members of the ECB's Executive Board) One ECB representative chosen from among the ECB representatives on the Supervisor Board Five representatives of national supervisors	The Supervisory Board shall appoint the representatives of NCAs pursuant to a rotation system which ensures representation based on the size of domestic banking systems.	The Steering Committee shall support the activities and prepare the meetings of the Supervisory Board
Supervisory Board	The Chair of the Supervisory Board The Vice-Chair of the Supervisory Board Four representatives of the ECB One representative of each participating member state.	The Chair and Vice Chair of the Supervisory Board are selected based on an appointment process involving the ECB, the EU Parliament and the Council. National representatives are appointed by member states.	The Supervisory Board is responsible for the planning and execution of supervisory tasks. It submits draft decisions to the ECB's Governing Council.
ABoR	The ABoR is Comprised of five members and two alternates.	The Governing Council appoints the ABoR after hearing the Supervisory Board.	The ABoR is responsible for reviewing internally the Supervisory Board's decisions.

2.3.3 The SRM

The transfer of supervisory tasks to the ECB rendered essential the centralisation of resolution tasks in the participating member states. The SRM was designed to ensure the swift and orderly resolution of failing banks and other financial institutions, to harmonise resolution practices across participating member states and to provide a credible financial backstop. The SRM aimed, thereby, to eliminate the need for taxpayer-funded bailouts and break the negative feedback loop between bank and sovereign balance sheets. At the heart of the SRM lies a new European agency: the SRB. The SRB is the operational centre and decision-making body of the SRM and is responsible for the effective and consistent functioning of the entire mechanism.

The SRM applies to credit institutions that fall within the remit of the SSM: that is, to banks that are deemed to be significant and are subject to the supervision of the ECB. The SRB is responsible for drawing up, adopting and updating resolution plans for all banks directly supervised by the ECB.[139] National resolution authorities, meanwhile, are responsible for resolution planning and resolvability assessments for less significant institutions.[140] Simultaneously, however, the SRB may at any time, after consulting with the relevant national resolution authority, assume direct responsibility for 'less significant' credit institutions whenever doing so is necessary to ensure the consistent application of high resolution standards.[141] The SRB can also assume direct responsibility if the resolution of less significant credit institutions requires the use of the SRF.

The SRB is composed of a Chair, a Vice Chair, four additional executive members and a member appointed by each participating member state to represent the interests of national authorities.[142] The appointment of the Chair and Vice Chair of the SRB follows a similar process to the appointment of the Chair and the Vice-Chair of the ECB's Supervisory Board. The Commission publishes the vacancies in the Official Journal of the EU and provides a

[139] SRM Regulation, Article 10.

[140] ibid., Article 9. Except insofar as the resolution of an institution requires recourse to the SRF described in greater detail below.

[141] ibid., Article 7(4)(b).

[142] ibid., Article 43.

shortlist of candidates for these positions to the European Parliament and the Council.[143] It then submits its proposal for the appointment of the Board Members to the European Parliament for approval.[144] Following the European Parliament's approval, the Council adopts an implementing decision acting by qualified majority.[145]

Decisions of the SRB are made by either the plenary or executive session. Table 5 below shows the composition, tasks and the voting rules for each session. When deliberating on the resolution of a specific bank, the executive session is composed of the Board Members and the national resolution authorities of the Member States in which the failing credit institution is established.[146] The executive session is responsible for decisions relating to the preparation, assessment and approval of resolution plans for individual credit institutions.[147] As discussed in greater detail below, it is also responsible for determining whether an institution meets certain threshold conditions for resolution and, ultimately, for adopting resolution schemes designed to effect the orderly resolution of institutions that satisfy these conditions.[148]

Table 5 – The SRB's sessions and responsibilities: *Decisions of the SRB are made by either (a) the executive or (b) the plenary session. The executive session is comprised of the Board Members and the national resolution authorities of the jurisdiction in which the failing credit institution is established. It is responsible for the adoption of resolution schemes whose use of the SRF is below than or equal to €5 billion and decides by consensus. The plenary session is comprised of the Board Members and the national resolution authorities of all member states. It adopts the resolution schemes whose use of the SRF is above €5 billion and decides on the financing of the SRF. The voting power of national authorities depends on the size of the member states' contributions to the SRF.*

Session	Composition	Tasks	Decision-making process
Executive	The Board Members and the national resolution authorities of the Member States in which the failing credit institution is established	(i) Adopting resolution plans and resolution schemes whose use of the SRF < €5 billion (ii) Determination of MREL;	Joint agreement by consensus. If joint agreement cannot be reached, the Board Members make a decision by simple majority

[143] SRM Regulation, Article 56.

[144] ibid.

[145] ibid.

[146] ibid, Article 53.

[147] ibid, Article 54(1).

[148] ibid., Article 18 and 54.

Session	Composition	Tasks	Decision-making process
		(iii) Application of simplified obligations for certain institutions (Art.11 of SRM); (iv) Decisions on some parts of the budget (Art. 60 of the SRM)	
Plenary	The Board Members and the national resolution authorities of all member states.	(i) Evaluating resolution tools when the use of the SRF > €5 billions and deciding on the financing of the SRF. (ii) Adopting the annual program activity, staff regulations and framework for cooperation with NCAs; (iii) Establishing the SRB's internal structures; (iv) Monitoring the SRB's budget and approving the accounts; (v) Deciding on the extraordinary *ex post contributions* to the SRF and alternative financing means	When use of SRF>€5 billions, simple majority representing 30% of SRF contributions. When deciding on the financing of the SRF, two-thirds majority representing at least 50 per cent. of contributions during the SRF's transitional period and 30 per cent. of contributions thereafter.

The plenary session comprises the Board Members and the national resolution authorities representing all member states. The role of the plenary board is to make decisions relating to resolution schemes that contemplate the use of more than €5 billion in capital by the SRF.[149] More broadly, the plenary board is responsible for evaluating the application of resolution tools when the net accumulated use of the SRF exceeds €5 billion in capital or €10 billion in liquidity in any consecutive 12-month period,[150] and for decisions relating to various aspect of the financing of the SRF.[151] For example, the plenary board is responsible for making decisions on raising extraordinary *ex post* contributions from credit institutions

[149] ibid., Article 50(1)(c).

[150] ibid., Article 50(1)(d).

[151] ibid., Articles 71 and 73.

where the resources available in the SRF are insufficient to support the resolution process.[152] The decisions of the plenary board in relation to resolution schemes whose use of the SRF exceed €5 billion in capital or €10 billion in liquidity are taken on the basis of a simple majority representing 30 per cent. of contributions to the SRF, whereas decisions related to the financing of the SRF are taken on the basis of a two-thirds majority representing at least 50 per cent of contributions during the SRF's transitional period and 30 per cent of contributions thereafter.[153]

The size of national compartments as of 9 August 2022 is shown in descending order in Table 6 below.[154] Germany and France represent more than 50% of the SRF contributions and, if they act in coalition, they can block any decision during the SRF's transitional period. This control over funds can be an important source of power, especially in the context of bank resolutions in which conflicting interests between member states are prone to arise.

[152] ibid.

[153] ibid., Article 52(3).

[154] This is the last time the size of national compartments became available on the SRB's website, Single Resolution Board, "National Compartments" (srb.europa.eu, 2024) available at: https://www.srb.europa.eu/system/files/media/document/2023-03-17_National-Compartment.pdf accessed 28 April 2024.

Table 6: Current Size of National Compartments*: This table shows the size of national compartments (in €mil) as of 9 August 2022 in the SRF and the % of the total SRF contributions each national compartment comprises. France and Germany in coalition represent more than 50% of the total contributions which can be an important source of power in the context of bank resolutions.*

Country	Current Size of National Compartments (in €mil) – Figures are rounded to the nearest decimal point	% of the SRF (Figures are rounded to the nearest decimal point)
France	19.741,09	30%
Germany	16.795,77	26%
Spain	6.360,01	10%
Italy	6.459,29	10%
Netherlands	5.196,71	8%
Belgium	2.365,24	4%
Austria	1.840,44	3%
Finland	1.374,23	2%
Luxembourg	1.202,17	1.7%
Ireland	1.076,95	1%
Portugal	931,32	1%
Greece	685,60	1%
Slovakia	178,43	0.2%
Cyprus	147,51	0.2%
Hungary	125.84,	0.2%
Bulgaria	111,35	0.1%
Slovenia	82,85	0.1%
Estonia	62.61	0.1%
Malta	61,39	0.1%
Lithuania	56,93	0.1%
Latvia	47,63	0.1%
TOTAL	64,903.37	100%

Notwithstanding the transfer of responsibilities to the SRB, national resolution authorities continue to play an important role in the functioning of the SRM. Ongoing tasks relating to the resolvability of credit institutions are carried out by Internal Resolution Teams ("**IRTs**")

comprised of staff from both the SRB and national resolution authorities.[155] Each IRT is led by a coordinator at the SRB who is responsible for the coordination of work within the IRT.[156] Each national resolution authority appoints a sub-coordinator and staff members who shall assist the IRT coordinator as regards the performance of resolution tasks in respect of specific credit institutions.[157]

The SRB staff and national resolution authorities are under an express obligation to cooperate closely and exchange information that is relevant to the efficient functioning of the SRM.[158] National resolution authorities are further obligated to assist the SRB in on-site inspections, investigations, resolution planning and preparing resolution decisions.[159] More importantly, national authorities are responsible for executing the decisions adopted by the SRB in accordance with the conditions laid down in their domestic law transposing the BRRD.[160]

The SRB issues guidelines, general instructions and recommendations to national resolution authorities on any matters that it deems necessary for the efficient performance of its resolution tasks.[161] If the SRB deems that the national resolution authority has not complied with its decisions or has applied them in a way that poses a threat to any of the resolution objectives, it can make direct resolution orders to credit institutions. In exercising such powers, the SRB must act in good faith having regard to any objections raised by national resolution authorities and national law transposing the BRRD. It is also worth emphasizing that the decisions taken by the SRB must not impinge on the fiscal responsibility of member states.[162] In this regard, only extraordinary public financial support should be considered to

[155] Decision of the Single Resolution Board of 17 December 2018 establishing the framework for the practical arrangements for the cooperation within the Single Resolution Mechanism between the Single Resolution Board and National Resolution Authorities (SRB/PS/2018/15) ("**SRM Framework**") available at: <decision_of_the_srb_on_cofra.pdf (europa.eu)> accessed 2 March 2022.

[156] ibid., Article 26.

[157] ibid.

[158] SRM Regulation, Article 31.

[159] ibid., Article 36(1).

[160] ibid., Article 29; SRM Framework, Article 11.

[161] SRM Regulation, Article 31(1).

[162] SRM Regulation, Recital 19 and Article 6(6).

be an impingement on budgetary sovereignty, while decisions related to the use of the SRF or of a deposit guarantee scheme must not be considered of fiscal nature.[163]

In addition to vertical coordination, the SRM also requires a substantive degree of horizontal coordination between the SRB and a number of EU institutions. While the SRB plays a central role in the resolution process, it is not the only body with decision-making authority under the SRM. In the majority of cases, the resolution process will be triggered by the ECB's determination that a credit institution under its supervision is failing or likely to fail.[164] This task is consistent with the ECB's role as the main banking supervisor. The SRB's can initiate the resolution process on its own initiative, but is awarded a rather supplementary role in this regard.[165] It must first inform the ECB of its intention to undertake this assessment and only if the ECB does not itself conduct the assessment within three days may the SRB advance on its own.

A credit institution is deemed to be failing or likely to fail when it is, or is likely in the near future to be, in breach of its prudential requirements for continuing authorization, balance sheet insolvent, unable to pay its debt as they become due, or in need of extraordinary public support.[166] Once the ECB makes this determination, the SRB must then evaluate (i) whether there is a reasonable prospect of a private sector solution materializing within a reasonable timeframe; and, if there is not, (ii) whether resolution action is necessary in the public interest.[167]

In relation to the assessment of whether an alternative private solution could be found, the SRM Regulation foresees that this must be done by the SRB in collaboration with the ECB. The ECB may also inform the SRB and national authorities if it considers that such a solution cannot be found. As to the assessment of whether resolution is in the public interest, the SRM Regulation provides a list of objectives that the SRB must take into account when

[163] ibid., Recital 19.

[164] ibid., Article 18(1).

[165] ibid.

[166] ibid., Article 18(4).

[167] ibid., Article 16(1)(b)-(c).

applying the resolution tools and exercising its resolution powers.[168] Specifically, the SRB must decide that a resolution process is in the public interest if it:

(i) ensures the continuity of the failing credit institution's critical functions;

(ii) avoids significant adverse effects on financial stability, in particular by preventing contagion, including to market infrastructures and by maintaining market discipline;

(iii) it is necessary to protect public funds by minimising reliance on extraordinary public financial support;

(iv) to protect depositors covered by the Deposit Guarantee Scheme Directive; or

(v) to protect client funds and client assets.

These objectives are not hierarchical, but each of them can act as a constraint on the separate pursuit of the others. The SRB must exercise discretion as to the trade-off and prioritization of each of them taking into consideration the nature and circumstances of each case. When pursuing the resolution objectives, the SRB must seek to minimize the cost of resolution and avoid destruction of value unless necessary to achieve the resolution objectives.[169] If the above thresholds are not met, the failing institution is wound up under normal insolvency proceedings in accordance with domestic laws.

Figure 4 illustrates the SRM decision making process. Following the ECB's determination that an institution is failing or likely to fail, the SRB must decide whether (a) a private sector solution is possible and (b) resolution is in the public interest. If resolution is not in the public interest, then the failing bank is liquidated pursuant to national insolvency laws. If resolution is in the public interest, the SRB is required to prepare and adopt a resolution scheme and to submit this scheme to the European Commission for review.[170] Within 24 hours of submission, the European Commission must then endorse or object to the proposed scheme. Within 12 hours of submission, the European Commission may also propose to the Council that it should either object to the scheme on the ground that it is not in the public interest, or that it should approve or reject a material modification put forward by the European Commission relating to the use of the SRF as contemplated by the original

[168] ibid., Article 14(2).

[169] ibid.

[170] ibid., Article 18(6).

scheme.[171] Where the European Commission objects to the scheme, or where the Council approves a material modification proposed by the European Commission, the SRB is required to modify the scheme within 8 hours.[172] Otherwise, if no objection has been expressed by the European Commission or Council within 24 hours of submission, the resolution scheme may enter into force.[173] The SRB must then ensure that the relevant national resolution authorities carry out all actions necessary to implement the scheme.[174]

The decision-making process under the SRM is subject to a series of strict deadlines. At the same time, the SRM also contains a number of procedural requirements that may serve to delay decision making. First, before deciding on a resolution action or the exercise of powers to write down or convert capital, the SRB must ensure that an 'independent', 'fair', 'prudent' and 'realistic' valuation of the assets and liabilities of the credit institution is undertaken.[175] Second, where resolution involves the granting of state aid, the scheme cannot be adopted before the European Commission has rendered an opinion as to the compatibility of the use of public aid with the internal market.[176] Finally, the SRB's decision to use the SRF triggers an investigation by the European Commission into whether the use of the SRF would distort or threaten to distort competition, affect trade between member states, or be incompatible with the internal market.[177] Where the European Commission issues a negative decision in this regard, the SRB must revise the resolution scheme to reflect the substance of the European Commission's objections. The Council, acting unanimously, may also decide that the use of the SRF is compatible with the internal market in exceptional circumstances.[178]

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[171] ibid., Article 16(7).

[172] ibid,

[173] ibid.

[174] For a detailed description of the process, see Single Resolution Board, 'The Single Resolution Mechanism – Introduction to Resolution Planning' (2016) available at: <intro_resplanning.pdf.pdf (europa.eu)>, accessed 2 March 2022.

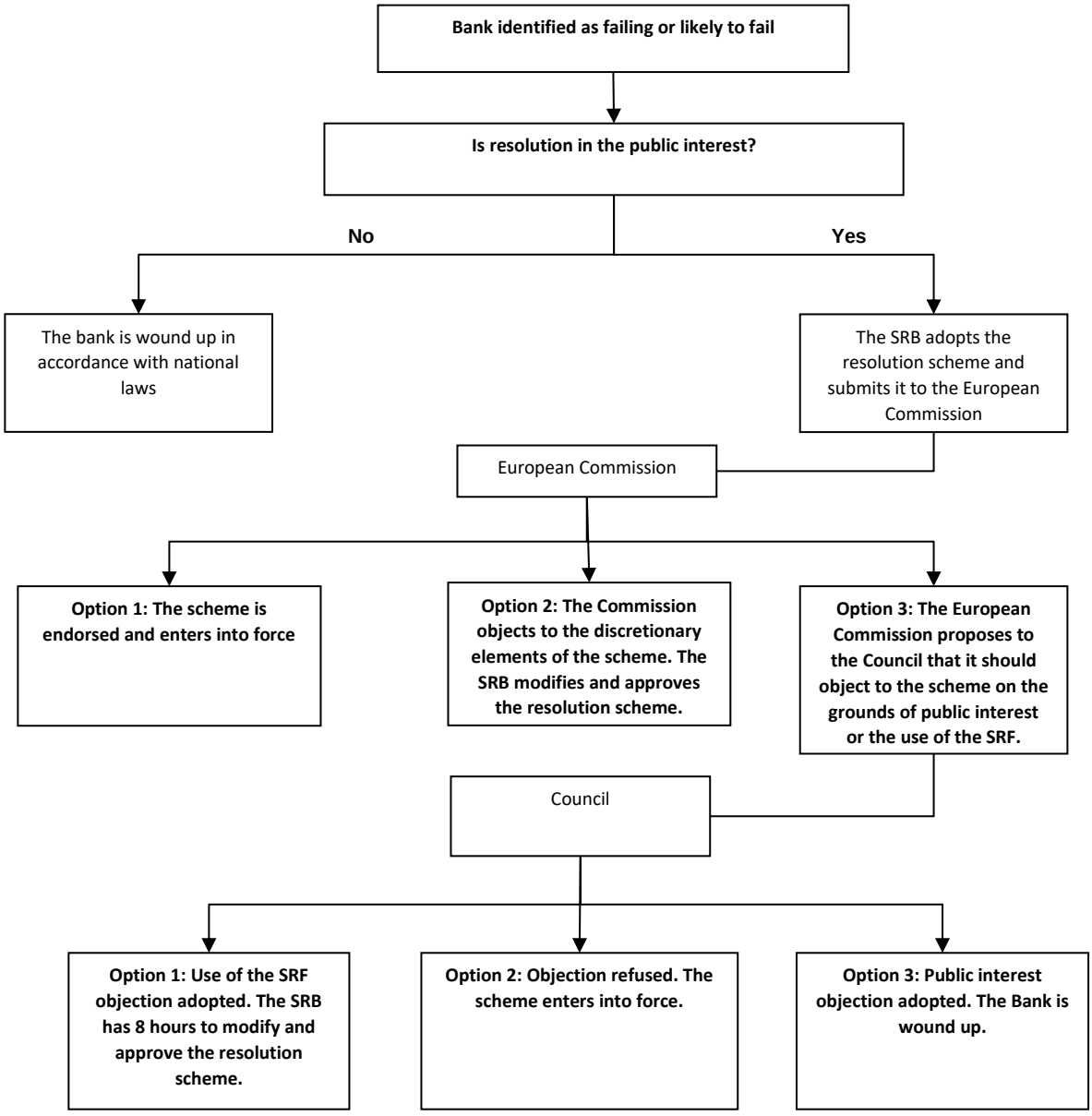
[175] SRM Regulation, Article 20(1).

[176] ibid., Article 19(1).

[177] ibid., Article 19(1) and 19(3).

[178] ibid., Article 19(10).

Figure 4 - Decision making process of the SRB: *The diagram illustrates the SRM decision making process. Following the ECB's determination that an institution is failing or likely to fail the SRB must decide whether (a) a private sector solution is possible and (b) if resolution is in the public interest. If resolution is not in the public interest, then the bank is liquidated pursuant to national insolvency law. If resolution is in the public interest, the SRB submits the resolution scheme to the European Commission for review. The European Commission must then (a) endorse the scheme or (b) object to the discretionary elements of the scheme or (c) proposes to the Council that it should object to the scheme on the grounds of public interest or the use of the SRF. When the European Commission objects to the discretionary elements of the scheme, the SRB is required to modify the scheme within 8 hours. When the European Commission proposes to the Council that it should object to the scheme on the grounds of public interest or the use of the SRF, the Council can (a) adopt the SRF objection and ask the SRB to modify the resolution scheme or (b) refuse the objection of the European Commission so that the scheme enters into force or (c) accept the public interest objection so that the bank is liquidated under national law.*



The European Commission makes its assessment with regards to the compatibility of the SRF financing with the internal market following a procedure which is identical to the State

aid control procedure. For this purpose, the Commission adopted a number of guidance documents and mainly the 2013 'Banking Communication.'[179] This Communication grants the European Commission significant powers including, in particular, the ability to make the use of the SRF contingent on a number of conditions, commitments or undertakings with respect to the beneficiary ailing bank, as well as requirements for the appointment of a trustee or an independent person to assist with the monitoring of the credit institution.[180] The ECB has observed that, as State aid control and the SRM framework serve different objectives, State aid control should not always prevail over other major policy considerations, such as the need to preserve financial stability.[181]

The SRB has four resolution tools at its disposal to deal with failing banks. The first and arguably the most important tool is generally referred to as the 'bail-in' tool; it gives the SRB the ability to write-down or convert into equity the unsecured liabilities of a credit institution under resolution.[182] The bail-in tool can be used to write-down or convert any unsecured liability, excluding covered deposits, client money or other assets, liabilities with a remaining maturity of less than seven days and certain obligations owed to employees, trade creditors, tax authorities and deposit guarantee schemes.[183] In exceptional circumstances, the SRB may also exclude liabilities from the application of the bail-in tool where:[184]

(i) it is not possible to bail-in the respective liabilities in a reasonable timeframe;

(ii) it is necessary to ensure the continuity of critical functions or core business lines;

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[179] Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') [2013] OJ C 216.

[180] ibid., Article 6(5).

[181] European Central Bank, 'Opinion of 6 November 2013 on a proposal for a Regulation of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Bank Resolution Fund and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council Opinion of the ECB on the SRM Proposal of 6 November 2013', 10. See also George Zavvos and Stella Kaltsouni, 'The Single Resolution Mechanism in the European Banking Union: Legal Foundation, Governance Structure and Financing" in Matthias Haentjens and Bob Wessels (eds.), *Research Handbook on Crisis Management in the Banking Sector,* 132.

[182] SRM Regulation, Article 27.

[183] ibid., Article 27(3).

[184] ibid., Article 27(5).

(iii) it is strictly necessary and proportionate to avoid giving rise to widespread contagion, especially regarding eligible deposits of natural persons and SME enterprises, which would disrupt the functioning of the financial markets, in a manner that could cause a serious disturbance to the economy of a member state or the Union; or

(iv) it would cause a destruction in value such that the losses borne by other creditors would be higher than if these liabilities were excluded from bail-in.

The SRB is only permitted to use the bail-in tool where there is a reasonable prospect that the proposed write-down or conversion, together with other measures, will restore the institution in question to financial soundness and long-term viability.[185]

The other resolution tools available to the SRB are all designed to facilitate the transfer of shares, assets, liabilities and other rights of credit institutions to one or more third parties. The 'sale of business' tool, for example, enables the SRB to arrange for a purchase of assets and assumption of liabilities by a private transferee bank.[186] This purchase is made possible by the sweeping powers given to the SRB to waive the ordinary property rights of the bank and its creditors. Where there is doubt about the quality of the assets, it is possible to effect partial transfers, whereby the purchaser takes the good assets, leaving toxic assets behind. The rump-up entity is then liquidated over a long period of time. Along the same vein, in case a private purchaser cannot be found, the 'bridge institution' tool enables the SRB to transfer ownership to a public sector purchaser, with a view to subsequently transferring ownership to an asset management vehicle or returning the institution to private ownership.[187] Finally, the 'asset separation' tool enables the SRB to transfer toxic assets to a public sector management vehicle for the purpose of managing these assets.[188]

In addition to the above tools, a response to the challenge of complexity in resolving large credit institutions has been for supervisors to engage *ex ante* in supervisory dialogue with credit institutions in order to identify how recovery and resolution might successfully be achieved *ex post*. This engagement involves the elaboration of recovery and resolution plans

[185] ibid., Article 27(2).

[186] ibid., Article 24.

[187] ibid., Article 25.

[188] ibid., Article 26.

that set out how the credit institution will respond to financial distress. Recovery plans identify measures of financial stress and a range of options that the institution can pursue in a range of circumstances.[189] These options can include divesting assets, raising equity capital, cancelling dividends and debt-equity swaps. The options are intended to be implemented by the institution itself, on its own initiative, if its financial position deteriorates. Resolution plans, meanwhile, set out how, if an institution fails, its business can safely be continued within the framework of resolution.[190] The idea is to provide supervisory authorities with a roadmap of necessary actions in order that they can be carried out quickly.

The BRRD requires each credit institution to draw up, and its competent authority to assess its recovery plan. The ECB or the national competent authorities are responsible for submitting recovery plans to the SRB, which examines them with a view to making recommendations in case it identifies any impediments to resolvability.[191] If such impediments are found, the SRB can request that national resolution authorities take measures, including the revision of intra-group financing agreements, limitations of exposures, imposition of disclosure requirements, divestiture of assets, the cessation of business activities and the issuance of loss-absorbing financial instruments.[192] The SRB is then itself responsible for drawing up, adopting and updating resolution plans for all credit institutions subject to direct supervision by the ECB and for conducting assessments of resolvability.[193]

The resolution of failing credit institutions under the SRM is supported by the SRF. Subject to the constraints identified above, the SRB may use the SRF for the purpose of providing loans or guarantees to credit institutions under resolution, purchasing their assets, or contributing capital to bridge financial institutions or asset management vehicles.[194] The SRB cannot however use the SRF to absorb losses or to recapitalise a failing credit

[189] BRRD, Section A of Annex A.

[190] BRRD, Section B of Annex A.

[191] SRM Regulation, Article 10.

[192] ibid, Article 10(11).

[193] ibid., Article 10(3).

[194] ibid., Article 76(1).

institution.[195] In effect, the SRF is designed to provide medium-term financing while the SRB and national resolution authorities implement the contemplated resolution scheme.

The SRF is intended to be financed primarily through the imposition of *ex ante* levies on credit institutions established in participating member states.[196] The levies imposed on individual credit institutions are to be calculated on the basis of a flat contribution reflecting the institution's pro rata share of the total liabilities of all credit institutions established in the relevant member state and the risk-adjusted contribution reflecting firm-level risk characteristics.[197] The SRB may also raise extraordinary *ex post* contributions from credit institutions where the resources available in the SRF are insufficient to cover the relevant losses.[198]

The target level of the SRF has been set at one per cent of covered deposits[199] in participating member states.[200] This translates into approximately €78 billion on the basis of current figures.[201] In the event that the *ex ante* and *ex post* contributions prove insufficient to cover the relevant losses, the SRB may authorise the SRF to borrow additional sums and/or enter into other contractual arrangements for the purposes of attracting third-party financial support.[202] As a final resort, the SRB is authorised to raise the capital necessary to ensure the orderly resolution of systemically significant credit institutions from public financial arrangements.[203]

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[195] ibid., Article 76(3).

[196] ibid., Article 70.

[197] ibid., Article 70(2)(a).

[198] ibid., Article 71.

[199] Covered deposits are those covered by a statutory deposit guarantee scheme, i.e., €100,000 per depositor per credit institution.

[200] SRM Regulation,

[201] Single Resolution Board, 'Single Resolution Fund Grows by €10.4 billion to reach €52 billion' (2021) available at: <Single Resolution Fund grows by €10.4 billion to reach €52 billion | Single Resolution Fund grows by €10.4 billion to reach €52 billion | Better Regulation> accessed 3 March 2022.

[202] SRM Regulation, Article 73.

[203] ibid., Article 74.

As a response to the Covid-19 pandemic, the Eurozone member states signed an agreement amending the ESM treaty.[204] This agreement provides the legal basis for a set of new tasks to the ESM, including the provision of a common backstop to the SRF, a stronger role in future economic adjustment programmes and crisis prevention. The common backstop to the SRF is intended to address situations where the SRF proves not to be sufficiently funded by the banking sector and will take the form of a credit line from the ESM to the SRF. The reform will come into force once Eurozone member states complete their respective national ratification process.[205] As of January 2024, Italy is the only country that had not completed the national ratification process.[206]

2.4 CONCLUSION

The EU has long pursued the goal of creating a single Eurozone banking market, as it would bring many advantages for the Eurozone member states. However, the Eurozone sovereign debt crisis revealed the problems that member states faced from the lack of unified supervision under a central authority in the Eurozone, such as the divergence of the EU single rulebook across different jurisdictions, the tendency of NCAs to favour their own banking markets over others and the "vicious circle" between failing banks and Eurozone member states.

To address these issues, the EBU was established, aiming to harmonize the rules by creating a Single Rulebook and common supervisory practices, establish a single European authority, the SRB, for the resolution of systemic banks and pool resolution funds at the European level for financing resolutions of failing banks. However, the establishment of the EBU was not a simple task. Member states had intense negotiations as they tried to safeguard their

[204] Agreement Amending the Treaty Establishing the European Stability Mechanism (adopted on 27 January and 8 February 2021) (to enter into force on the date when instruments of ratification, approval or acceptance have been deposited by all the Signatories), available at: < https://www.esm.europa.eu/about-esm/esm-reform-documents/esm-treaty-amending-agreement > accessed 20 October 2024.

[205] Fitch Ratings, 'Fitch Affirms European Stability Mechanism at 'AAA'; Outlook Stable' (2024) available at: <https://www.fitchratings.com/research/sovereigns/fitch-affirms-european-stability-mechanism-at-aaa-outlook-stable-12-01-2024> accessed 28 April 2024.

[206] ibid.

national interests. As a result, the final form of the EBU was quite different from the initial proposal and remained incomplete in many aspects.

3 THE HEATED NEGOTIATIONS OVER THE EBU

3.1 INTRODUCTION

The transfer of supervisory responsibilities from NCAs to the ECB and SRB under the EBU represented a monumental shift in financial governance that would seem politically improbable at an earlier point in time. As explained in Chapter 1 (*The Evolution of the EU Banking Market: Integration, Crisis and Power Dynamics*), the EU had been working for many years to establish a common market in financial services. Despite these dedicated efforts, as well as the EU's single market rules, European countries have pursued strong banking sector protectionism and until recently they maintained home supervisory and regulatory authority.[207] Such preferences were especially evident among the Eurozone's largest economies.[208]

Eurozone member states were reluctant to give up control over the credit institutions established in their jurisdictions to the EU level because of the important role banks play in their economies. Banks are crucial for the economies of member states because they can channel the flow of funds to the economic sectors that matter most for them. Moreover, the ability of member states to cope with economic shocks depends on the ability of banks to channel the flow of money in the economy. By adjusting interest rates, imposing regulatory reserve requirements and implementing other measures that can affect the availability of credit in the economy, NCAs can either stimulate or restrain spending and investment according to the economic situation, thus smoothing the economic cycle.

It is not surprising, then, given these reasons that the negotiations over the establishment of the EBU were very long and difficult with member states trying to protect domestic preferences. There was a clear divide among member states regarding the design of the EBU and the regulatory areas that could have distributional consequences. In the end, the final outcome of the EBU was different from what was planned and somewhat incomplete. Although supervisory and resolution responsibilities were transferred to the ECB, there is still a need for a high degree of coordination between the centralised EU bodies and NCAs. Also, the single rulebook is not fully completed, leaving room for *ex post* judgement by the

[207] Rachel A. Epstein, *Banking on Markets: The Transformation of Bank-State Ties in Europe and Beyond* (2017, OUP), 27.

[208] ibid.

actors involved in supervisory decision making in the EBU. More importantly, the mutualisation of resolution funds is incomplete and essentially remains under the control of NCAs. If such regulatory areas are incomplete and require *ex post* judgement, then it is expected that the responses of member states and the kind of interests that they will consider when they make supervisory decisions under the EBU will be similar to the interests they considered when they negotiated over the establishment of the EBU.

This chapter is structured as follows. First, it examines the reasons for the resistance of Eurozone member states to transfer control over supervisory and regulatory responsibilities of banks to an EU entity. Second, it identifies the areas where member states negotiated hard to safeguard their national interests. Third, it explains that the regulatory rules are incomplete and the reasons for such incompleteness. Fourth, it analyses why the EBU rules are especially incomplete and explains why the mechanisms employed by the EBU regime to deal with such incompleteness are inadequate and *ex post* discretion will still be needed. Finally, it concludes that if *ex post* judgement is needed, member states will take into account similar preferences to those when they negotiated the establishment of the EBU regime and will try to protect national interests. Therefore, we need to examine the role of power in the application of the EBU framework to assess whether a balance of interests between Eurozone member states is achieved or whether some member states face more institutional constraints to voice their preferences.

3.2 THE STRATEGIC SIGNIFICANCE OF BANKS AND THE CATALYSTS FOR CENTRALISED BANK SUPERVISION

The willingness of Eurozone member states to retain national control over their banking systems is associated with more than just immediate financial consequences. It also reflects a vision for long-term socioeconomic growth and stability.[209] Banks are not only guardians of a nation's wealth but also creators of economic opportunities.[210] They are essential in directing funds into profitable investments, encouraging entrepreneurship and helping small and large businesses to thrive. Through their lending and credit policies, banks can prioritize

[209] ibid., 21.

[210] Franklin Allen and Elena Carletti, “The Roles of Banks in Financial Systems” in Allen N. Berger, Philip Molyneux and John O.S. Wilson, *The Oxford Handbook of Banking* (OUP 2012), 50.

sectors that are important for national interests, such as infrastructure, health, education and green technologies.

Furthermore, the role of banks becomes even more significant in the context of international economic competition. In an era where economic power is closely linked to technological progress, the ability to fund research and development is vital.[211] Banks can provide the needed financial support for cutting-edge research, thereby promoting innovation and securing a competitive advantage in the international market. This financial support also extends to protecting domestic industries from foreign takeovers and providing the means for domestic companies to grow globally. In essence, a state's tight control over its banking sector can act as a strategic tool, enabling it to pursue both defensive and assertive economic strategies on the world stage, ultimately increasing its sovereignty and influence in international affairs.

Additionally, the foundations of banking institutions are closely linked to the objectives of macroeconomic governance.[212] Bank regulation serves multiple purposes, one of which is to control the amount of money that banks circulate into the economy. This regulatory role is essential because it enables banks to act as main conduits for the execution of monetary policy. By controlling the money supply, financial regulators aim to maintain economic stability and prevent the adverse effects of inflation or deflation.[213] Through mechanisms such as reserve requirements, interest rate adjustments and lending standards, banks are regulated to ensure that their activities align with the broader economic objectives set by monetary authorities. The relationship between monetary policy and banking regulation underscores a complex dynamic where banks are not merely passive entities but active participants in the economic framework. By adjusting the availability of credit, banks can either encourage spending and investment during economic downturns or restrain it during periods of overheating, thereby tempering the economic cycle.

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[211] Sudipto Bhattacharya and Gabriella Chiesa Gabriella, 'Proprietary Information, Financial Intermediation, and Research Incentives' (1995) 4(4) Journal of Financial Intermediation 328.

[212] John Zysman, *Governments, Markets and Growth: Financial Systems and Politics of Industrial Change*, (1983, Cornell University Press).

[213] IMF, 'Monetary Policy and Central Banking' (imf.org, 2024) < https://www.imf.org/en/About/Factsheets/Sheets/2023/monetary-policy-and-central-banking> accessed 20 October 2024.

A country's ability to cope with economic shocks partly affects its global status. According to experts and policy makers, international banks tend to favour their local economies over foreign ones when financial troubles arise.[214] This can reduce the credit supply in those foreign markets, making them more economically vulnerable. When banks face financial instability, they often have to support their home markets. This can be due to various factors: lower risks at home during crises, pressure from national authorities to strengthen their domestic financial buffers and government aid that requires more domestic lending.[215] This creates the impression that governments have more control over banks that are owned or run locally, which makes foreign bank ownership less appealing. By limiting the role of international banks, countries try to protect themselves from possible financial turmoil that could come from these institutions.[216] The capacity to reduce the effects of foreign financial institutions enhances a nation's geopolitical power by lowering its exposure to financial instability.[217] The way a nation deals with and recovers from economic challenges not only reflects its fiscal strength but also its relative influence and position in the world.

Nations often leverage their control over financial systems as a strategic response to the shifting dynamics of the global economy, aiming to preserve or enhance their competitive edge. This control is crucial for managing the fallout from global economic disturbances and for promoting full employment.[218] The intricacies of financial systems shed light on how companies strategize for the future, the organization of labour markets and the ways countries handle economic recessions.[219] For economies that primarily use banks for funding rather than capital markets, the domestic regulation of these banks is vital for their

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[214] Rachel A. Epstein, "When do Foreign Banks "Cut and Run"? Evidence from West European Bail-Outs and East European Markets" 21(4) Review of International Political Economy, 847; Nouriel Roubini and Brad W. Setser, *Bail-outs or Bail-Ins? Responding to Financial Crises in Emerging Economies* (2004, Columbia University Press); Wolf Wagner, Dirk Schoenmaker, Philip Lane, Elena Carletti, Thorsten Beck and Franklin Allen 'Cross-border banking in Europe: Implications for financial stability and macroeconomic policies' (cepr.org, 2011) available at <https://cepr.org/voxeu/columns/cross-border-banking-europe-implications-financial-stability-and-macroeconomic> accessed 20 October 2024.

[215] Epstein (n 207), 21.

[216] ibid.

[217] ibid.

[218] John Gerard Ruggie, "International Regimes, Transactions and Change: Embedded Liberalism in the Postwar Economic Order" (1982) 36(2) International Organization 379.

[219] Peter Hall and David Soskice, *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*, (2001, OUP); Bob Hancké, Martin Rhodes, Mark Thatcher, *Beyond Varieties of Capitalism: Conflict, Contradictions and Complementarities in the European Economy* (2017, OUP).

ability to adapt. Given the close relationships banks have with their borrowers, they are typically more inclined to have a long-term view compared to other financial intermediaries. This long-term perspective allows them to absorb short-term losses while the economy adjusts.[220] On the other hand, foreign creditors, who lack these entrenched connections, might be less accommodating of short-term economic downturns, potentially offering less support for economic activities during transitional periods. In essence, the domestic banks' deep-rooted associations within their own economies position them to better facilitate activities that align with sustained growth and adaptation, unlike foreign lenders who may be more focused on immediate financial gains.[221]

Therefore, given the Eurozone's reliance on banks as the primary source of financing its economy, NCAs had few incentives to relinquish their control over large banks to supranational European authorities.[222] Enhancing the competitiveness and expansion of domestic champions, while containing foreign penetration in the domestic system by competing European banks was a primary concern of NCAs.[223] In addition to competitive considerations, fiscal and distributive issues associated with the operation of banks gave NCAs strong disincentives to transfer powers to European authorities. In particular, any transfer of supervisory responsibilities would require the introduction of corresponding burden-sharing mechanisms.[224]

On the other hand, large European banks that operated on a global scale often supported the idea of a more integrated European financial market.[225] Having consistent rules and easier processes that align with their strategic vision appealed to them, especially since it would

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[220] Hall and Soskice argue that in the coordinated market economies found in Continental Europe, banks are prepared to tolerate short-term financial setbacks during economic downturns due to their focus on long-term profitability. Conversely, capital markets, driven by a short-term outlook, are more inclined to demand swift and significant changes (such as employee lay-offs) to restore profitability promptly.

[221] Epstein (n 207), 22.

[222] Guiseppe Montalbano, *Competing Interest Groups and Lobbying in the Construction of the European Banking Union*, (2021, Palrgrave Macmillan).

[223] ibid., 101.

[224] ibid.

[225] Daniel Mugge, 'Rendering the Marketplace: Competition Politics in European Finance' (2006) 44(5) Journal of Common Market Studies 991.

help them overcome the difficulties of dealing with the laws of different EU countries.[226] A unified regulatory framework would let these banks expand their operations more efficiently, avoiding the mixture of national regulations that raised their compliance costs. However, these banks also understood the downside of centralization. Centralized supervision by the EU could reduce the regulatory competition that existed among member states for a long time. This competition benefited banks in the past, giving them the freedom to choose the most favourable regulatory environments. By using differences in supervisory standards, these financial institutions were able to improve their operations and make the most of their regulatory arbitrage opportunities.[227]

The move toward centralization showed a changing paradigm in the banks' relationship with domestic political spheres. When banks operated primarily on a national level, they built and used relationships with local politicians, which often brought them significant benefits.[228] However, as they expanded across national borders, the value of such connections started to decline. Instead, they preferred a centralized supervisory mechanism, suggesting that for banks with large ambitions, the future is in favouring a more coherent and standardized regulatory framework at the EU level.[229] This narrative illustrates the banks' changing attitude on regulation within the EU, i.e., a shift from preferring localized political ties and regulatory flexibility to supporting a more uniform and centralized approach as they increase their international reach.

The Eurozone sovereign debt crisis served as a catalyst against member states' resistance to centralisation. This pivotal moment underscored the inadequacy of a fragmented supervisory system in ensuring financial stability. Recognising this, major cross-border banks within the Eurozone saw the opportunity to advocate for a unified supervisory framework. They argued that such a framework would not only bolster financial stability but also create a more efficient and competitive banking sector across the Eurozone. The

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[226] Pepper D. Culpepper, 'Death in Veneto? European Banking Union and the Structural Power of Large Banks' (2021) 24(2) Journal of Economic Policy Reform 134.

[227] Wymeersch (n 38), 5-6.

[228] Culpepper (n 226).

[229] Culpepper (n 226).

push for centralisation was thus viewed as a strategic move to streamline regulations and eliminate the inefficiencies of the existing patchwork system.

The main areas of dispute between member states during the negotiations of the EBU, evolved around (a) the scope of centralised supervision, (b) the burden sharing mechanisms and (c) the mechanics of resolution tools. The complexity of the EBU regime can be attributed to the political compromises made between member states so that an agreement on the EBU could be reached. If the set-up of the EBU was subject to such heated negotiations, however, it is expected that the decisions of member states in situations where the EBU regime requires them to exercise *ex post* judgement will be influenced by similar considerations.

3.2.1 Scope

A major source of disagreement among member states in the EBU talks was the scope of the SSM and SRM.[230] Specifically, whether all banks in the euro area or only the main cross-border banks should be under the direct authority of the ECB and SRB for oversight and resolution. As indicated above, the Eurozone sovereign debt crisis was a chance for big global banks to advocate for more centralisation. The banks became less reliant on NCAs and the states became more reliant on them as the banks expanded their international presence in the years before the Eurozone sovereign debt crisis.[231] The costs of fragmented supervision outweighed those resulting from a loss of privileged relationships with local authorities. The banking associations from Germany, the Netherlands and other creditor countries emphasized the need for centralised supervision for all euro area banks as a leap forward to enhance financial market discipline, without the need for burden-sharing mechanisms.[232] On the other hand, the European associations of small cooperative, savings and public banks argued for a cautious and differentiated approach opposing the transfer of supervisory powers to supranational bodies.[233]

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[230] For a discussion of the preferences of member states during the establishment of the EBU, see Howarth and Quaglia, *The Political Economy of the European Banking Union* (2016, OUP), Chapter 5.

[231] Culpepper (n 226).

[232] Montalbano (n 222), 123.

[233] Howarth and Quaglia (n 230), Chapter 5.

Countries with less concentrated banking sectors, such as Germany, Austria and Finland did not want to give up control of their small and domestic oriented banks. At the same time, they were willing to accept the requests of their cross-border institutions to be supervised by the ECB and SRB.[234] In Austria and Finland, there was still a large number of independent cooperatives (around a third) that had a pure local focus. The Austrian and Finnish officials thought that it would be problematic for the ECB to supervise these smaller and locally-focused entities and preferred not to give full supervisory powers to the ECB.[235] Germany, especially, wanted to protect the country's cooperative and savings bank sector, which historically played an important role for the local economy, from direct ECB and SRB supervision. German savings banks had a strong interest in the local economy and a close presence in the local community life. Local politicians were on bank boards.[236] The tight connections between the savings banks and local and other German politicians made the federal government support the protection of existing practices and the policy of limiting direct ECB supervision to only systemically important banks.[237]

In contrast, France, Netherlands, Italy and Spain, which had banking systems that were either very concentrated or stressed by the euro-crisis, favoured a more extensive ECB and SRB involvement for all Eurozone banks to ensure fair competition.[238] The French government raised its worries about unequal treatment of member states, because its banking system was controlled by five big institutions that would all come under direct supervision by the ECB. The French Ministry of Finance at that time argued that the distinction between small and big banks was not very rational, because banking crises often originated from smaller financial institutions.[239]Another issue was how to share tasks between the ECB, SRB and NCAs and how to make institutional arrangements compatible with domestic laws. This question was relevant, as it would affect the level of supranational

[234] ibid.

[235] ibid.

[236] ibid.

[237] ibid.

[238] ibid.

[239] The Spanish *cajas,* which were small cooperative banks, triggered the most acute phase of the sovereign debt crisis in 2012. This weakened their argument that they should be exempted from a centralised supervisory system because of their limited systemic significance; for an overview of the Spanish saving banks sector see Richard Deeg and Shawn Donnelly, 'Banking Union and the future of alternative banks: revival, stagnation or decline?' 39(3) West European Politics.

bank supervision and resolution and, therefore, the actual power of the ECB and SRB in relation to both NCAs and national governments. Many member states, especially Germany, preferred a gradual approach to building the SSM and SRM. Such a system would begin with a network of NCAs until a centralised authority was established in the future after EU treaties had been amended and appropriate measures were taken to protect national taxpayers.[240] Specifically, German policy makers insisted that resolution decisions be made by the European Council, which operates by unanimity, allowing each member state to keep its veto.[241]

As discussed in section 2.3 (*The European Banking Union*) of Chapter 2 above, the political compromise reached on the SSM and SRM resulted in an *incomplete* transfer of supervisory responsibilities to the ECB and the SRB. The ECB became in charge of the most significant credit institutions in the Eurozone, while NCAs kept their supervisory powers for the less significant ones. More importantly, NCAs are the main sources of information for all banks under the ECB's supervision.[242] The final structure of the SSM regarding significant banks is a combination of a centralised model and decentralised supervision, where important powers are exercised at EU level, but NCAs remain strongly involved in the supervisory process.

Likewise, the SRM covers all banks directly supervised by the ECB. The SRB has a significant range of powers, including the adoption of the resolution scheme, the decision to put an entity under resolution, the choice of the resolution tools as well as the use of the SRF.[243] National resolution authorities are, however, in charge of the resolution of all other banks, unless a bank needs access to the SRF. Furthermore, national resolution authorities retain some influence over the resolution process vis-à-vis significant credit institutions through their participation in the SRB plenary session that decides on the use of the SRF when it exceeds a certain threshold and through giving the Council the final decision if the Commission proposes substantially modifying the SRB proposal on the SRF financing.[244]

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[240] Howarth and Quaglia (n 67), 130.

[241] ibid.

[242] SSM Framework Regulation, Article 115.

[243] For additional information relating to the powers of the SRB, see Section 2.3.3 *(The SRM*) of Chapter 2 above.

[244] Zavvos and Kaltsouni (n 181).

When the resolution scheme is adopted, national resolution authorities are responsible for implementing it within their jurisdiction. To ensure member state budgetary sovereignty, the SRM cannot require governments to provide extraordinary public support to any bank under resolution.[245]

3.2.2 Burden-sharing mechanisms

The EBU reform plans entailing debt mutualisation and fiscal transfers in the euro area encountered resolute opposition from NCAs in Germany and Nordic countries, who were the potential net contributors to such a European burden-sharing mechanism.[246] These countries fiercely opposed the possibility that the ESM be allowed directly to recapitalise the ailing banks of a member state without centralisation of supervision. They pointed out that "Europe-wide" burden sharing would increase incentives for banks and national governments in the Eurozone periphery to engage in risky behaviour.[247] The former German Finance Minister Wolfgang Schäuble required that the use of ESM funds depends on the creation of the SSM to reduce the risk of moral hazard, requiring that both sovereigns and banks that get financial help meet strict requirements.[248] In particular, the former German Finance Minister suggested that the set-up of the EBU should be a two-stage process, with the construction of a "timber-framed, not a steel-framed, banking union" in the first instance, with a resolution mechanism based on a network of national authorities and relying on national funds.[249]

Based on this reasoning, an independent third-party supervisor who can oversee the supervisory activities of NCAs should be created to lessen moral hazard if ESM funds are to be obtained.[250] Furthermore, the same countries demanded that the ECB, in close cooperation with the ECB, carry out stress tests to evaluate the Eurozone credit institutions' capital situation and make them address any legacy issues before taking over supervisory

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[245] SRM Regulation, Recital 19.

[246] Howarth and Quaglia (n 67), 129.

[247] ibid.

[248] ibid.

[249] UK Parliament – European Union Committee, 'Genuine Economic and Monetary Union' and the Implications for the UK' (2014) available at: <House of Lords - 'Genuine Economic and Monetary Union' and the implications for the UK - European Union Committee (parliament.uk)> accessed 5 March 2022, paras 66-67.

[250] ibid., para 82.

responsibility.[251] This exercise would lower the chance that European funds would be spent to compensate for past supervisory shortcomings.

3.2.3 Resolution Tools

The introduction of the bail-in tool soon appeared as a significant issue of contention among banks and member states. The Commission's consultative document included two main options regarding the treatment of bail-in-able debt.[252] The "comprehensive approach" conferred resolution authorities with a statutory power to write-down or convert all senior debt into equity.[253] The "targeted approach" required credit institutions to issue a minimum amount of bail-in-able debt under specific contractual terms specifying how bail-in will be exercised whenever the institution meets trigger conditions.[254] Table 7 shows the diverging views that emerged in relation to the design of the bail-in regime, including (i) the scope of application, (ii) the legal basis on which the exercise of bail-in would be based i.e., statutory or contractual and (iii) the date of the entry of the bail-in regime into force.

In terms of scope, large European banks supported the bail-in tool together with the sale of business tool as the preferred options for organising resolution of cross-border banks.[255] As the French bankers advocated, the main concern for large European banks was to strengthen market-sanctioning capacity over weaker credit institutions. The largest banks would be the biggest *ex ante* contributors to the SRF and would bear the highest costs in case of resolution schemes requiring the use of the SRF.[256] The bail-in tool would have the merit of shifting the costs of resolution to the failing bank. In parallel, the sale-of-business tool would allow large banks to accede to favourable mergers and acquisitions.[257] As plainly explained by the chief executive of BNP Paribas, the sale of business tool would enhance opportunities for large banks to acquire weaker institutions in the Eurozone and prompt the concentration of

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[251] ibid.

[252] European Commission, 'Technical Details of a Possible EU Framework for Bank Recovery and Resolution' (2011) available at: < This document is a working document of the Services of DG MARKT for discussion and consultation purposes (europa.eu)>, accessed 5 March 2022, 87-89.

[253] ibid.

[254] ibid.

[255] Montalbano (n 222), 154.

[256] ibid.

[257] Culpepper (n 226).

the European financial market, a process "led by the strongest banks in the most powerful economies".[258]

For this reason, the associations of large credit institutions pushed for a comprehensive statutory bail-in regime applying to all liabilities from the date of the entry of the regime into force.[259] At the same time, they expressed concerns about the impact the bail-in regime would have on some of their critical business operations if specific liabilities were not excluded from its scope.[260] For this reason, they called for the exclusion from the scope of bail-in of all investment instruments, like trading securities, covered bonds and derivatives.

Table 7 – Negotiating Positions and Outcomes: *This table shows the negotiating positions of large cross-border and smaller savings banks in relation to the design of the bail-in. Large cross-border banks pushed for a wide scope of application of the bail-in tool excluding short-term debt and other investment instruments. Small local banks established in the Eurozone periphery were primarily concerned with the impact of the bail-in on investor confidence and pushed for the exclusion of deposits and a long-phasing in period. The final BRRD legislation mirrored the preferences of large cross-border banks.*

Area	Large cross-border banks	Small local banks	Outcome
Scope of the Bail-in Tool	Exclusion of short-term creditors, covered and mortgage-backed bonds and all the liabilities linked to derivatives' contracts	Exclusion of depositors	Exclusion of short-term debt, preferential treatment of unsecured depositors
Legal basis	Statutory	Contractual	Statutory
Timing of introduction	Immediately	After the adoption of a common fiscal backstop	Introduced in 2016 (contrary to initial agreement to introduce the regime in 2019). The Commission started using the bail-in tool in 2013.

On the other hand, small savings banks established in the Eurozone periphery wanted the bail-in rules to apply only to large interconnected institutions.[261] They were particularly concerned about the risk of creditors' loss of confidence and stressed the need for contractual bail-in with a long phasing-in period to avoid volatility. The broader the scope of the debt write-down instruments and the sooner the new regime would enter into force, the higher

[258] Toby Fildes, 'Transcript Interview with Jean-Laurent Baonnafe' (GlobalCapital.com, 2013) Global Capital Euromoney Institutional Investor PLC.

[259] Montalbano (n 222), 161.

[260] ibid, 162.

[261] ibid, 155-156.

would have been the potential drawbacks for the fragile sectors in the Eurozone debtor states.[262]

In addition, as small savings banks typically relied on deposits for funding their operations, they pushed for the exclusion of deposits from the application of the bail-in tool.[263] They also opposed the pressures from the ECB and Germany to introduce the bail-in tool as soon as possible, especially without the adoption of a common fiscal backstop.[264] The banks with the largest capital shortfalls were established in the Eurozone periphery, which had been hit hardest with the crisis. The entry of the bail-in regime into force would mean that periphery states would have little choice in dealing with their ailing banks than to (a) force losses on the banks' bondholders – often amounting to small savers/taxpayers or (b) accept a take-over by large credit institutions established in more creditworthy member states (given the limited availability of national capital).

The protection of depositors became a significant issue after the experience of the Cypriot banking crisis in March 2013, when the bail-in mechanism was first used to recapitalise the Cypriot failing banks.[265] The crisis was triggered by losses from the Greek debt restructuring in late 2011 in the island's two biggest banks.[266] The IMF revealed that Cyprus could ill-afford to rescue its banking sector: the bill to save Cyprus' banks was nearly 50% of the country's GDP.[267] Not surprisingly, therefore, international creditors led by the IMF insisted on the bail-in solution as the only way to resolve the crisis. The comments of the former President of the Eurogroup, Jeroen Dijsselbloem, that Cyprus would be used as a model for future bailouts spread panic among investors and policy officials in the Eurozone

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[262] ibid.

[263] ibid., 162.

[264] European Financial Services Round Table, 'How Regulation Can Preserve the Contribution of Financial Firms to Economic Growth in Europe" (efr.be, 2012), 14.

[265] For an overview of the Cypriot banking crisis, see Athanasios Orphanides, 'What Happened in Cyprus? The Economic Consequences of the Last Communist Government in Europe' (2014) LSE Financial Markets Group Special Paper Series 232.

[266] ibid.

[267] Panicos Demetriades, 'Failing banks, Bail-ins, and Central Bank Independence: Lessons from Cyprus' (voxeu.org, 2016) available at: Bank bail-ins: Lessons from the Cypriot crisis | VOX, CEPR Policy Portal (voxeu.org), accessed 5 March 2022.

periphery.[268] It meant that large deposits in the Eurozone periphery were at risk and EU policy officials, perhaps if forced by core member states' public opinion, would impose severe penalties on Eurozone periphery states whose banks are both fragile and too large for the sovereign to save.

The final text of the BRRD closely mirrored the preferences of large credit institutions and creditor member states.[269] The adopted Directive provided that the bail-in tool would apply to all liabilities from the date of its entry into force, including unsecured deposits. Nevertheless, in response to concerns expressed by large cross-border credit institutions, a set of liabilities related to securities market operations were excluded from the scope of the bail-in tool, including covered bonds and short-term liabilities. In addition, the SRM Regulation conferred the SRB with the discretionary power to exclude shareholders and creditors from the application of bail-in "where necessary to avoid the spreading of contagion and financial instability".[270] The application of the bail-in tool came into force in July 2016 to synchronize it with the entry into force of the SRM.

In the wake of intense and often contentious political negotiations among European member states, the EBU as it stands today is a construct marked by notable *incompleteness* and falls short of the comprehensive and cohesive vision that was originally proposed. The compromises made to reach a consensus among diverse national interests have led to an EBU that lacks full-fledged integration in key areas. Notably, the level of coordination required between NCAs and the inadequate pooling of resources to address cross-border banking crises may have significant implications for the effective operation of the regime.

Therefore, it is important to carefully review the areas where the EBU's rulebook is still *incomplete*, especially as these gaps can cause member states to make *ex post* judgments. In situations where the framework is unclear or vague, member states may have to interpret the rules and make decisions in real-time, often under the stress of urgent and critical situations. These decisions can affect the EBU's effectiveness and credibility, possibly

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[268] Larry Elliott, 'Cyprus bailout: Dijsselbloem's U-turn creates chaos in the markets' (the guardian.com, 2013) available at: <Cyprus bailout: Dijsselbloem's U-turn creates chaos in the markets | Cyprus | The Guardian> accessed 5 March 2022.

[269] Montalbano (n 222), 176.

[270] BRRD, Article 27(5).

leading to uneven application of policies and a lack of certainty that could have distributional consequences for Eurozone member states.

3.3 INCOMPLETENESS OF RULES

When drawing regulatory rules, it is impossible for rule makers to write rules that are complete, in the sense that they specify *ex ante* the rights and obligations of regulated parties in every future state of the world.[271] Such rules would leave no scope for the exercise of discretion, as they would stipulate how regulators and regulatees should behave in every conceivable contingency. The key characteristic of such a legal system would be that all judgements under the governing legal provisions would be made in advance of actual cases.[272] In practice, however, the vast majority of rules fall short of this standard of perfect "completeness".[273] The pervasiveness of incomplete rules can be attributed to a number of different factors, including (a) deliberate choice, (b) innovation, (c) limitations of language, (d) lack of foresight and (e) political disagreement.

3.3.1 Deliberate Choice

As a starting point, writing complete rules would be inefficient, even if it were possible.[274] In many areas, people do not have enough information to make rules that will work well enough. This is especially true for complex areas of law such as financial regulation. Many people and experts believe that it is too early to create detailed rules for financial activities and that it would be much better to focus on the results that need to be achieved.[275] The reason is that rule makers would have to deal with potentially high *ex ante* costs of

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[271] Katharina Pistor and Chenggang Xu, 'Incomplete Law' (2003) 35(4) New York University Journal of International Law and Politics 931, 932.

[272] Cass R Sunstein, 'Problem with Rules' (1995) 83(4) California Law Review 953, 961.

[273] Oliver Hart and John Moore, 'Incomplete Contracts and Renegotiation' (1988) 56 Econometrica 112.

[274] Oliver Hart and John Moore, 'Foundations of Incomplete Contracts' (1999) 66(1) The Review of Economic Studies 115; Sanford Grossman and Oliver Hart, 'The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration' (1986) 94(4) Journal of Political Economy 681.

[275] Andrew G Haldane, 'The dog and the frisbee' (bis.org, 2012) available at: <Andrew G Haldane: The dog and the frisbee (bis.org)>, accessed 5 March 2022.

negotiating, creating and writing supposedly complete rules.[276] After that, the government agencies in charge of enforcing these rules would have to deal with the costs of checking compliance, as well as the costs of proving to regulatees or other third parties that a certain situation, has actually, happened.[277]

3.3.2 Innovation

Innovation is a constant driving force that rapidly transforms industries, with financial sectors being no exception. As such, regulatory frameworks often lag behind these swift advancements.[278] The creation and evolution of new concepts, technologies and financial instruments exemplify the dynamic nature of market innovation.[279]

Regulatory rules, by their nature, are fixed responses designed to address specific market conditions at the time of their creation. However, these rules can quickly become outdated as they might not accommodate ongoing changes and learning within the market. Consequently, they may require frequent updates to align with the fast-paced evolution characteristic of modern financial markets.[280]

In light of these challenges, there is an argument to be made for the strategic design of regulation that intentionally leaves room for interpretation and flexibility. By not being overly prescriptive, such rules can adapt more fluidly to unforeseen developments without necessitating immediate legislative changes. This approach is supported by evidence indicating that overly complex and detailed regulations can impose burdensome challenges on both regulators and market participants. Not only can these intricate rules be expensive

[276] Numerous scholars have identified these front-end contracting costs as a barrier to (complete) contracting. See Ronald Coase, 'The Nature of the Firm' (1937) 4 Economica 385; Kathryn Spier, 'Incomplete Contracts and Signalling' (1992) 23 The RAND Journal of Economics 432; Hart and Moore (n 273); Hart and Moore (n 274).

[277] For a more detailed description of the back-end costs of verifying contracts, see Robert Scott and George Triantis, 'Anticipating Litigation in Contract Design' (2006) 115 Yale Law Journal 814.

[278] Dan Awrey, 'Regulating Financial Innovation: A More Principled Based Proposal?' (2011) 5 Brook. J. Corp. Fin. & Com. L., 274.

[279] Dan Awrey and Kathryn Judge, 'Why Financial Regulation Keeps Falling Short' (2020) 61(1) Boston College Law Review 2295, 2305.

[280] ibid.

and cumbersome, but they may also be less effective when it comes to managing and controlling financial crises.[281]

3.3.3 Limitations of language

Because of the nature of language, rules will have ambiguities which will require interpretive judgement.[282] Even when the meaning of a legal term is clear in the abstract, uncertainty or *ex post* judgements may break out at the point of application.[283] In Hart's terms, rules have an "open texture", which call for *ex post* judgements by interpreters and enforcement agencies.[284]

The need for interpretive judgement is apparent in rules that contain broad standards to which enforcement authorities should adhere.[285] For example, rules that oblige enforcement authorities to act in the "public interest" need a great deal of interpretive work in order to generate the necessary content for legal provision. With such standards, it is not possible to know what "public interest" means in advance and everything will depend on the interpretive practices of the authority responsible for enforcement. More importantly, enforcement authorities may interpret the notion of "public interest" in different ways and take dissimilar enforcement actions in the context of ostensibly similar situations.

One of the reasons for ambiguity is that, like other documents, laws are drafted against a host of background assumptions and understandings, some of which are very basic.[286] In order to interpret legal provisions and understand what they mean, law enforcers must take into account the economic and institutional context surrounding them. To put it differently, the same words may mean something different in different contexts. For instance, the SRB may take resolution action against a failing credit institution only if such resolution action is necessary in the public interest. The results of such public interest assessment can change

[281] Haldane (n 275).

[282] Alan Schwartz, 'Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies' (1992) 21(2) The Journal of Legal Studies 271, 278.

[283] HLA Hart, *The concept of law* (Second Edition, Clarendon Press Oxford 1994), 124.

[284] ibid., 128.

[285] Sunstein (n 272), 965.

[286] Pistor and Xu (n 271), 938.

depending on the economic circumstances surrounding such failure.[287] In a systemic crisis scenario, regulators will generally be more cautious to initiate resolution procedures vis-à-vis a failing credit institution to avoid introducing additional volatility to the economy.[288] Similarly, national and EU authorities may have a different opinions of what "public interest" actually means depending on whether the impact of resolution is examined from a national or European perspective.

The exercise of interpretive discretion is not without limits in practice. Simply because a rule contains "undetermined" legal terms does not mean the administration automatically has discretion in defining its practical meaning.[289] Article 19 of the Treaty of the European Union mandates that the European Court of Justice ensures the law is upheld in the interpretation and application of the Treaties. Hence, it is the responsibility of the EU Courts, rather than the administration, to provide definitive interpretations of legislation. The General Court must review the administration's interpretation and override it if it finds it lacking.[290] However, a discretion may be recognised if the EU Courts conclude that the use of indeterminate legal terms reflects the intention of the rule-maker to grant decision-making latitude to the administration. When such intent is evident, the administration possesses what is known as a "discretion proper" or a "power of appraisal".[291]

Furthermore, rules frequently impose limitations on *ex post* judgments by outlining a framework within which enforcement agencies can operate. This is done by specifying objectives that indicate compliance with standards. For instance, rules may require regulators to act "in the public interest," which is considered met if the goal of safeguarding taxpayers' money is achieved. The integration of clear objectives and broad standards narrows the scope for acceptable actions by regulators and courts.

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[287] Sebastiano Laviola, 'System-wide Events in the Public Interest Assessment' (europa.eu, 2021) available at: <System-wide events in the Public Interest Assessment | Single Resolution Board (europa.eu) > accessed 5 March 2022.

[288] Anat Admati and Martin Hellwig, *The Bankers' New Clothes: What's Wrong with Banking and What to Do about It - Updated Edition* (Princeton University Press, 2016), 77.

[289] Miro Prek and Silvère Lefevre, ""Administrative Discretion", "Power of Appraisal" and "Margin of Appraisal" in Judicial Review Proceedings before the General Court" (2019) Common Market Law Review 339, 356.

[290] Paul Craig, *EU Administrative Law,* 2nd ed., (OUP, 2012), 408.

[291] Prek and Lefevre (n. 289), 356.

Nonetheless, subject to these constraints, enforcement agencies will still have to exercise a degree of judgement at the stage of application of rules. Objectives can be established at varying degrees of specificity, but they are generally cast at high level. For example, rules often spell out general goals and objectives, while deliberately leaving unspecified the required instruments to achieve these objectives.[292] The choice of instruments is left to regulators or the courts, who can choose the appropriate form and methods for delivering better policy outcomes.[293]

In other situations, rules impose an obligation on enforcement agencies to consider a number of objectives when reaching regulatory decisions. If these objectives conflict, disputes break out at the point of application,[294] when enforcement agencies exercise discretion so as to accommodate two competing objectives or to develop interpretive principles for harmonizing them. There will be situations where enforcement agencies will be able to refer to rules of priority to resolve such disputes.[295] In the absence of such rules, however, they will be called upon to make a choice on a case-by-case basis.

Even where there is no invitation from the text of the law itself or from its drafters for judgements, interpreters may be required to give laws content at the point of application.[296] It is common to find rules that have explicit exceptions for cases of necessity or emergency. Where there are unforeseen circumstances that generate a conflict between the explicit prescription of the rule and other important purposes implicit in the rule or embodied elsewhere, both the enforcement agency and the regulated party may find it inappropriate or unfair to apply the rule. In these situations, enforcement officials can resort to general escape clauses or explicit regulatory processes that enable them to decide to adjust or not to enforce a rule in what they consider to be special circumstances.

The consequences of making such exceptions depend on the details. An exception could be vague, as in the idea that supervisory authorities may exclude certain liabilities from bail-in

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[292] Pistor and Xu (n 271).

[293] Paul Tucker, *Unelected Power: the Quest for Legitimacy in Central Banking and the Regulatory State* (2018, Princeton University Press), 86.

[294] Sunstein (n 272), 989.

[295] ibid.

[296] Jefferey M Sellers, 'Regulatory Values and the Exceptions Process' (1984) 93(5) The Yale Law Journal 938.

if it is strictly necessary to achieve the continuity of critical functions (what does "strictly necessary" and "critical functions" mean?). Or the exception could be narrow and specific, as in the statement that liabilities to institutions with an original maturity of less than seven days are exempt from bail-in.

The very facts that a rule has at least one exception and that finding this exception is part of ordinary interpretation, means that in nearly every case an enforcement authority faces the question of whether the rule is reasonably interpreted to cover the circumstances at issue.[297] There may be situations in which the application of the rule to the facts are easy. Nevertheless, any judgement whether to apply the rule to the particular case will depend on claims about the relevant similarities and differences between the exception and the case at hand.[298]

3.3.4 Lack of foresight

In addition to the limitations of language, rules are often incomplete because law makers face uncertainty about the future. In coming to terms with an unknowable future, it is helpful to distinguish between risk and uncertainty.[299] Risk concerns events where it is possible to define precisely the nature of the future outcome and to assign a probability to the occurrence of that event based on that experience.[300] The complexity of financial markets, however, makes it prohibitively costly for lawmakers to gather and analyse each potential future state of the world, to calculate the probability that each state will materialize and to use this information to allocate the most efficient bundle of rights and responsibilities to regulatees in connection with each potential eventuality.

Moreover, rules are incomplete because lawmakers face more fundamental uncertainty about the future. Whereas risk can be identified *ex ante* and estimated, probabilistically,

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[297] Sunstein (n. 272), 987.

[298] ibid, 985.

[299] In his influential publication, Frank Knight made a critical differentiation between risk and uncertainty. According to Knight, risk pertains to incidents that can be assigned a known or knowable probability distribution. In contrast, uncertainty involves situations where it is impossible to determine numerical probabilities. This distinction is thoroughly discussed in Frank Knight, *Risk, Uncertainty and Profit* (Cosimo Classics 2006), pages 232-233.

[300] Ronald Gilson, Charles Sabel and Robert Scott, 'Braiding: The Interaction of Formal and Informal Contracting in Theory, Practice and Doctrine' (2010) 110 Columbia Law Review 1377, 4.

uncertainty in this context refers to categories of events that may happen that are beyond our collective imagination.[301] These are Frank Knight's "unknown unknowns"[302] and encompass the "radical uncertainty" that Mervyn King describes.[303] No law is issued with full knowledge of the factual situations to which it will be applied and no rule will be issued with a full understanding of its animating purposes.[304] In other words, law makers face cognitive and temporal limits on their ability to identify potential states of the world, to assess the probability that those states will occur and, ultimately, to write the detailed state-contingent contracts necessary to regulate future behaviour.

3.3.5 Political disagreement

In some situations, rules are incomplete because it is not a matter of being rushed or of being unable to predict, but rather a conscious decision to postpone some conflicts and to avoid hard issues that could not be resolved by agreement.[305] In other words, lawmakers may prefer incomplete over relatively complete law as a means to avoid difficult policy choices and shift responsibility for possible backlashes to the law enforcers.[306] This kind of incompleteness is not a result of an oversight, but a deliberate tactic to raise the likelihood that the outstanding provisions will be settled in a way that meets the expectations of the stakeholders involved in the negotiation process.

These situations are especially pertinent in the context of the EU, as it is comprised of member states whose legal systems and traditions differ. More importantly, member states often have to agree on issues of acute sensitivity that make politicians reluctant to put aside

[301] Frank Knight (n 299).

[302] Kathryn Judge, 'Information Gaps and Shadow Banking' (2017) 103 VA. L. REV. 411, 417-418.

[303] Mervyn King, *The end of Alchemy*: *Money, Banking and the Future of Global Economy* (2016, Little Brown), 120.

[304] HLA Hart (n 283); Sunstein (n 272), 984.

[305] Omri Ben-Shahar, 'Agreeing to disagree': Filling Gaps in Deliberately Incomplete Contracts' (2004) Wis. L. Rev. 389.

[306] Eli M. Salzberger, 'A Positive Analysis of the Doctrine of Separation of Powers, or: Why Do We Have an Independent Judiciary?' (1993) 13 INT'L REV. L. & ECON. 349, 350. See also Joseph A. Grundfest & A.C. Pritchard, 'Statutes with Multiple Personality Disorders: The Value of Ambiguity in Statutory Design and Interpretation' (2002) 54 STAN. L. REV. 627, 628-29, which suggests that lawmakers may decide to leave a law highly ambiguous, or incomplete, because that is the only compromise they can reach.

their national divergent interests.[307] As noted in section 2.3 (*The European Banking Union*) above, the Eurozone sovereign debt crisis demonstrated that member states were extremely reluctant to share fiscal responsibility and to deal with other member states' financial woes, given fierce opposition by, and accountability to, domestic constituencies.

When aspects of EU legislation cannot be resolved at once, EU member states prefer to achieve consensus piecemeal.[308] This strategy is based on the assumption of EU member states that it might be easier to resolve some contentious issues after having most of a legal framework established, or that future talks might achieve what current talks did not.[309] They expect that strong resistance to altering the current situation will diminish as the benefits of the new system become evident and problems that were very contentious can lose political relevance when affected member states get used to the new order.[310] On the other hand, piecemeal legislation enables politicians to set aside sticky issues in the hope that they might be able to sidestep them or take a larger share of the gains when the terms of the provisions are renegotiated at a later stage.

3.4 THE INCOMPLETENSS OF THE EBU

The previous section argued that regulatory rules are incomplete due to several factors namely (a) deliberate choice, (b) innovation, (c) limitations of language, (d) lack of foresight and (e) political disagreement.

This section will argue that the rules implementing the EBU are no exception, as they leave ample room for the exercise of *ex post* discretion. When law is incomplete there is a need to clarify the meaning of the law, to interpret it and apply it to specific cases. This task requires the exercise of discretionary judgement, which, depending on the legal system in question can be allocated to the legislative, executive or judicial branches of government.

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[307] Eilis Ferran, 'European Banking Union: Imperfect but it can work' (2014) Legal Studies Research Paper Series Paper No 30/2014, available at: <European Banking Union: Imperfect, But It Can Work by Eilis Ferran :: SSRN> accessed 6 March 2022, 25.

[308] ibid., 26. Ashoka Mody, 'A Schuman Compact for the Euro Area' (2013) Bruegel Essay and Lecture Series available at: <essay_schumann compact:Essay series.qxd (bruegel.org)> accessed 5 March 2022, in which he expresses a sceptical view on what it can be achieved through incremental steps.

[309] Ferran (n 307), 27.

[310] ibid.

This can prove problematic, as, although the member states have agreed to a common goal under the EBU framework, they face very powerful incentives to defect in search of unilateral gains. As section 3.2 illustrated, the set-up of the EBU was subject to heated negotiations between member states. The preferences of member states on the pillars of the EBU were heavily influenced by the impact of the reforms on domestic economies and the competitiveness of national banking sectors. In terms of mutualisation of resolution funds, in particular, member states found themselves with opposing opinions when they met around the negotiating table. More creditworthy member states were reluctant to cede control over their fiscal resources to an EU agency and face the risk of bailing out stakeholders in other Eurozone countries.

If the set-up of the EBU was subject to such heated negotiations, however, it is expected that the decisions of member states in situations where the EBU regime requires them to exercise *ex post* judgement will be influenced by similar considerations. The central issue then becomes which member states have the *power* to decide the issues which are not specified in the EBU framework and influence policy outcomes in their favour.

3.4.1 The incompleteness of the supervisory and resolution framework

(i) The SSM

The Single Rulebook aims to provide a unified regulatory framework for the European banking sector. However, upon closer examination, it becomes evident that is not as single as the title suggests. The Single Rulebook comprises two different legal instruments: regulations and directives. Whereas regulations apply directly in all member states, directives should be implemented into national law in an appropriate manner for the member state. Importantly, although directives bind national authorities as to the result to be achieved, they delegate substantive discretion to member states as to the means to achieve the relevant objectives. Even regulations confer substantive flexibility to member states to accommodate domestic preferences.[311]

[311] Guido Ferrarini, 'Single Supervision and the Governance of Banking Markets' (2015) Law Working Paper No 294/2015 available at: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2604074> accessed 5 March 2022, 22.

To illustrate this point, the CRDIV package allows for around 155 options, of which approximately 30 were created for specific member states.[312] These options cover a wide range of prudential requirements applicable to credit institutions and give flexibility to member states[313] on how to apply these provisions.[314] The rules on definition of capital under the CRR offer a relatively straightforward example. One of the most fundamental aims of the CRDIV package is to ensure that banks have adequate loss-absorbing capacity. Core Equity Tier 1 ("**CET1**") equity is the highest quality of capital and therefore a cornerstone of the regime. One would expect that what constitutes CET1 is clearly and uniformly defined across the EU. Instead, the CRR adopts a list of criteria that financial instruments must meet to be CET1 and authorities must approve all CET1 instruments.[315] There are often issues related to the interpretation of the criteria and the exercise of discretion is required as to when a financial instrument meets these criteria.[316]

For example, there is divergence between member states with regard to the inclusion of hybrid instruments in capital.[317] The list is spelled out in such a way that, in addition to common equity, banks might also use "silent participations," which are popular with public banks in Germany. The details of these funding instruments depends on the contract, but typically the holders are not given any right of control and the lack of control is compensated for by a debt-like promise to pay a fixed return unless the bank is incurring losses.[318] In addition, French policy makers characterized as "completely unacceptable" the exclusion of the calculation of banking groups' insurance subsidiaries' capital towards CET1 capital

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[312] Howarth and Quaglia (n 230), 189.

[313] Exercise of discretion is required as to rules on bonus caps, definitions of executive directors, large exposure limits, methods to calculate capital and liquidity ratios. For a comprehensive analysis, see Valia Babis, 'Single Rulebook for Prudential Regulation of Banks: Mission Accomplished?' (2015) 26(6) European Business Law Review 779.

[314] For the options contained in the BRRD, see Pamela Lintner, 'Overview on the BRRD: Financial Sector Advisory Center (FINSAC) Workshop from Experts to Experts Recovery and Resolution Finance'(wordlbank.org, 2015) available at: <http://pubdocs.worldbank.org/en/289241430926223474/ 01-BRRD-Workshop-Pamela-Lintner-WB.pdf> accessed 8 Feb 2015.

[315] CRR, Articles 26-31.

[316] BCBS, 'Basel III Regulatory Consistency Assessment (Level 2) – Preliminary Report: European Union', 22; EBA, 'Opinion on the Definition of Capital' (EBA/Op/20212/03).

[317] Ayadi, Arbak and De Groen, "Implementing Basel III in Europe: Diagnosis and Avenues for Improvement" (2012) CEPS Policy Brief No 275, available at:< https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2098932> accessed 12 May 2024.

[318] Admati and Hellwig (n 288), 187.

requirements. For this reason, the French Government fought against the inclusion of such a ban in EU capital requirements legislation that would result in French banks losing a total of 28.9 per cent. of CET1 capital.[319] Moreover, at the same time, the CRR includes considerable exemptions from CET1 requirements for institutions that are defined under national law as mutuals and cooperatives. This delegation of discretion raises the prospect of substantive divergence between the prudential regulatory regimes of each of the SSM's participating member states.[320]

In addition, the ECB has been granted specific supervisory tasks over credit institutions under the SSM which involve several areas where judgment calls are necessary. For example, the ECB has the authority to grant or withdraw licences and approve the acquisition and disposal of qualifying holdings in credit institutions. The ECB will have to use judgment when evaluating how viable a bank's business model and its governance structures are or deciding if new shareholders are suitable and what impact they have on financial stability. The ECB's discretion in matters of licensing and overseeing qualifying holdings has a direct influence on the entry and consolidation of banks within the Eurozone. Historically, regulators in individual countries may have imposed stringent conditions on new market entrants or on the acquisition of stakes in domestic banks to protect financial stability and to maintain some level of control over their banking sectors. These conditions could have been particularly restrictive in smaller countries, where financial systems were often more vulnerable and thus perceived as needing greater protection. However, with the ECB now centralizing the supervisory process, the focus shifts to a more uniform set of criteria applied across the entire Eurozone. This uniformity, coupled with the ECB's mandate to ensure an integrated European banking market, can potentially make it easier for banks to expand into periphery countries.

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[319] David Howarth and Lucia Quaglia, 'The Comparative Economy of Basel III in Europe' (2016) 35(3) Policy and Society 205, 210; IMF 'France Selected Issues Paper' (July 2011) IMF Country Report No 11/212 available at: < France: Selected Issues Paper in: IMF Staff Country Reports Volume 2011 Issue 212 (2011)> accessed 5 March 2022.

[320] Nikos Maragopoulos, 'When the Banking Gets Tough, the Large Get Going: How Capital Regulation is Driving Consolidation' (2021) European Banking Institute Working Paper Series 2021 No 89 available at: <When the banking gets tough, the large get going: How capital regulation is driving consolidation by Nikos Maragopoulos :: SSRN> accessed 5 March 2022.

(ii) The SRM

As far as the EBU resolution framework is concerned, although the BRRD aimed to be a comprehensive harmonisation measure to unify the diverse practices across Europe, it does not provide a complete framework.[321] The BRRD allows a degree of flexibility by permitting NCAs to complement the prescribed measures with additional tools and powers, provided that they do not impede the efficacy of group resolution strategies and comply with the overarching resolution objectives set out in the BRRD.[322]

More importantly, the EBU resolution framework sets out *open-ended provisions and exceptions* to rules that leave significant room for the exercise of judgement. For instance, as noted in section 2.3 (*The European Banking Union*) of Chapter 2 above, before a resolution action is taken against a credit institution, the ECB or SRB must determine that: (a) the institution is *failing or likely to fail*, (b) there is no private sector or supervisory action that would prevent the failure of the institution within a reasonable timeframe, (c) a resolution action is necessary *in the public interest* and (d) extraordinary public financial support is required *except* where**,** in order to remedy a serious disturbance in the economy of a Member State and preserve financial stability, the extraordinary public financial support takes the form of an injection of own funds or purchase of capital instruments at prices and on terms that do not confer an advantage upon the institution.[323]

(a) Precautionary recapitalization

Although one of the main aims of the EBU was to reinforce market discipline by making access to public funds almost impossible,[324] the EBU rules leave open the possibility of extraordinary public support outside resolution ("**precautionary recapitalisation**").[325] The decision-making process with respect to precautionary recapitalisation is visualised in

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[321] Danny Busch, Mirik B.J. van Rijn and Marije Louise, 'How Single is the Resolution Mechanism' (2019) EBI Working Paper Series No 30 available at <How Single is the Single Resolution Mechanism? by Danny Busch, Mirik Rijn, Marije Louisse :: SSRN> accessed 6 March 2022.

[322] BRRD, Art. 37(9).

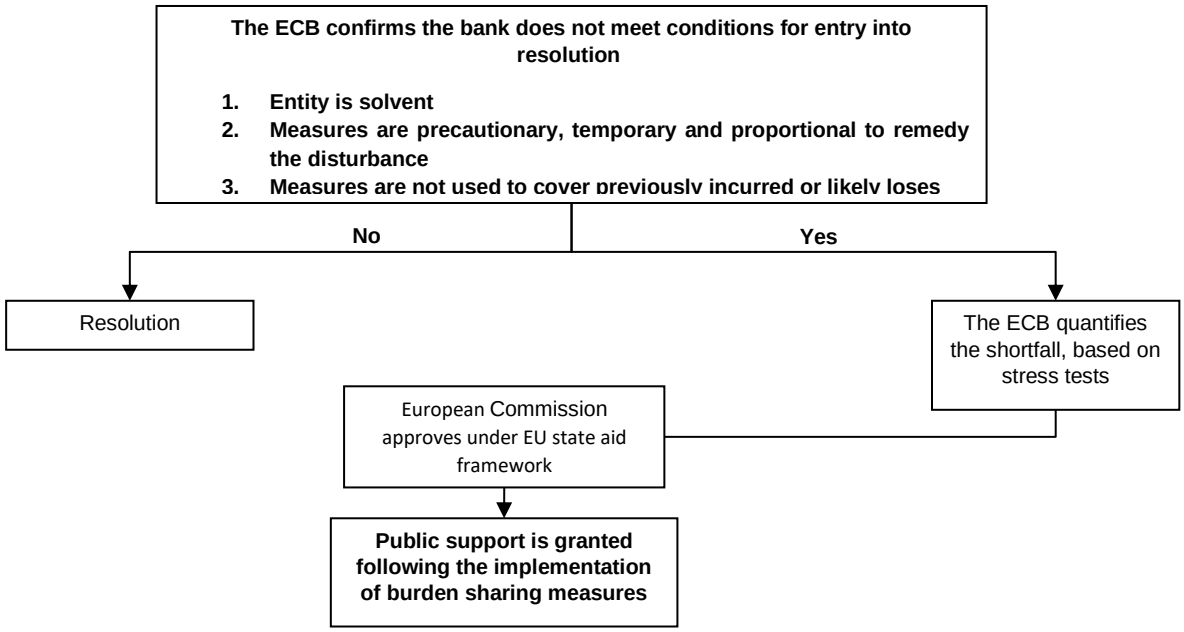
[323] BRRD, Article 32(4); SRM Regulation, Article 18(1).

[324] Christos Hadjiemmanouil, 'Limits on State-Funded Bailouts in the EU Bank Resolution Regime' (2017) EBI Working Paper Series 2017 – No 2 < Limits on State-Funded Bailouts in the EU Bank Resolution Regime by Christos Hadjiemmanuil :: SSRN> accessed 6 March 2022.

[325] ibid.; BRRD Article 32(4).

Figure 5 below. After the bank applies to its government authorities for a precautionary recapitalisation, the ECB has to be informed and must confirm that (a) the bank is solvent (b) the measures are only precautionary in nature and (c) the measures are not used to cover previously incurred or likely losses. In case the ECB decides that the above conditions are met, the competent resolution authority quantifies the shortfall based on the stress test and requests that the EU Commission approves the measures under the EU state aid framework.[326]

Figure 5: The decision-making process related to precautionary measures: *This figure shows the decision-making process related to the application of precautionary recapitalisation measures. After the bank applies to its government authorities for precautionary recapitalisation, the ECB has to confirm that (a) the bank is solvent, (b) the measures are only precautionary in measure and (c) the measures are not used to cover previously incurred losses. If the ECB decides that the above conditions are met, it decides the amount of shortfall under the adverse scenario of the relevant stress test. Once this confirmation has been received, national authorities can go ahead with providing state support conditional on final approval by the European Commission under State aid rules.*



To clarify the concept of precautionary recapitalization, we can break down the provision into its fundamental parts, as set out below. The provision allows the relevant authorities to

[326] European Central Bank, 'What is Precautionary Recapitalisation and How Does it Work' (bankingsupervision.europa.eu, 2 May 2018) available at: < https://www.bankingsupervision.europa.eu/about/ssmexplained/html/precautionary_recapitalisation.en.html#:~:text=A%20precautionary%20recapitalisation%20describes%20the%20injection%20of%20own,approval%20under%20the%20European%20Union%20State%20aid%20framework> accessed 26 October 2024; BRRD, Article 37(10)(b).

exercise *ex post* discretion in specifying many elements related to precautionary recapitalization.

(I) The aim of precautionary recapitalisation is to remedy a serious disturbance in the economy of a Member State and preserve financial stability

The presence of a "serious disturbance" in the economy suggests the sector's overall vulnerability, increasing the risk of a systemic crisis if the bank becomes insolvent.[327] Due to this "serious disturbance", it will be challenging for the private sector to solely support the bank's recovery, highlighting the importance of state aid.[328] The justification for such government assistance is to prevent the collapse of a systemic bank from causing a domino effect.[329] The flexibility of providing precautionary support was introduced by the legislators to allow for targeted measures aiming at financial stability and to cater for systemic liquidity shortages.

The EBU authorities have not issued any official documents that detail the primary factors required to evaluate a "serious disturbance" in the economy of a Member State. The use of the term can be traced back to the TFEU, whose Art. 107(1) establishes the general prohibition on State aid, unless this is justified by the existence of a serious disturbance in the economy.[330] In light of this, the European Commission issued its 2013 Banking Communication, outlining the particular regulations for various forms of governmental support extended to credit institutions and the authorisation of restructuring plans according to State aid guidelines.[331] The European Commission has consistently noted that the Eurozone sovereign debt crisis exemplifies a scenario where the allocation of State aid would be permissible under the Treaty, albeit subject to certain conditions.[332] In later

[327] Rodrigo Olivares-Caminal and Costanza Russo, 'In-Depth Analysis – Precautionary Recapitalization: Time for a Review' (europarl.eu, July 2017) available at: <https://www.europarl.europa.eu/RegData/etudes/IDAN/2017/602092/IPOL_IDA(2017)602092_EN.pdf > accessed 26 October 2024, 10.

[328] ibid.

[329] ibid.

[330] TFEU, Article 107(3)(b).

[331] European Commission, 'Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ("**2013 Banking Communication**")' (Communication) COM [2013] OJ C216/1

[332] 2013 Banking Communication, para 5.

rulings, the Commission pointed to financial market stress, economic downturns and broader adverse spill-over impacts as potential elements of such a disruption. [333]

Regarding financial stability, the Commission associates it with the necessity to avoid negative repercussions arising from the insolvency of a credit institution and the obligation to ensure that the entire banking system continues to offer sufficient loans to the real economy. [334] Extraordinary public support may be of vital importance to preserve banks' critical functions so that any problems do not spread to the wider banking system.

(II) The price and terms of the recapitalisation should not "confer an advantage upon the institution"

The price and terms of the recapitalisation should not "confer an advantage upon the institution".[335] This language seems to exclude any capital injection that does not occur under market conditions.[336] Nevertheless, the essential aim of this provision is to permit a bank that is "unable to raise capital privately in markets"[337] to secure capital from public resources without triggering resolution. It should be noted that in the Commission's initial decision on exemptions, the European Commission described precautionary recapitalisation using the term "undue advantage," which denotes an "advantage incompatible with the internal market under State aid rules."[338]

Nevertheless, the main purpose of this provision is to enable a bank, which is "unable to raise capital privately in markets"[339] to raise capital from public sources without triggering resolution. It is to be noted, that in the first decision of the Commission on the use of exemptions the wording used by the European Commission relating to precautionary recapitalisation was "undue advantage", that is to say an "advantage incompatible with the internal market under State aid rules".[340] The European Commission acknowledges that any

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[333] Olivares-Caminal and Russo (n. 327), 11.

[334] 2013 Banking Communication, para 7.

[335] BRRD, Article 32(4).

[336] B. Mesnard, A. Margerit and M. Magnus, 'Precautionary Recapitalisations under the Bank Recovery and Resolution Directive: Conditionality and Case Practice (europarl.eu, 5 July 2017), available at: <https://www.europarl.europa.eu/RegData/etudes/BRIE/2017/602084/IPOL_BRI(2017)602084_EN.pdf> accessed 26 October 2024, 2.

[337] ibid, 2.

[338] ibid.

[339] BRRD, Recital 41.

[340] Mesnard, Margerit and Magnus (n 336), 2.

recapitalisation in such circumstances favours the beneficiary bank, as the bank is unable to raise capital privately in the markets.

(III) Precautionary recapitalisation should be confined to solvent institutions

The EBA has clarified that solvent institutions means an institution that does not and is not likely in the near future (a) infringe the conditions for authorisation, (b) hold less assets than liabilities or (c) fail to pay its debts as they fall due.[341]

One of the main concerns is that many banks certified as solvent by the ECB may not actually be solvent. The valuations of illiquid assets, especially, can fluctuate significantly based on the methods and conditions applied. Evaluating a bank's assets becomes even more complex during crisis situations due to increased uncertainty regarding the fair value of a failing bank's assets.[342] In particular, during stress conditions, the discrepancy between regulatory and market values can be substantial, leading to uncertainty about the bank's true solvency.[343]

(IV) Precautionary recapitalisation is limited to the capital injections needed to address shortfall under the adverse scenario of a stress test

The EBA stress tests evaluate the bank's financial position if placed under severe pressure. The basic idea is to examine what the impact of a negative shock would be on the bank's viability.[344] These shocks can be triggered by (i) market-wide events, such as recession or stock market crash, (ii) idiosyncratic events which are bank-specific or (iii) a combination of the two. It is worth noting that the European Court of Auditors highlighted that the stress tests conducted by the EBA may not be accurate due to several key issues. Key decisions at

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[341] European Banking Authority, 'Single Rulebook Q&A – Solvency In the Context of Article 32(4)(d)' (eba.europa.eu, 17 April 2015) available at: <https://www.eba.europa.eu/single-rule-book-qa/qna/view/publicId/2015_1777> accessed 26 October 2024.

[342] Willem Pieter de Groen, 'Valuation Reports in the Context of Banking Resolution: What Are the Challenges' (europarl.europa.eu, June 2018) available at: < https://www.europarl.europa.eu/RegData/etudes/IDAN/2018/624418/IPOL_IDA%282018%29624418_EN.pdf> accessed 26 October 2024.

[343] The variations among different valuations can be significant. For example, in the adverse scenario for Spanish Banco Popular, the discrepancy between the book value and the economic value amounted to €19.2 billion, representing approximately 13% of the total assets. For further details, see Willem-Pieter de Groen, 'Precautionary Recapitalisation: Time for a Review' (europarl.europa.eu, July 2017) available at: < https://www.europarl.europa.eu/RegData/etudes/IDAN/2017/602091/IPOL_IDA(2017)602091_EN.pdf> accessed 26 October 2024, 11.

[344] Olivares-Caminal and Russo (n. 327), 10.

the EBA were taken by NCAs, leading to an insufficient EU-wide perspective in the design and implementation of stress tests.[345] Additionally, the EBA lacked control over important stages of the process, resulting in important systemic risks being subject to a low level of stress or none at all.[346] Consequently, the results often did not accurately reflect the true capital positions of participating banks

(V) The measure shall not be used "offset losses that the institution has incurred or likely to incur in the future"

Precautionary recapitalisation measures shall not be used to offset past losses as well as losses that the bank is going to incur with a high degree of certainty. The current regulation and technical standards leave, however, room for flexibility in the methodologies and assumptions for valuations.[347] In addition, the information available to independent valuators is often not sufficient to enable them to prepare the valuations and provide an estimate of the losses the bank is likely to incur in the future.[348] More importantly, any decisions made with respect to valuations of banks are private in nature. Any public disclosure of data is prohibited due to financial stability concerns. For example, doubts have often been raised as to whether specific banks met the criteria for precautionary recapitalisation measures.[349]

(VI) The precautionary recapitalisation measures shall be of "precautionary" and "temporary" nature and "proportionate" to remedy the consequences of serious disturbance in the economy of a member state

There is a lack of clear definitions for what "precautionary" and "temporary" means in the EBU regulations. Neither the relevant norms themselves nor the recitals provide reliable guidance on this. Therefore, the regulation leaves open a huge space for flexibility and institutional leeway, which can be exploited by politicians driven by the political heat of the

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345 European Court of Auditors, 'EU-wide Stress Tests for Banks: Unparalleled Amount of Information on Banks Provided but Greater Coordination and Focus on Risks Needed' (eca.europa.eu, 2019) available at: https://www.eca.europa.eu/Lists/ECADocuments/SR19_10/SR_EBA_STRESS_TEST_EN.pdf accessed 26 October 2024, 9.

346 ibid, 10.

347 Willem Pieter de Groen (n 342), 16.

348 ibid., 10.

349 Shawn Donnelly and Ioannis G Asimakopoulos, 'Bending and Breaking the Single Resolution Mechanism: the Case of Italy' (2020) 58(4) Journal of Common Market Studies 856, 865.

moment to provide disguised bail-out packages to failing credit institutions established in their jurisdictions.

(VII) The precautionary recapitalisation shall be conditional on final approval under State Aid rules

The use of public funds in the context of precautionary recapitalisation will need to considered in tandem with the framework of State aid, including the European Commission's approval of a restructuring plan.[350] The key aspects of the 2013 Banking Communication include: (a) ensuring that shareholders and subordinated creditors contribute, provided that doing so does not jeopardise financial stability, (b) the requirement for a comprehensive bank restructuring plan, (c) proof that all private sector solutions have been fully utilised and (d) if recapitalisation is necessary to uphold financial stability, such measures may be provisionally approved as rescue aid prior to the ratification of a restructuring plan.[351]

The use of precautionary recapitalisation will most likely necessitate a contribution from the private sector. According to the 2013 Banking Communication, "the bank and its capital holders should contribute to the restructuring as much as possible with their own resources."[352] Furthermore, the Communication stipulates that "before granting any kind of restructuring aid, whether through recapitalisation or impaired asset measures, all capital-generating measures, including the conversion of junior debt, must be exhausted, provided that fundamental rights are respected and financial stability is not jeopardised." [353]

Nevertheless, it is worth noting that the burden sharing provisions of the 2013 Banking Communication are significantly less cumbersome than the ones contained in the EBU rules. The 2013 Banking Communication requires a bail-in of shareholders and junior creditors, while the SRM Regulation extends the scope of bail-in to senior creditors as well as requiring an 8 per cent. creditor contribution to bank losses before public funds can be

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[350] 2013 Banking Communication, Recital 50.

[351] Olivares-Caminal and Russo (n. 327), 12.

[352] 2013 Banking Communication, para. 15.

[353] According to clause 41 of the 2013 Banking Communication: "Adequate burden-sharing will normally entail, after losses are first absorbed by equity, contributions by hybrid capital holders and subordinated debt holders. Hybrid capital and subordinated debt holders must contribute to reducing the capital shortfall to the maximum extent. Such contributions can take the form of either a conversion into Common Equity Tier 1 (16) or a write-down of the principal of the instruments. In any case, cash outflows from the beneficiary to the holders of such securities must be prevented to the extent legally possible."

provided. In addition, the provisions of the 2013 Banking Communication leave some space for flexibility where an increase of private sector contributions will have an adverse impact on financial stability.[354] The authorities involved in the decision-making process can waive the requirement for private sector contributions if, the implementation of such measures, will "endanger financial stability or lead to disproportionate results".[355] This has been explicitly acknowledged by the European Commission stating that "financial stability remains the overarching objective of its assessment".[356]

In conclusion, the uncertainty surrounding precautionary recapitalization stems from several factors. The complexity of accurately assessing the financial health of institutions necessitates the exercise of *ex post* discretion, as the regulatory framework leaves room for interpretation and adaptation to specific circumstances.

(b) Resolution of failing institutions

If a credit institution does not qualify for precautionary recapitalisation, the ECB must determine whether the institution is failing or is likely to fail. The EBU framework attempts to constrain the above judgement by introducing specific triggers that the ECB must take into account for its assessment: (a) the institution infringes or will, in the near future, infringe the requirements of continuing authorisation, (b) the assets of the institution are, or will, in the near future be, less than its liabilities, (c) the institution is, or will, in the near future, be unable to pay its debts as they fall due.[357] Although the ECB must have regard to the above objective elements, such as the institution's capital and liquidity position, the EBA guidelines state that, when the ECB is exercising its discretion, the identification of a single element should neither lead to an automatic determination that an institution is failing or likely to fail, nor automatically trigger resolution actions.[358] The 'time horizon' when considering whether an institution is "failing or likely to fail in the near future" is not defined in the EU resolution framework. The ECB must exercise its discretion to apply the most

[354] Donnelly and Asimakopoulos (n 349), 864.

[355] 2013 Banking Communication, para 45.

[356] ibid., paras 7-8.

[357] SRM Regulation, Article 18(4); BRRD 32(4).

[358] European Banking Authority, 'Final Report Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail under Article 32(6) of Directive 2014/59/EU' (eba.europa.eu, 2015) available at: < EBA-GL-2015-07 GL on failing or likely to fail.pdf > accessed 26 October 2024, 3.

appropriate time horizon, make a forward-looking assessment and apply tailored solutions depending on the reasons why an institution ran into difficulties, its position in the banking system and its standing in the respective economy.[359]

Even if the ECB determines that an institution is failing or likely to fail, resolution proceedings can only be initiated if the use of resolution tools is necessary "in the public interest."[360] This assessment is complicated by various elements, including the different approaches taken by national resolution authorities in the application of the public interest objective.[361] The former Chair of the SRB, Elke König, emphasized in a statement that the SRB is faced with 19 or more different national insolvency procedures.[362] The existing differences among national insolvency frameworks and the fact that some of these national insolvency frameworks are similar to those available in resolution complicate the handling of banking crises in a cross-border context.[363]

Under the current framework, resolution is seen as an *exception* to be granted only if liquidation under national insolvency proceedings would not achieve to the same extent one or more of the resolution *objectives*. The SRM and the BRRD set out five resolution objectives, two of which refer to financial stability: (a) to ensure the continuity of critical functions, which addresses the spill-over effects on the real economy via the lending channel; (b) to avoid significant adverse effects on financial stability, which covers the spill-over effects on other banks and financial institutions (c) to protect public funds by minimising reliance on extraordinary public financial support (d) to protect depositors and

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[359] Andras Dombert, 'Failing or Likely to Fail? Putting the European Banking Union to the Test' (bis.org, 2017) available at: < Andreas Dombret: Failing or likely to fail? Putting the European banking union to the test (bis.org)> accessed 6 March 2022.

[360] SRM Regulation, Article 18(1)(c).

[361] European Parliament, 'Further Harmonizing EU Insolvency Law from a Banking Resolution Perspective?' (europarl.eu, 2018) available at <Cases for further harmonising EU insolvency law for banks? (europa.eu)> accessed 26 October 2024.

[362] Elke König, 'European Parliament ECON Committee Hearing – Speech' (srb.europa.eu, 30 July 2018) available at: <European Parliament ECON Committee Hearing - Speech by Elke König | Single Resolution Board (europa.eu)> accessed 26 October 2024.

[363] Single Resolution Board, 'SRB Replies to the Consultation on the CMDI Review' (srb.europa.eu, 20 April 2021) https://www.srb.europa.eu/system/files/media/document/2021-04-20_srb_replies_consultation_cmdi_review.pdf accessed 4 October 2023.

(e) to protect client funds and client assets by minimising the cost of resolution and avoid destruction of value.[364]

The EBU legislation does not stipulate *a clear hierarchy* of the above resolution objectives, so that the legislation leaves ample room for EU policy makers to impose their sense of what comprises the public interest. More importantly, there will be situations where the above mandated objectives contradict each other, in part or as a whole and will not be able to be fully achieved as a result. For instance, protecting client funds by avoiding the destruction of value may require the use of public funds, creating a competing relationship between these two goals. The SRB will, thus, have to make important decisions prioritising specific objectives over others depending on the circumstances. Moreover, the SRB will take into account both the financial position of the bank and the economic environment in which it operates before making a public interest assessment. This means, in essence, that the SRB can reach different results depending on whether a bank fails while the economy grows or declines.[365]

When the SRB determines that the resolution of credit institution is in the public interest, it holds significant discretionary power in choosing and deploying the appropriate resolution tools. The SRB's discretion extends to identifying circumstances where it may be necessary to apply exclusions or exceptions, particularly with respect to the bail-in mechanism. In these instances, the SRB assesses whether the strict application of bail-in rules would be detrimental to the public interest or counterproductive to the resolution objectives.[366] The SRB has, thus, discretion to exclude totally or partially certain liabilities from bail-in if among others it is not possible to bail-in such liabilities in a reasonable timeframe, the exclusion is strictly necessary to avoid contagion or value destruction.[367] The core purpose

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[364] SRM Regulation, Article 14(2).

[365] Elke König, 'To resolve or not to resolve: a public interest assessment fit for purpose' (2020, srb.europa.eu) available at: <To resolve or not to resolve: a public interest assessment fit for purpose | Single Resolution Board (europa.eu)> accessed 6 March 2022.

[366] The SRB has the discretion to exclude certain liabilities from bail-in in exceptional circumstances, such as when it is impractical due to timing or complexity, to maintain essential bank functions, to prevent systemic risk and financial contagion, especially to protect deposits of individuals and SMEs, ensure economic stability and prevent value destruction, see BRRD Article 44(3).

[367] SRM Regulation, Article 27(5)(c).

of this discretion is to strike a prudent balance between safeguarding taxpayer money and upholding the stability of the financial system.

The inclusion of the exceptions to bail in pose a challenge for legislators. It is precisely because of these exceptions that the need for external financial support may arise.[368] On the one hand, the expectation that public support will be available may give rise to moral hazard concerns. On the other hand, a generalised promise that financial support may always be preceded by activation of the bail-in instrument may be destabilising. Thus, the modalities of the bail-in tool set significant limits to its scope, introducing significant discretionary elements, which place in question its uniformity of application.

(iii) The EU resolution funds

In addition to the EBU regulatory framework, the mutualisation of EU funds for the resolution of credit institutions remains an incomplete endeavour as the existing framework does not mitigate the risks posed by large banking failures. As noted in section 3.2.2 (*Burden Sharing Mechanisms*), there were intense discussions between Eurozone member states on essential institutional issues that involved financial consequences of sharing risks. The ECB in its Opinion of 6 November 2013 stated that access to fiscal resources is an essential element of the SRM's backstop arrangements.[369] Moreover, various expert observers argued that a Europe-wide deposit insurance scheme would provide adequate insurance for all eligible deposits in the euro area, establish fair competition in the Eurozone and reduce the possible imbalances to the single market, caused by different national schemes.[370]

Despite the above arguments, it was decided that member states would retain significant control over the use of the EU resolution funds, ensuring that these funds remained outside the direct control of EU bodies such as the SRB. The SRF was structured to initially include separate national compartments, which were to be gradually mutualised over an eight-year transitional period from 2016 to 2023. During this phase, each national compartment would contribute to the fund, with the aim of moving towards a fully mutualised system by the end

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[368] Hadjiemmanouil (n 324), 5.

[369] European Central Bank (n 181), para 2.8.

[370] Herman Van Rompuy, 'Towards a Genuine Economic and Monetary Union' (consilium.europa.eu, 26 June 2012) available at: <https://www.consilium.europa.eu/media/33785/131201.pdf> accessed 26 October 2024.

of the period. As of 1 January 2024, the SRF is no longer compartmentalized, signifying that all resources have been mutualized to form a common financial safety net for the banking sector across the Eurozone.[371] This milestone achievement also signifies the fund's attainment of the targeted level of at least 1 percent of covered deposits, which aligns with the regulatory requirements intended to ensure that the SRF has sufficient capacity to deal with bank failures without recourse to public funding.[372]

During the transition phase, in situations where a credit institution faced resolution, funding had to initially be sourced from the national compartment of the member state where the institution was located. If the resources within this compartment were insufficient to manage the resolution effectively, the affected member state could request to access the financial compartments of other member states. However, the SRF treaty incorporated a safeguard allowing member states to object to the redistribution of funds to other national compartments under certain conditions. A member state could exercise this right of objection if the proposed fund transfer threatened to interfere with an imminent resolution operation within its own jurisdiction or if there was an active resolution action already underway that could be compromised.[373] Additionally, objections could be raised if the transfer represented a significant portion of the member state's allocated resources, specifically more than a quarter of its available compartment, or if there is doubt about the recipient state's commitment to repaying the funds through national means or securing equivalent backing from the ESM in line with the predetermined framework.

Moreover, the use of the SRF is subject to strict conditionality which gives member states the right to object to its use on multiple grounds. The SRF is only accessible when participating member states maintain a legal resolution framework that aligns with and achieves outcomes consistent with the established SRM. This means that for the SRF to be used, contributing member states must have in place robust and equivalent legal structures that ensure the consistent and effective application of resolution actions across the Union. The SRF framework includes provisions that allow member states to opt out of their

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[371] Single Resolution Board, 'What is the Single Resolution Fund' (srb.europa.eu, October 2024) available at: < https://www.srb.europa.eu/en/single-resolution-fund> accessed 26 October 2024.

[372] ibid.

[373] Agreement on the Transfer and Mutualisation of Contributions to the Resolution Funds (21 May 2014) available at: < https://www.riigiteataja.ee/aktilisa/2051/1201/5006/osamaks_ingl.pdf> (the "**IGA**") accessed 26 October 2024, Article 7(4).

commitments in response to significant changes in the underlying conditions that were present when the SRF agreement was originally entered into.[374] These provisions serve as a political and economic safety valve, permitting member states to reassess their participation should there be a transformation in the circumstances that could affect their national interests or the stability of their financial systems. In practice, this means that while there is a framework for sharing resources to manage bank failures, the full mutualization of the SRF can be considered incomplete. Member states can, under certain conditions, prevent the pooling of funds, which would otherwise be used to mitigate banking crises on a collective European basis. In the context of the SRM, this is mitigated by the possibility that a member state will request the CJEU to verify the existence of a fundamental change of circumstances and the subsequent implications.[375]

In addition to the above, the use of international treaty to regulate the transfer and mutualisation of contributions to the SRF creates another source of incompleteness. It opens the door for national courts' review of the agreement. Under domestic constitutional rules, international treaties may be subject to *a priori* review in front of national constitutional or supreme courts. Therefore, any future decision to grant financial assistance to an ailing credit institution pursuant to this agreement is open to challenge before Member States' court on constitutional grounds.[376]

Following the set-up of the SRF, the impact of the Covid-19 pandemic on many Eurozone member states provided further impetus for the mutualisation of fiscal resources at an EU level. The ESM Treaty was modified in response to the pandemic, allowing the SRB to ask the ESM for a backstop facility that could cover any potential uses of the SRF. The proposal of the Commission, however, for the establishment of a European Monetary Fund aimed at integrating the ESM into the EU legal framework was not without controversy. Due to *political disagreement*, the reform package endorsed by member states represented a missed

[374] ibid., Articles 9(1) and Articles 9(2).

[375] Federico Fabbrini, 'On Banks, Courts and International law: The Intergovernmental Agreement on the Single Resolution Fund in Context' (2014) Maastricht Journal of European and Comparative Law, 450.

[376] Ioannis Asimakopoulos, 'International Law as a Negotiation Tool in Banking Union; The Case of the Single Resolution Fund' (2018) 21(2) Journal of Economic Policy Reform 118.

opportunity for further of mutualisation of fiscal resources which remains largely incomplete.[377]

As a preliminary matter, the decision making structure remained intergovernmental with all major ESM decisions still requiring unanimity of member states – in particular any decision to grant financial assistance.[378] Furthermore, many countries still require the approval of their national parliaments before they can vote in favour of granting financial assistance. This reliance on unanimity exposes member states requesting financial assistance to the political climate in each member state, thereby increasing the risk of potential investor runs on domestic banking systems.[379]

The backstop facility provided by the ESM shall take the form of a revolving credit line under which loans can be provided. The criteria for the approval of these loans are quite strict and include among others that the SRB does not have recourse to other sources of funding, the principle of fiscal neutrality is respected, the condition of the permanence the legal framework on bank resolution is complied with and the national authorities in the territories of which the resolution action takes place have complied with their obligations to transfer contributions to the SRF.[380] As the wording of these criteria is quite *vague*, the decision whether to grant financial assistance to the SRB lies with the member states' governments involved in the decision making process. The Eurozone sovereign debt crisis, however, demonstrated that their actions are heavily influenced by domestic constituencies and political considerations.

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[377] Lucas Guttenberg, 'A missed opportunity – 5 reasons why ESM reform will fail to deliver' (aei.pitt.edu, 24 April 2019) Bertelsmann Stiftung Policy Brief available at: < http://aei.pitt.edu/102501/1/2019.apr.pdf> accessed 26 October 2024.

[378] ibid.

[379] ibid.

[380] European Stability Mechanism, 'Guideline on the Backstop Facility to the SRB for the SRF' (esm.europa.eu, October 2024) available at: <https://www.esm.europa.eu/sites/default/files/migration_files/20191206_-_draft_backstop_guideline_-_publication_version.pdf> accessed 26 October 2024.

3.4.2 Reasons for the incompleteness of the EBU framework

The incompleteness of the Single Rulebook is pragmatic and a *deliberate choice* of the EU legislators, as a one-size-fits approach to banking regulation would be bound to fail due to the differences between the structure of member states' banking systems and their legal traditions and institutions.[381] Several EU member states, the European Parliament and even the Commission itself called for "European specificities" to be taken into account during the negotiations leading to the adoption of the CRD package.[382] Moreover, many governments asked for flexibility in the BRRD, especially in relation to the application of resolution tools vis-à-vis failing credit institutions.[383]

The precautionary recapitalisation and bail-in exceptions provide a degree of flexibility to implement specific measures designed to enhance financial stability and address systemic liquidity deficits. These measures are particularly relevant when a solvent bank, after undergoing a stress test or comprehensive assessment, finds it challenging to secure capital from private markets.[384] Such situations will often be ambiguous and will depend on the authorities' interpretation which will determine the form of intervention. The existence of such exception can be considered to be *a deliberate choice* of member states to accommodate the overarching need to protect financial stability. The condition that such measures should only be made available in the event of a serious disturbance in the economy may hint at exogenous events beyond the bank's control and the fragility of the sector as a whole which would be more prone to a systemic crisis should the bank slip into insolvency. Since the financial support may avoid a future insolvency of the bank being the trigger of a domino effect, a precautionary recapitalisation measure could be considered to limit negative spill over effects on financial stability.

Nevertheless, the criterion of "serious disturbance" used in the Commission's assessment provides great latitude for interpretation. No further clarification or quantitative and

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[381] ibid.; Martin Hellwig 'Yes Virginia, There is a European Banking Union! But It May Not Make Your Wishes Come True' (ssrn.com, 2014) available at: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2487757> accessed 6 March 2022, 14.

[382] Howarth and Quaglia (n 319), 188.

[383] Howarth and Quaglia (n 230), Chapter 6.

[384] Mesnard, Margerit and Magnus (n 336), 1.

qualitative indications have been provided as to the specifics of this assessment.[385] The Commission merely states that "the global financial crisis can create a serious disturbance in the economy of a member state and that measures supporting banks are apt to remedy that disturbance". The *language* of the BRRD is quite ambiguous and policy outcomes will be determined on a case-by case basis depending on the economic and institutional context in which the bank requesting financial support is operating.

In addition, it is important to note that it is not only domestic distinctive features of banking systems that explain member states' position on the Single Rulebook, but also *political disagreement* over the content of the rules. The inclusion of options and discretions in the prudential rulebook enabled legislators to prevent a deadlock on contested regulatory issues that would be caused by a one-size-fits-all approach. In the face of difficult issues over which consensus could not be reached, EU legislators made the deliberate choice to leave parts of the Single Rulebook unspecified and provide ample discretion to law enforcers at the implementation stage. The political and economic relevance of the options and discretions is observable from the interests that industry stakeholders paid to any consultations about their harmonization.[386] The adoption of the CRDIV package was also met with considerable member state reticence and the intra-EU negotiations on EU capital rules were highly controversial.[387]

As noted in section 3.4.1 (*The Incompleteness of the Supervisory and Resolution Framework*) above, French, German, Spanish and Italian banks had pressing concerns regarding the proposed ban on the double counting of insurance subsidiaries' capital for some banks and the counting of hybrid capital instruments – capital which has some features of both debt and equity – towards capital requirements.[388] In terms of the liquidity rules, the

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[385] Nicolas Veron, 'Precautionary Recapitalisation: Time for Review?' (bruegel.org, 2017) available at: <https://www.bruegel.org/system/files/wp_attachments/PC-21-2017-BRRD-1.pdf> accessed 26 October 2024, 6.

[386] European Central Bank, 'Feedback statement on Responses to the Public Consultation on a Draft Regulation and Draft Guide of the European Central Bank on the Exercise of Options and Discretions in the European Union Law' (bankingsupervision.eu, March 2016) available at: < Feedback statement Responses to the public consultation on a draft Regulation and draft Guide of the European Central Bank on the exercise of options and discretions available in Union law (europa.eu)> accessed 6 March 2022.

[387] For an overview of the various negotiations between member states and their respective preferences on the CRDIV package, see Howarth and Quaglia (n 230), Chapter 9.

[388] ibid., 187.

German, French, Dutch and Spanish governments opposed the inclusion of a narrow definition of liquid assets. This resulted in the CRDIV including less prescriptive language than Basel III on what counted as an eligible liquid asset: "liquid assets would include transferable assets that are of extremely high liquidity and credit quality" and "transferable assets that are of high liquidity and credit quality."[389] More recently, several EU member states are trying to persuade the EU Commission to dilute stricter capital rules that may have a negative impact on domestic institutions' competitiveness.[390]

More generally, collaboration between member states to adopt common regulatory standards under the EBU framework can be pictured in terms of a trade-off between domestic stability and EU stability.[391] National regulators often face a trade-off between protecting the interests of their local constituencies and those of foreign stakeholders, and they typically have strong incentives to prioritise the former.[392] The most direct result is that, whenever the protection of EU financial stability requires a sacrifice in terms of domestic welfare, states will be more reluctant to follow the EBU rules.

In other words, the exercise of national options and discretions included in the Single Rulebook imply a distributive choice between member states. The adoption of certain choices related to capital adequacy and resolution standards for financial institutions may put domestic banks in an uncompetitive position against regulated entities in other member states. National legislators and regulators will be inclined to favour domestic competitiveness without accounting for the potential effect of their choices on the financial stability of other jurisdictions.[393] These political economy problems extend to the whole set of financial policies, namely whenever national authorities have to exercise discretion under the EBU regime.

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[389] ibid., 195.

[390] Sam Fleming and Martin Arnold, 'Paris and Berlin Lead Fight to Dilute Brussels' Stricter Capital Rules' (ft.com, 8 June 2021) available at: <https://www.ft.com/content/0122b5c4-1cd2-4c17-aaee-590f10205543>, accessed 26 October 2024.

[391] For a general discussion of the role of financial regulators in the context of cross-border operations of banks and the relevant trade-offs they face, see David Andrew Singer, *Regulating Capital: Setting Standards for the International Financial System* (Ithaca, NY: Cornell University Press).

[392] Federico Lupo-Pasini, *The Logic of Financial Nationalism: The Challenges of Cooperation and the Role of International Law* (Cambridge, CUP 2017), 47.

[393] ibid.

In addition to the above, there was heavy *political disagreement* over precautionary recapitalisation measures between member states and the exception was added to the final version of the BRRD following pressure from the Council.[394] The Council stressed the importance of including the possibility of public equity injections when a bank is viable, irrespective of whether complies or is marginally below its capital requirements.[395] The European Parliament repeatedly expressed doubts on the rationale for that provision, which in the absence of appropriate safeguards, it could be used opportunistically by politicians to bail-out banks outside the context of resolution.[396] Indeed, the recent experience in respect of the liquidation of the Italian banks shows that member states may take advantage of the ambiguity of the provisions to provide public financial support to banks facing difficulties in their jurisdictions outside the resolution framework.[397]

Political disagreement was equally evident regarding the mutualisation of resolution funds at the EU level among member states. Policymakers in Germany, Austria, Finland, and the Netherlands expressed particular concern over the potential emergence of "moral hazard," whereby banks and sovereigns might be incentivised to engage in risky behaviour.[398] They were also worried about legacy issues stemming from previous instances of supervisory forbearance.[399] They were therefore keen to minimize the elements that could result in fiscal transfers from fiscally and financially stable member states to ailing states and their banks.[400] They feared that their governments and banks would become net contributors to these funds, bailing out stakeholders in other countries. For this reason, they insisted on setting up a small SRF through an intergovernmental agreement outside the EU legal framework. In addition, they argued that the funds of the ESM as a backstop of the SRF

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[394] Mícheál O'Keeffe, 'Essays on the Political Economy of Financial Crises: Causes, Containment and Resolution' (lse.ac.uk, September 2014) available at: <https://etheses.lse.ac.uk/3097/1/OKeefe_Essays_on_the_Political_Economy.pdf> accessed 6 March 2022. 134-135.

[395] ibid.

[396] Alex Barker, 'EU reaches landmark deal on failed banks.' (ft.com, 12 December 2013) available at: <https://www.ft.com/content/555f3ade-6303-11e3-a87d-00144feabdc0> accessed 26 October 2024.

[397] See Chapter 6 (*Bank Resolution Cases In Practice Under the EBU*) of this thesis.

[398] Lucia Quaglia, 'The Politics of an "Incomplete" Banking Union and Its Asymmetric Effects' (2019) 41(8) Journal of European Integration 955.

[399] ibid.

[400] ibid, 959.

could not be used to cover legacy problems, to be revealed by a comprehensive assessment of euro area banks by the ECB.[401]

On the other hand, the Commission supported by French, Spanish and Italian policy makers proposed that a large SRF should be set up to break the nexus between banks and sovereigns.[402] In addition, they pushed for the use of the ESM to directly recapitalise ailing banks, rather than doing so indirectly, via loans to member states which would weaken their fiscal position. They also regarded an EDIS as an essential pillar of the EBU, as it would complement centralised supervision and prevent deposit flights in countries hit by the sovereign debt crisis.[403]

To overcome *political disagreements* between member states, the European Parliament and the Commission dropped the establishment of the EDIS off the agenda and tolerated the *partial* establishment of common resolution funds based on international law.[404] Although the European Parliament initially rejected the set up of the SRF outside the EU legal framework, as it would have no influence over the process, it subsequently accepted it in order to make the agreement possible.[405] The ESM funds could be used for direct bank recapitalisation but subject to a cap of €68bn and only if the private sources and public backstops proved to be insufficient.[406] Ultimately, either the banks or the governments of the banks' home member states would have to repay any funds received.

To a lesser extent, the incompleteness of the EBU framework can be attributed to the *inherent limitations of language*, which can result in ambiguities and the need for interpretation. Terms and concepts in legal and regulatory texts are often complicated and may not have clear equivalents in the different languages and legal systems of the EU. For example, "public interest" and the situations where the "bail-in" tool can be used require

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401 Joachim Schild, 'Germany and France at Cross—Purposes: the Case of Banking Union' (2018) 21(2) Journal of Economic Policy Reform 102.

402 Quaglia (n 398).

403 David Howarth and Lucia Quaglia, 'The Difficult Construction of a European Deposit Insurance Scheme: A Step Too Far in the Banking Union?' (2018) 21(3) Journal of Economic Policy Reform 190.

404 Fabbrini (n 375).

405 ibid.

406 ESM, 'How Much Could the ESM Lend to the Single Resolution Fund?' (esm.europa.eu, October 2024) available at: <https://www.esm.europa.eu/content/how-much-could-esm-lend-single-resolution-fund > accessed 26 October 2024.

careful interpretation to prevent confusion or inconsistency among member states. The difficulty of these concepts, along with the diversity of legal and cultural knowledge within the EU, can cause different understandings that affect the consistent application of the BRRD.

3.5 CONCLUSION

This chapter showed that as banks have a key role in the economy, the Eurozone member states resisted giving up their authority over their supervision to EU authorities. This changed when multinational banks began to grow abroad and the gains they would get from a unified European regulatory framework would outweigh keeping close ties with local politicians. The Eurozone sovereign debt crisis gave more incentives to these banks to lobby for centralised supervision as they would be able to take over weaker competitors in other member states. As the negotiations unfolded, the discussions over the EBU were influenced by national interests of member states and their wish to protect domestic financial interests. As a result, the EBU remains incomplete and the supervisory actors involved in the decision making process will have to make significant *ex post* judgements with distributional consequences for the Eurozone member states. Given the tense discussions over the establishment of the EBU, we can expect the decisions of policy makers to be guided by similar considerations when they use their discretion. It is important, therefore, to examine the role of power in the decision making processes under the EBU and to determine whether all Eurozone member states have the same institutional constraints to express their policy interests.

4 THE POWER FRAMEWORK

4.1 INTRODUCTION

To this point, this thesis argued that even when the details of the EBU rules have been prescribed with the utmost detail, there are still uncertainties left for supervisory actors to determine by exercising their discretion *ex post*. In addition, the ECB and the SRB rely extensively on NCAs in connection with the day-to-day supervision of both systemically significant and less significant banks. The reliance of ECB and SRB on NCAs can, however, prove problematic as national actors often have diverging interests which will guide their interpretations of and actions towards, supervisory issues and put them in a situation of conflict.

The EBU framework provides that the ECB and the SRB in the exercise of their powers need to act in the interests of the EU as a whole.[407] However, the regime fails to significantly change the strong incentives for member states to prioritise their own interests within the EBU's collaborative decision-making process. Such national conflicting interests will come front and center in the context of any future crisis when national actors will perceive themselves as remaining on the hook for providing financial support to banks. Therefore, to gain a better understanding of how conflicts between NCAs will be resolved, it is important to examine the allocation of *ex post* power within the EBU.

This chapter conceptualizes the EBU as a loose network of supervisory actors who, despite agreeing *ex ante* to collaborate towards the common goal of Eurozone financial stability, find themselves facing conflicts due to their differing national goals and preferences. These differences create strong incentives for defection *ex post*. The resolution of conflicts of interest and the choice between alternative policy paths in the context of the EBU hinges on the power relations between the actors involved in bank supervision. It is therefore important to examine the allocation of *ex post* power in the context of the EBU institutional framework and determine whether all member states face similar institutional constraints in their ability to influence policy outcomes in their favour.

[407] SSM Regulation, Article 19.

To do this, this chapter builds a power framework that encourages rigorous attention to power in its different forms, namely *instrumental power*, which invokes the influence of actors to prevail in decision-making fora; *institutional power*, a reflection of how certain procedural norms and objectives systematically favour specific actors; and *structural power*, which emanates from the positions that actors occupy within an organization, shaping their capacities and interests.[408] These conceptions of power should not be seen as competing concepts, but rather as different forms in which power works in the way financial regulation is written, supervised and enforced in the context of the EBU. This tripartite framework of power suggests that member states within the EBU can be categorized as 'core' and 'periphery,' with core states generally possessing greater influence over regulatory practices and decision-making processes.

4.2 WHAT IS POWER?

In general terms, power is the ability to influence others and achieve one's preferred outcomes, even in the face of resistance.[409] Many theories of power seek to represent the concept of power as a contest of actors' interaction, rather than as the underlying organisational and political structures that shape these actors and their ways of relating or acting.[410] In such theories, the focus is on actors' abilities to bring about changes in the activities of another person.[411] Power becomes an attribute that an actor possesses and may use knowingly as a resource to shape the actions or conditions of action of others.[412]

Other conceptions of power are more attentive to how the structural position of an actor in an organisation or the economy creates opportunities for such actor and shapes its respective

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[408] This chapter builds on various conceptualisations of power elaborated in detail by other academic scholars. The aim of the analysis in this chapter is not to discover the truth about power and its meaning, but rather to develop a useful framework for application in the context of EU Financial Regulation. This framework draws on ideas from various scholars regarding what power is and how it is exercised. For example, Michael Barnett and Raymond Duvall classify power into four types: compulsory power, institutional power, structural power and productive power (see Michael Barnett and Raymond Duvall, 'Power in Global Governance', in Michael Barnett and Raymond Duvall (eds), *Power in Global Governance* (Cambridge CUP 2005)); Steven Lukes, in his three-dimensional view of power, categorises power into decision-making power, non-decision-making power and ideological power (see Steven Lukes, *Power: A Radical View* (Macmillan 1974)); Amitai Etzioni identifies three types of organisational power: coercive, utilitarian and normative (see Amitai Etzioni, *Comparative Analysis of Complex Organizations: On Power, Involvement, and Their Correlates* (The Free Press 1961)); Joseph Nye, in his conceptualisation of power, analyses the concept of soft power, which, unlike hard power relying on coercion or inducement, achieves influence through attraction and co-opting others to what one wants (see J Nye, *Soft Power: The Means to Success in World Politics* (Public Affairs 2004)).

[409] Max Weber, *The theory of social and economic organization* (New York: Free Press, 1947), 152.

[410] ibid; Robert Dahl, *Who Governs? Democracy and Power in an American City* (Yale University Press 1961).

[411] ibid.

[412] Michael Barnett and Raymond Duvall, "Power in International Politics" (2005) 59(1) International Organization 39.

capacities and interests.'[413] In these conceptions, the focus is on the form of the relationships between actors. The different organizational and economic structures which place actors into different roles vis-à-vis one another form a different system of power. A structuralist would apply the term 'power' to the structure, for it is the structure that both constrains and enables the options of actors.

Both analyses reveal truths about the way power operates in the context of banking regulation and supervision. Specifically, a comprehensive analysis of power dynamics should certainly examine the ability of actors to use resources to control the behaviour of others. Yet one also needs to consider the structures and processes of organisational life that enable and constrain the ability of actors to shape their fates and influence policy outcomes. In other words, if we concentrate on the set of relationships that constrain and enable actors, then we privilege structure. If we orient power around particular actors or groups, then we examine the power of actors.

Depending on whether we opt to highlight the structure of the system or the attributes of specific actors in our conceptualisations of power we can classify power into three types. The first type is *instrumental* power, which emphasizes control of identifiable actors over the objections of other actors through the deployment of resources.[414] The second type is *institutional* power, which emphasizes the role of institutions in constraining or enabling actors' actions. Institutional power is rooted in the formal and informal rules, norms and procedures that govern the behaviour of actors within a specific context.[415] It is the authority and influence that stems from established roles, relationships and practices within an organisation or system. For example, an organisation's hierarchy, decision-making processes and internal policies are all manifestations of institutional power. Institutional power can create constraints and opportunities for actors, determining what actions are possible, who can make decisions and how resources are allocated. The third type is

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[413] Charles E. Lindblom, *Politics and Markets: The World's Political Economic Systems* (Basic Books 1977); Susan Strange, *States and Markets* (Continuum 2nd editions, 2004); Kenneth N. Waltz, *Theory of International Politics* (Waveland Press 2010), Immanuel Wallerstein*, The Modern World-System I: Capitalist Agriculture and the Origins of the European World-Economy in the Sixteenth Century* (University of California Press, 2011); Cornelia Woll, *The Power of Inaction: Bank Bailouts in Comparison* (Ithaca, NY: Cornell University Press, 2014).

[414] This conceptualisation of power aligns more closely with Dahl's understanding of power, or with the first dimension of power as described by Lukes (Dahl, n. 410; Lukes, n. 408).

[415] This conceptualisation of power aligns with Bacharach and Baratz's view that power manifests itself not only in decisions that are made but also in those that are not made, see Peter Bachrach and Morton S. Baratz, *Power and Poverty: Theory and Practice* (Oxford University Press 1970). It also corresponds to Lukes' second dimension of power (Lukes, n. 408), as well as Barnett and Duvall's conceptualisation of institutional power (Barnett and Duvall, n. 408).

structural power, which focuses on actors' position within the structure of the organisation and the broader political and economic system in which they are embedded.[416] Whereas institutional power refers to the authority and influence that emanate from established rules and procedures, both formal and informal, that govern the behaviour of actors within a specific context, structural power represents a deeper more pervasive form of power that influences the broader socio-economic and political landscapes. For example, a nation's economic strength, historical context and geopolitical influence can create power dynamics between countries. Structural power can influence the way institutions are designed, the distribution of resources within a system and the range of options available to actors.

When it comes to financial regulation, institutions can either strengthen or undermine the structural power relations among states. Many international financial organisations have voting power that is based on financial contributions or economic size, which gives more leverage to richer countries.[417] These countries can then influence policies and decisions that can maintain their economic superiority. Such structures can worsen existing inequalities by aligning global financial rules with the preferences of these powerful nations. Moreover, informal ties between regulators and financial actors can shape decisions and strategies.[418] Informal networks can enable information sharing and lead to "revolving doors" where the same people rotate their roles within institutions in the financial system, politics and regulators, which can damage the interests of periphery countries and the public at large.[419]

Conversely, institutions can challenge structural power asymmetries by integrating periphery states into decision-making processes. International organizations can ensure that their objectives, such as economic growth and sustainability, explicitly account for the

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[416] The concept of structural power, which emanates from the positions actors occupy in the world system or society, is heavily influenced by Marx's classification of society into the owners of the means of production and others; see Karl Marx, *Capital: A Critique of Political Economy*, vol I (Samuel Moore and Edward Aveling trs, Frederick Engels ed, first published 1867, Progress Publishers 1887). Since then, other analyses of power based on structural relationships have been developed. For example, Wallerstein's World-Systems Theory builds on this foundation; see Wallerstein (n. 413). Some authors have applied this theory to banks, exploring how their significant societal roles confer upon them considerable power; see Strange (n. 484) and Woll (n. 484). More broadly, Waltz emphasised the need to focus on system characteristics when analysing power within the international system involving states, see Waltz (n 413).

[417] Joseph E. Stiglitz, "Democratizing the International Monetary Fund and the World Bank: Governance and Accountability" (2003) 16(1) Governance 111.

[418] Anne-Marie Slaughter, *A New World Order* (Princeton University Press, 2004).

[419] For an overview of the revolving door phenomenon in the context of the US financial regulation, see David Lucca, Amit Seru and Francesco Trebbi, "The Revolving Door and Worker Flows in Banking Regulation" (2014) 67 Journal of Monetary Economics 17.

impacts on weaker economies, with necessary adjustments made to support these states. By consulting representatives from periphery nations before making decisions, these institutions can incorporate diverse perspectives and address specific concerns, leading to more equitable policies. Additionally, by providing financial support, technical assistance, and capacity-building programs, they empower economically weaker states to better engage with and benefit from the global financial system. Establishing and advocating for global financial standards that emphasise ethical lending and inclusive practices further protect these nations from exploitative behaviours, creating a fairer international economic landscape.

It is essential to recognize that the above classification of power into instrumental, institutional and structural does not treat the different types of power as necessarily competing concepts, but rather as different forms of power which are simultaneously present in an organisation and can interact with each other in various ways. For example, structural power can shape the design of the EU institutions, when the underlying economic, historical and geopolitical factors of member states influence the creation and development of formal and informal rules, norms and procedures within the Eurozone banking system. As illustrated in chapter 3 (*The Heated Negotiations over the EBU*), the creation of the EBU was the product of the broader economic and political context in the EU, particularly the cross-border expansion of banks in other jurisdictions and their declining dependence on their relationships with the NCAs of their home jurisdictions for promoting their interests and the Eurozone sovereign debt crisis. The design of EU policies in general and the EBU in particular was influenced by the structural power of bigger and more economically powerful member states, such as Germany and France.[420] On the other hand, institutions can mediate, challenge or reinforce structural power dynamics. This means that institutions can serve as a channel through which power is exercised or as a buffer that mitigates the influence of structural power. As this thesis will demonstrate, the EBU's decision-making process reinforces structural power dynamics. While the EBU strives to promote equal representation of all member states in its governance structures, economically stronger countries still have a greater say in shaping policies and supervisory priorities. This can lead to a situation where the interests of the more powerful countries are prioritized over those

[420] Schild (n 401).

of the weaker member states, further entrenching the existing power imbalances in the Eurozone.

In summary, considering all forms of power, namely instrumental, institutional and structural, allows for a more comprehensive and nuanced understanding of the complex dynamics within organizational politics. By exploring these different dimensions of power, we can better appreciate the various forces that shape decision-making, resource allocation and outcomes in the context of the EBU. Instrumental power highlights the ways in which actors exercise control and influence over others through the deployment of resources. Institutional power focuses on the impact of formal and informal rules, norms and procedures on actors' behaviour and opportunities. Structural power delves into the broader socio-economic and political landscape that shapes the foundations of both institutions and the actions of individual actors. Each of these power dimensions operates simultaneously and can interact in various ways, creating a multifaceted and interconnected web of power dynamics within the Eurozone banking system. By embracing a multidimensional approach to power that encompasses instrumental, institutional and structural dimensions, we can gain valuable insights into the complex workings of organizational politics.

4.3 INSTRUMENTAL POWER

Instrumental power focuses on the ability of one actor to directly control the actions of another through the deployment of resources.[421] Some of the most famous formulations of power fall under this concept. Weber defined power "as the probability that one actor within a social relationship will be in a position to carry out his own will despite resistance, regardless of the basis on which this probability exists."[422] In a similar vein, for Dahl power is best understood "as the ability of A to get B to do what B otherwise would not do."[423] In Dahl's conceptualisation of power, the focus is on how decisions are made and power is determined by the frequency of who wins or loses in respect of issues in decision making arenas.[424] The exercise of power consists in overcoming opposition, that is, in defeating contrary interests by employing various resources. 'Instrumental' refers to the means

[421] Barnett and Duvall (n 408), 13-15.

[422] Weber (n 409), 152.

[423] Robert A. Dahl, 'The Concept of Power' (1957) 2(3) Behavioural Science 201, 203.

[424] Dahl (n 410).

through which actors exercise political power, such as lobbying and privileged access to senior policymakers.

Within this dimension of power, expertise in financial regulatory issues can be conceived as resources to be mobilized to influence public debates, countering expertise with better expertise.[425] The assumption is that NCAs with more expertise in relation to cross-border banking operations will have greater influence. Expertise often takes the form of policy analysis or advocacy based on research of a given problem that claims to be objective. The burgeoning research and analytical capacity, the release of working papers on salient topics related to banking regulation and the frequent holding of conferences strengthen an actor's influence in decision-making.[426]

In this conception of power, little attention is paid to those voices or issues which are not represented in the decision-making process or to how power affects the ways certain problems come to be framed.[427] If certain voices are absent in the debate, their non-participation is interpreted as their own apathy or inefficacy, rather than as a process of exclusion from the political process.[428] This theory suggests that groups hoping to influence policy decisions will not necessarily succeed in all their attempts to influence policy, but neither will be they systematically denied access to influence the decision-making process. Thus, the marketplace of policy ideas is open and accessible to all.

4.4 INSTITUTIONAL POWER

Political scientists Bacharach and Baratz challenged Dahl's vision of an open society in which power is exercised through informed debate in decision making arenas.[429] They introduced the concept of non-decision making, suggesting that a fuller understanding of power would include decisions that are not made. In particular, they argued that the

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[425] John Gaventa and Andrea Cornwall, 'Power and Knowledge' in P. Reason and H. Bradbury (Eds.), *Handbook of Action Research: Participative Inquiry and Practice* (London: Sage Publications 2001), 71-73.

[426] A line of research explains the creation and functioning of the ECB by focusing on the role of experts and the emergence of a powerful epistemic community, i.e., a network of professionals from a variety of disciplines and background, see Peter M. Haas 'Introduction: Epistemic Communities and International Policy Coordination' (1992) 46(1) International Organisation 1, 2-3. For a discussion on the role of personalities in shaping policy directions see James Basham and Aanor Roland, 'Policy Making of the European Central Bank During the Crisis: Do Personalities Matter' (ipe-berlin.org, June 2014) Working Paper No. 38/2014 available at: <https://www.ipe-berlin.org/fileadmin/institut-ipe/Dokumente/Working_Papers/ipe_working_paper_38.pdf> accessed 27 October 2024.

[427] Gaventa and Cornwall (n 425), 70.

[428] ibid.

[429] Bachrach and Baratz (n 415).

examination of power was not only about who won and who lost in decision-making fora, but also about suppressing the addition of new issues to an agenda.[430] They suggested that, before we can look at the results of formal decision-making, we first need to look at what they call the "mobilization of bias" existing in the political system they analysed.[431]

"Mobilisation of bias" represents the dominant set of beliefs, values and institutional processes and procedures which need to be used that work to privilege some groups in relation to others. In this view, rules and procedures can be used to allow some voices to enter the decision-making process and to discredit the legitimacy of others. Even where previously excluded actors do enter the scene, they may be required to frame their issues in a way that would be acceptable to the powerful in order to be heard.[432] In other words, before we look at the results of formal decision making, we should look at "the dominant values, the myths and the established political procedures and the rules of the game" as well as look at "which persons or groups . . . gain from the existing bias and which . . . are handicapped by it."[433] Thus, powerful participants can structure political institutions in ways that preserve their own interests or power, or they can arrange procedural rules to make it difficult for others to challenge the system. If powerful actors can stack the rules of the game so that certain issues are never addressed or weakly raised, decisions that are not reached are also important to consider in determining who has political power.[434] In addition, any threatening demands or incipient issues can also be deflected by steering them through time-consuming procedures that are built into the political system. These tactics are particularly effective against poorly resourced groups which cannot withstand delay.

Within the institutional dimension of power, the conceptual focus is on the formal and informal institutions that mediate between actors and the ways the powerful can work through rules and procedures that define those institutions to constrain the actions of others. Whereas compulsory power rests on the resources that the powerful possess and deploy to force others to do what they otherwise would not do, powerful actors cannot necessary be

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[430] The study of politics, Bachrach and Baratz argued, must focus on "both on who gets what, when and how and who gets left out and how", see Bachrach and Baratz (n 415), 105.

[431] Elmer E. Schattschneider, *The Semi-Sovereign People: A Realist's View of Democracy in America* (Holt, Rinehart and Winston 1960), 71.

[432] Gaventa and Cornwall (n 425), 71.

[433] Peter Bachrach and Morton S. Baratz, "Two Faces of Power" (1962) 56(4) The American Political Science Review 947, 952.

[434] Schattschneider (n 431).

said to possess the institutions that constrain the less powerful. The powerful actors derive their power because they stand in particular relation to institutional arrangements and can take advantage of those institutions to shape the actions of the less powerful or preclude them from voicing their grievances.

In other words, institutions can lock other actors into a stable order and operate as mechanisms of political control. A set of procedural rules, practices and objectives operate systematically to the benefit of certain actors and at the expense of others. When actors agree to tie themselves to the commitments and obligations of specific institutional arrangements, they agree to reduce their autonomy. Those who benefit are in better position to protect and promote their vested interests. The base of their institutional power would consist of rulemaking processes, formalized lines of responsibility, control of scarce resources and control of decision-making processes.

4.4.1 *Rule-making power*

The structure of every legal order directly influences the distribution of power within an organisational field. Rulemaking is a power strategy with which powerful actors can make others do what they want.[435] Rules do this by specifying the behaviours that are permissible by different parties in interdependent relations while delegitimating the actions available to others.[436] For example, an agency created by statute might be tasked with protecting financial stability and afforded the power to adopt policy tools to meet that objective. The statute may permit, but not compel, the agency to enact a policy.

Thus, actors with rulemaking powers can restrict the procedural and substantive discretion in regulatory policy. They may impose deadlines on regulatory agencies setting out when their authority begins and ends. Statutes and case law may govern what process must be used for specific policy decisions to be made. Rules may determine which or what kind of regulatory agency has substantial policy making authority as well as impose limits on that

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[435] For a discussion of rule-making as a source of power, see Frances Fox Piven and Richard A. Cloward, 'Rulemaking, Rule breaking, and Power' in Thomas Janoski, Robert. R Alford, Alexander M. Hicks and Mildred A. Schwartz (eds), *The Handbook of Political Sociology: States, Civil Societies and Globalization* (Cambridge, CUP 2003), 43-47.

[436] "The modern state", Weber says bluntly, "is a compulsory association which organizes domination", see Max Weber 'Politics as a Vocation; in H.H. Gerth and C. Wright Mills (eds), *From Max Weber: Essays in Sociology*, (London: Routledge, 2009), 82-83.

policymaking discretion. Laws shore up power by singling out for prohibition or restriction the strategies available to some actors and not the strategies available to others.

In the EU, there is the formal aspect of legal competence.[437] The EU operates under a system of conferred competences, which means that EU fora can exercise law making powers only if the EU Treaties include an explicit legal basis for that issue area.[438] The legal basis specifies what type of action the EU can take, which may or may not include the competence to adopt binding legislation. Moreover, the EU operates under the principle of subsidiarity, which states that the EU can only deal with an issue when the issue cannot be dealt with at least equally well by the member states. Although this principle is hard to enforce legally, it presents an important political hurdle that needs to be taken.[439]

Rules themselves are, therefore, a major focus of contention. Actors will battle about what actions are permissible by whom in interdependent relations. Once laws are enacted, they constrain behaviour so that actors with different interests have to bargain around entitlements set by law using procedures sanctioned by judicially enforced rules. Also, actors with law-making powers can modify the rules to alter the legitimate repertoire of political action by different participants and accommodate their interests.[440]

4.4.2 *Boundary management*

Organisations are often divided into different groups or departments, i.e., boundaries, which operate together towards a common objective. These boundaries can be functional, geographical, hierarchical, or even cultural and they play a critical role in shaping the way power is exercised and distributed within the organization. Control over boundaries helps actors monitor changes occurring outside one's group or department and initiate timely responses. In the context of institutional forms of power, boundary management is

[437] TFEU, Article 2.

[438] ibid.

[439] The exercise of EU competences is subject to two fundamental principles laid down in Article 5 of the TFEU, the principles of proportionality and subsidiarity, see Article 5 of the TFEU.

[440] Piven and Cloward (n 435), 40.

particularly important as it enables key actors to influence decision-making processes and resource allocation by controlling the flow of information and access to critical resources.[441]

Actors who control boundaries gain access to critical information and are in a powerful position to interpret what is happening in the outside world and thus define the organisational reality that will guide action.[442] This form of power goes beyond formal authority and is often exercised through informal channels and mechanisms. For example, steering committees within organisations are able to exert major impact on the way a decision-making body views the reality of a given situation by determining who is given access to the agenda of the decision-making body and when and by managing information in a way that highlights or downplays the importance of events and activities occurring elsewhere in the organisation.

Boundary management is an essential component of institutional form of power as it allows actors to shape organizational structures, processes and culture in ways that serve their interests and objectives. By controlling the boundaries between different groups or departments, powerful actors can reinforce existing power dynamics, create new ones or even undermine the power of others. For instance, boundary management can be used to consolidate power by ensuring that critical resources and decision-making authority are concentrated within a specific group or department, or it can be used to create strategic alliances and partnerships that enhance an actor's influence within the organization.

Moreover, boundary management also plays a crucial role in determining the organization's adaptability and responsiveness to changes in its external environment.[443] By effectively managing the boundaries between different groups or departments, organizations can foster greater collaboration and information sharing, allowing them to anticipate and respond to emerging challenges and opportunities more effectively. Conversely, poor boundary

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[441] Gareth Morgan, *Images of Organization* (Sage Publications 1997); Herminia Ibarra, 'Network centrality, power, and innovation involvement: Determinants of technical and administrative roles' (1993) 36 Academy of Management Journal, 471; David B. Jemison, 'The importance of boundary spanning roles in strategic decision-making' (1984) 21 *Journal of Management Studies*, 131.

[442] ibid. In multinational corporations, boundary spanners must empower themselves and others by skilfully navigating cultural repertoires to enable cooperation, see Aimée A. Kane and Natalia Levina ''Am I still one of them?' Bicultural immigrant managers navigating social identity threats when spanning global boundaries' (2017) 54 Journal of Management Studies 540; Noriko Yagi and Jill Kleinberg, 'Boundary work: An interpretive ethnographic perspective on negotiating and leveraging cross-cultural identity' (2011) 42 Journal of International Business Studies 629.

[443] Morgan (n 441); For an overview of the literature on the views of power as emerging from resource dependencies, see William Ocasio, 'Organizational Power and Dependence' in Joel A.C. Baum (ed), *The Blackwell Companion to Organizations* (New York, Blackwell Publishing 2017), 368-370.

management can lead to siloed thinking, limited information exchange and reduced organizational agility, which can ultimately undermine the organization's ability to adapt and compete in an ever-changing world.

In conclusion, boundary management is a critical aspect of institutional forms of power, as it enables actors to influence decision-making processes, control access to resources and shape the organization's structures, processes and culture. By effectively managing the boundaries within and between different groups or departments, actors can consolidate their power, create strategic alliances and enhance the organization's overall adaptability and responsiveness to external challenges and opportunities.

4.4.3 *Control of scarce resources*

Organisational subunits must transact with each other and with organisations in their environment in order to acquire resources.[444] The resources that are obtained in such transactions vary in terms of how difficult they are to secure and in terms of how critical they are to the organisation's functioning. Such transactions may create dependencies, especially in relation to resources which are not always readily available or under the control of non-cooperative actors. Asymmetries in the dependencies that underlie such exchanges explain asymmetry in power between the actors involved.[445]

For example, suppose a periphery Eurozone country is facing a banking crisis, with several of its major banks experiencing severe liquidity shortages and the risk of insolvency. In this situation, the country's NCA may need to request emergency financial assistance from the ECB and the SRB, as well as negotiate with other Eurozone member states to secure the necessary funding and support. The resources required to address the banking crisis, such as financial aid and technical assistance, may not be readily available or under the control of cooperative actors. As the next chapter will demonstrate, core Eurozone member states, which hold significant influence within the ECB and the SRB due to their economic and

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[444] Jeffrey Pfeffer and Gerald Salancik, *The External Control of Organizations: A Resource Dependence Perspective* (New York, New York: Harper and Row 1978); Several studies provide empirical support for a resource dependence theory of organizational power. For example, in studies of departmental power in universities, resource dependencies were found to be of significant determinants in power, see Jeffrey Pfeffer and William Moore, 'Power in University Budgeting: a Replication and Extension' 19 Administrative Science Quarterly 453; Gerald Salancik and Jeffrey Pfeffer 'The Bases and Uses of Power in Organisational Decision Making: The Case of University" 19 Administrative Science Quarterly 453.

[445] Graham Astley and Paramjit S. Sachdeva, 'Structural Sources of Intraorganizational: Power: A Theoretical Synthesis' (1984) 9(1) Academy of Management Review 104.

financial clout, may be hesitant to provide the needed support, fearing potential risks to their own financial systems or negative political repercussions.[446] In this scenario, the periphery country's NCA becomes highly dependent on the core states and the European institutions for the resources needed to address the banking crisis. This dependency creates an asymmetry in power between the actors involved, as the core states and the European institutions hold significant control over the availability and terms of the required resources. The core states may use their control over these scarce resources to impose strict conditions on the periphery country, such as requiring the implementation of austerity measures, structural reforms or additional regulatory oversight. In this manner, the core states can exercise power over the periphery country by controlling the access to critical resources, shaping the response to the banking crisis and influencing the periphery country's economic and financial policies.

In summary, an ability to exercise control over any of the resources can provide an important source of power within and between organizations. Control over financial flows is the most important resource. It is not necessary to have full control over financial decisions within an organisation. An actor can exercise power by having just enough control to pull the crucial strings that can create changes at the margin.[447] The influence of powerful actors can be illuminated by examining the formal requirements for approval of the use of financial resources, the informal processes whereby approval of specific actors is sought and the extent to which the pattern of approval decisions reflects priorities of powerful actors.

4.4.4 *Control of decision-making processes*

Decision-making processes and other rules that guide organizational functions is another source of institutional power.[448] Procedural requirements affect the institutional environment in which organisations make decisions and thereby limit an agency's range of feasible policy options. Whereas powerful actors may not know what specific policy outcomes they may want an organisation to adopt in the future, they will know which interests ought to influence a decision. By structuring the rules of the game of the agency,

[446] See section 5.3.3 (*Control of Scarce Resources*) of Chapter 5 for an in-depth analysis of how financial resource control within the EBU framework serves as a significant source of power for the core states.

[447] Morgan (n. 441).

[448] Morgan (n. 441), 166.

powerful actors ensure that the influence accorded to specific interests is not random, but the agency will adopt policy decisions responsive to their interests.[449]

(i) Formal authority

Formal authority is the right to rule and select actions affecting part or the whole of an organization. Authority results from the charter of an organisation allocating the right to decide on specified issues to a member or a group of an organisation.[450] The charter outlines the lines of authority and responsibilities of various positions and sets out the formal power structure of the organisation.[451] The superior's right to give instructions is enacted by a legitimized procedure that is considered by both superior and subordinate as correct. To the extent subordinates follow the instructions of superiors because they believe that the latter have a right to exercise power by virtue of their position, the authority structure is also a power structure.[452] The exercise of authority is based on the subordinates' acceptance of the powerful actor's right to exercise control.

(ii) Representation

By controlling who participates in decision-making processes, powerful actors can influence policy outcomes in their favour. By adopting rules which involve participants who support their cause and excluding participants who oppose it, political actors can change the policy agenda. For example, it makes quite a difference whether issues relating to the resolution of a failing bank are discussed by regulators or politicians. Each set of decision-makers will come up with another angle to the issue and stress different aspects. Politicians are more likely to focus on short-term electoral payoffs and base their decision to bail-out an ailing financial institution on factors unrelated to financial stability.[453] On the contrary, regulators are more likely to disregard electoral forces and focus on the impact of the institution's failure on the financial system.[454]

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[449] Matthew D. McCubbins, Roger G. Noll and Barry R. Weingast, 'Administrative Procedures as Instruments of Political Control' (1987) 3(2) The Journal of Law, Economics and Organization 243.

[450] Morgan (n 441), 166.

[451] Astley and Sachdeva (n 445), 105-106.

[452] ibid.

[453] Stavros Gadinis, 'From Independence to Politics in Financial Regulation' (2013) 101(2) From Independence to Politics in Financial Regulation 327, 331.

[454] ibid.

In other words, by controlling representation, powerful actors control the extent to which competing interests are represented within an organisation – that is, in the extent to which organisational members adhere to and promote given interests. Such internal representation can be the outcome of hiring processes that bring into the organisation members who adhere to specific values and objectives. Internal representation is also influenced by broader societal logics that provide organisational members with cognitive templates that influence their perception of which objectives and practices are appropriate.[455] Organisational members who have been socialized or trained into a specific institutional logic are likely to be committed to defending it should it be challenged.[456] The composition of the staff in terms of nationality may also reveal commitment to specific values over others.

(iii) Process

The entire sequence of decision making – notice, comment, deliberation and approval – can afford numerous opportunities to powerful actors to intervene when an organisation seeks to move to a direction the powerful do not like.[457] By determining whether a decision can be taken, whether it must be presented before a committee and which committee, whether it must be supported by a full report and whether it should be discussed at the beginning or at the end of a meeting, the powerful can have considerable impact on decision outcomes. These procedures ensure that important information is distributed to the powerful who can react prior to the adoption of a policy choice. The timing of decision-making and the pace of negotiations are critical factors that powerful actors can manipulate. By strategically scheduling meetings, setting agenda orders and controlling notice periods, they can influence when and how issues are discussed to their benefit. Expediting decisions can rush favourable outcomes with minimal opposition, while deliberate delays can exhaust and sideline less powerful voices.

(iv) Voting Power

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[455] Institutional logics theory posits that societal institutions, such as the legal system or the financial industry, come with their own beliefs, practices and values. These logics shape how individuals within these institutions think and act. They essentially provide a cognitive roadmap, guiding members on what is deemed appropriate or inappropriate in their institutional setting. *See* Patricia H Thornton and William Ocasio, "Institutional Logics" in R. Greenwood, C Oliver, K Sahlin and R Suddaby (eds), *The Sage Handbook of Organizational Institutionalism* (Sage Publications 2008), 99-129.

[456] Anne-Clare Pache and Filipe Santos., 'When World Collide: The Internal Dynamics of Organisational Responses to Conflicting Institutional Demands (2010) 35(3) Academy of Management Review 455.

[457] McCubbins, Noll and Weingast (n 449).

Voting rights among actors involved in decision-making are a clear example of the institutional power that can be leveraged to advance interests in decision-making fora. Unlike the democratic norm in political elections, where one person receives one vote, the distribution of votes in EU fora is based on the principle that member states with larger populations have more votes than those with smaller populations.[458] In the context of EU financial regulation, voting power is typically allocated to member states with larger financial systems or greater contributions to EU funds.[459] Consequently, wealthier member states possess the voting power to independently pass resolutions in EU decision-making fora. Additionally, these same member states can effectively use the threat of a veto to sway the majority of other member states towards their preferred positions.

(v) Objectives

The objectives of an organisation may be structured in such a way that they systematically favour the interests of some actors and disadvantage others.[460] Objectives establish the foundations on which the decisions of an organisation should be made and set out the evaluative criteria against which the performance of a particular organisation is going to be assessed. Goals are expressions of the core system of values and will not be easily challenged or negotiable within an organisation. In certain situations, the statute can be vague in policy objectives, seemingly giving an organisation great policy discretion, but the administrative process can be designed to assure that the outcomes will be responsive to the powerful. For example, if the statute sets out various objectives without stipulating a clear hierarchy between them, powerful actors can use the administrative process to frame the mandate as they see fit.

(vi) Instruments

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[458] Richard Baldwin and Mika Widgrén, 'Council Voting in the Constitutional Treaty. Devil in the Details' (aei.pitt.edu, July 2004) CEPS Policy Brief No. 53 available at: <https://aei.pitt.edu/6579/1/1133_53.pdf> accessed 27 October 2024.

[459] For instance, the institutions governing the European Stability Mechanism (ESM) have allocated greater voting power to member states that are the largest financial contributors, see Federico Fabbrini, "States' Equality v States' Power: the Euro-crisis, Inter-state Relation and the Paradox of Domination" (2015) 17 Cambridge Yearbook of European Legal Studies 1.

[460] Selznick views organizations as "social organisms" with unique cultures, missions and values, which leaders must nurture and protect, see Philip Selznick, *Leadership in Administration: A Sociological Interpretation* (New York, Harper & Row 1949).

The responsiveness of organisations to specific issues is likely to differ depending on the instruments and resources they have at their disposal to deal with them.[461] Establishing a role for an organisation is not just about legal remit. Even if an organisation has legal authority to make decisions in respect of given issues, it must also be sufficiently equipped to deal with them. If an organisation has no expertise and organisational capacity to deal with some issues, it will be less responsive to them.[462] In the context of the EU, EU agencies may be less responsive to issue areas for which they have no track record.

(vii) Control of counter-organisations

For every issue, there may be different organisations with significant sharing of authority. In the context of the EU, power is spread vertically between many levels of government and horizontally across multiple EU institutions and actors.[463] Policymakers who encounter obstacles in their traditional policy venues generally seek new venues for policy-making that are more amenable to their preferences and goals.[464] Actors who can gain access to or otherwise hold some sway over the groups who might oppose them have more chances to mobilize potential supporters for their issues.

Interest groups will turn to national or European level when and insofar as the political opportunity structure is at one level is more favourable than at another.[465] If there are strong political issues to bypass the EU by turning to national level or vice versa, powerful actors will frame the debate accordingly. The adoption of preferred policies often occurs when actors succeed in shifting debates and decision-making on an issue to new venues which are susceptible to different kinds of arguments than the venue that originally deal with the issue.[466]

The key element in forum shopping is the way in which an issue is redefined or framed.[467] By framing an issue, the lines between the proponents and opponents of a proposal may be

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461 Sebastiaan Princen, *Agenda Setting in the EU* (London, Palgrave Studies in European Union Politics 2009), 30-31.

462 ibid.

463 ibid, 11.

464 Frank R. Baumgartner and Bryan D. Jones, *Agendas and Instability in American Politics* (Chicago, The University of Chicago Press 2nd edition 1993), 31.

465 Princen (n 461), 19-43.

466 Baumgartner and Jones (n 464).

467 Josh Lerner and Jean Tirole, 'A Model of Forum Shopping' (2006) 96(4) American Economic Review 1091.

drawn differently. The key to issue framing is to highlight some dimensions of an issue and downplay others, even if all of them are relevant in principle. This type of selective issue framing is a ubiquitous characteristic of political processes, since it is difficult for people to consider all sides of an issue at the same time.[468] Hence, agenda setting is about giving information that highlights the side of an issue that will make certain venues more receptive to it. As long as convincing arguments can be made to tie the issues with established overall objectives that are held to be central to the purpose and identity of a policy venue, powerful actors can bring onto and exclude items from the agenda.

4.5 STRUCTURAL POWER

As illustrated above, institutional power focuses on how actors can exploit differential institutional constraints on action to force others to do what they otherwise would not do. It emphasizes the role of institutions in constraining or enabling other actors' actions. It is rooted in the formal and informal rules, norms and procedures that govern the behaviour of actors within a specific context. The authority and influence that stem from established roles, relationships and practices within an organisation or system constitute institutional power. This type of power can create constraints and opportunities for actors, determining what actions are possible, who can make decisions and how resources are allocated.

Structural power, on the other hand, focuses on actors' positions within the structure of the organization and the broader political and economic system in which they are embedded.[469] It examines the structure of relationships between actors create different opportunities for some and constraints for others. In this dimension of power, the structure of relationships between actors defines who the actors are and what capacities they are endowed with. In contrast to instrumental and institutional power, structural power examines the endowment of capacities that will shape interactions between actors even if powerful actors do not become active at all. In other words, structural positions allocate differential capacities and typically differentially advantages, to different positions. The consequence is that structures that distribute asymmetric privileges also affect the interests of actors. As Lukes puts it "is it not the supreme and most insidious exercise of power to prevent people, to whatever

[468] Princen (n 461), 34.

[469] Waltz (n 413), 79-101.

degree, from having grievances by shaping their …preferences… in such a way that they accept their role in the existing order of things?".[470]

Structural power represents a deeper, more pervasive form of power that influences the broader socio-economic and political landscapes. It encompasses factors such as a nation's economic strength, historical context and geopolitical influence, which can create power dynamics between countries. Structural power can shape the design of institutions, the distribution of resources within a system and the range of options available to actors. In contrast to institutional power, which refers to the authority and influence that emanate from established rules and procedures, structural power captures the underlying power dynamics that shape the broader system in which actors operate.

It is important to recognise that institutional power and structural power are interconnected and can influence each other in profound ways. Institutions often determine the allocation of resources, such as capital, information or decision-making authority, among actors. This allocation of resources can influence the structure of relationships by creating dependencies, reinforcing hierarchies or facilitating cooperation between actors. By establishing rules, norms and procedures, institutions can impact the behaviour of actors and the interactions between them, which in turn, contribute to the formation and maintenance of networks, hierarchies and alliances.

The interrelationship between institutional and structural power within complex systems can lead to a reinforcing cycle. Actors with greater institutional power, such as those with more control over the rules and norms within institutions, can use their influence to shape the broader structure of relationships between actors. This, in turn, can impact the distribution of structural power, as the structure of relationships determines the relative positions and capacities of actors within a system. Conversely, structural power imbalances between actors can be magnified by the institutional framework of a system. Rules and regulations enacted by powerful actors within institutions may place additional constraints on weaker actors, further limiting their policy options and reinforcing their dependency on more powerful actors.

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[470] Lukes (n 408), 28.

Furthermore, institutions confer legitimacy and establish norms within a system. By legitimizing certain practices, actors or relationships, institutions can shape the structure of relationships by reinforcing existing power dynamics or enabling new ones to emerge. For example, as chapter 3 (*The Heated Negotiations over the EBU*) illustrated, during the Eurozone sovereign debt crisis, financial stability concerns played a significant role in legitimising bail-out practices of systemic banks. The provision of bail-out packages to struggling Eurozone credit institutions aimed to restore market confidence and stabilise the Eurozone's financial system. However, it also reinforced existing power dynamics within the Eurozone. Core member states, such as Germany and France, played a significant role in designing and implementing the bail-out packages, leveraging their influence within European institutions to shape the terms and conditions of the financial assistance.[471] By supporting and legitimising bail-out packages as necessary measures to maintain stability, core states reinforced their existing power dynamics within the Eurozone.[472]

In summary, the distinction between institutional and structural power lies in their focus of analysis and the primary mechanisms of influence. Institutional power emphasizes the strategic use of rules, norms and procedures within specific institutions, while structural power highlights the broader distribution of power within society arising from the structure of relationships between actors. Although institutions can shape actors' positions within networks and contribute to structural power, differentiating between these dimensions is valuable for understanding the various aspects of power dynamics within complex systems.

Structural analyses of the economy have a long tradition, in particular in Marxist thought, which has emphasized how the capital labour relationships in capitalist economies define the interests of workers vis-à-vis capital owners and vice versa. World system theorists also draw on this conception of power to argue that structures of production generate particular kinds of states identified as core and periphery: the position of states in the world system generate corresponding sets of interests.[473] These studies argue that periphery states adopt

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[471] Brunnermeier, James and Landau analyse how the Eurozone's economic conflicts are rooted in two distinct traditions: Germany's ordo-liberal approach, emphasizing rules, fiscal discipline and limited intervention versus France's more "interventionist" perspective, which advocates for flexibility, fiscal activism and a strong central authority. The authors analyse how these conflicting ideologies influenced responses to the Eurozone sovereign debt crisis, Markus Brunnermeier, Harold James and Jean-Pierre Landau, *The Euro and the Battle of Ideas* (Princeton 2016, Princeton University Press).

[472] Schild (n 402).

[473] Wallerstein (n 413).

conceptions of interest that support their own domination and their lesser position in the word system.[474]

In the relationship between banks, the government and other firms, governments depend on the banks directly to give continued access to credit to the real economy. While all banks play an important role in the economy, some of them may become too large, complex or interconnected to fail.[475] A disorderly liquidation of such financial institutions could lead to great destruction of value and threaten financial stability. Absent appropriate safeguards, uncertainty surrounding their failure may lead states to bail them out to avoid the distress associated with the failure of such banks. Multinational banks can, thus, exploit their structural position in the economy to shape the foreign economic policies of states, as well as global economic policies.[476]

In the context of regulatory organisations, I argue that we can conceptualise them as a network of different groups and departments which must collaborate in order to function. We can use the term organizational boundaries to simply refer to demarcation between different groups or departments ort between an organisation and its environment. These differentiated departments are reintegrated through interconnecting workflows that form a stable network of interactions. I propose that structural power can be analysed by reference to this network of interactions. These networks may remain highly informal and to a degree invisible. Moreover, they may be internal to an organization or extend to include actors outside. Sometimes they are explicitly interorganizational, such as interlocking directorships where the same people serve to the boards of different organisations. I argue that those actors who occupy central positions in the network have better access to information and financial resources and can promote their interests more effectively by strategically coordinating other groups.

The operation of organisations implies a certain degree of interdependence, so that unpredictable situations within the organisation or in the environment within which the organisation operates may have considerable implications for operations elsewhere. The ability to deal with either internal or environmental uncertainties that influence the day-to-

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474 ibid.

475 Gary H Stern and Ron J Feldman, *The Hazards of Bank Bailouts* (Washington, DC, The Brookings Institution 2009).

476 Strange (n 413); Woll (n 413).

day operation of an organisation gives individuals or subunits considerable power in the organisation.

More specifically, actors occupying central positions in the network can monitor changes occurring outside one's group and initiate timely responses. In particular, such actors can gain access to critical information and guide organizational action by influencing how events happening within or outside the organisation are going to be framed. Being at the hub of the financial regulatory network, they have better access to critical information from various sources, including financial institutions, international regulators and market intelligence. This superior access enables them to detect early warning signs of potential crises, assess risks more accurately and craft pre-emptive measures to mitigate uncertainties. By controlling who gets the information, powerful actors can systematically influence the definition of organizational situations and hence the ways in which an organisation reacts to these situations. Even by the process of slowing down or accelerating particular information flows, thus making information knowledge available in a timely manner or too late for it to be of use to its recipients, the viewer can wield considerable power.

In other words, by controlling the information flow, actors in the core of an organisational network have the ability to cope with uncertainties that influence the day-to-day operation of an organization. Organization implies a certain degree of interdependence so that discontinuous or unpredictable situations is one part of an organisation have considerable implications for operations elsewhere. An ability to deal with these uncertainties give an individual, group or subunit considerable power in the organisation as a whole.

In conclusion, the position of actors, both within the organisation and the institutional environment in which actors operate, influences actors' likelihood to shape outcomes in their favour.[477] Moreover, studies suggest that an organisation's informal structure may be more critical than its formal structure to explain power dynamics within organisations.[478] For example, steering committees have disproportionate power in their ability to have access to executive committees. By determining when and how the executive committee is

[477] Julie Battilana, 'The Enabling Role of Social Position in Diverging from the Institutional Status Quo: Evidence from the UK National Health Service' (July-August 2011) 22(4) Organization Science 817.

[478] Ibarra (n 441).

presented with information and highlighting or downplaying the importance of events or activities occurring elsewhere in an organisation, steering committees can shape the agenda.

4.6 CLASSIFICATION OF EBU MEMBER STATES INTO CORE AND PERIPHERY

The EBU can be conceptualised as a system, i.e., as a set of actors connected by economic and political relationships. This network of relationships exhibits structure creating different opportunities for some actors and constraints for others.

Figure 6 depicts the interconnectedness of Eurozone countries based on the location of bank affiliates.[479] The visualisation was created based on the publicly available data published on 19 August 2024 List of Supervised Entities report by the ECB.[480] It provides a graphical representation of how banks from different Eurozone countries have established affiliates in other member countries, illustrating the complex web of financial relationships within the region.

Each node in the graph represents a Eurozone country. The size of a node is proportional to its degree, which indicates the number of different countries where domestic banks of that country have affiliates. For example, a large node signifies a country whose banks have widespread operations across many other countries. Edges in the network are directed and indicate the presence of bank affiliates. An arrow from country A to country B signifies that banks from country A have affiliates in country B. For instance, an arrow from Germany to Italy suggests that German banks operate affiliates in Italy. The thickness and direction of these edges help visualize the flow of banking relationships and the extent of cross-border banking operations.

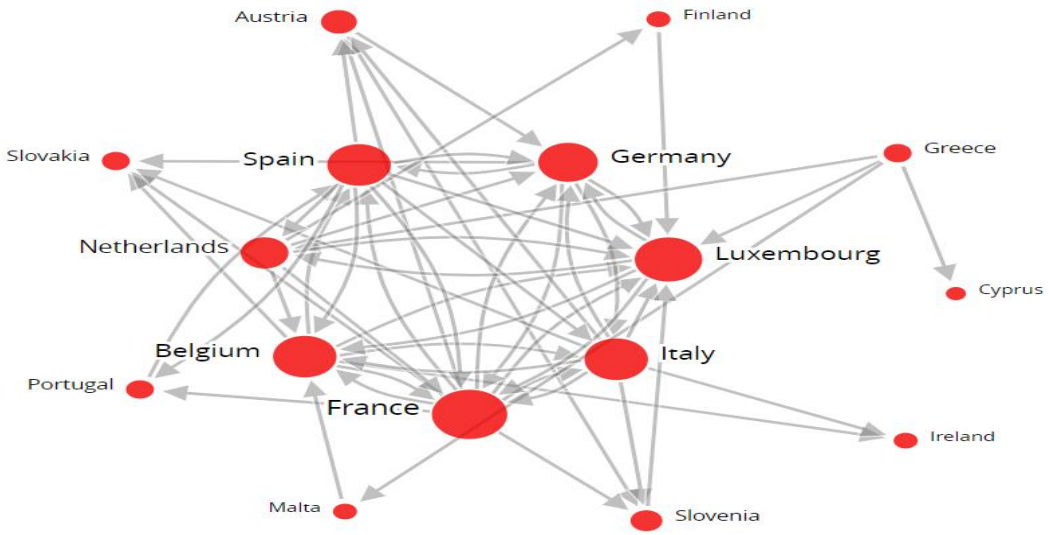
This visualization reveals the prominence of certain countries within the network, emphasizing their extensive international banking activities. Seven countries emerge as the

[479] The figure was created using advanced network analysis techniques, which involve mapping and analysing the relationships and interactions between various entities. This method uses algorithms to identify key nodes, measure the strength and direction of connections, and visualize the overall structure of the network. The data was derived from the publicly available 'List of Supervised Entities' report published by the ECB on 19 August 2024, see European Central Bank 'List of Supervised Entities' (2024) available at : https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.listofsupervisedentities202408.en.pdf accessed 27 October 2024.

[480] ibid.

core of the network: Germany, France, Italy, Spain, Luxembourg, Belgium and the Netherlands. These countries are central to the network, characterized by their high degree of connectivity. Their banks have established numerous affiliates in other Eurozone countries, making them key players in the region's financial landscape. The large size of their nodes reflects their significant role in cross-border banking activities. This interconnectedness is crucial for understanding systemic risk, as financial distress in one country could potentially impact several others due to these established connections. Furthermore, the visualization underscores the importance of these core countries in maintaining financial stability within the Eurozone. Their central roles mean that they are pivotal in the propagation of financial activities and risks across the region.[481] Consequently, regulatory bodies and financial institutions must pay close attention to the dynamics within these core countries to manage and mitigate systemic risks effectively.

Figure 6: The core-periphery network below was plotted based on the August 2024 data published by the ECB. The size of the nodes is proportional to the number of countries where banks have affiliates. The core countries represent a group of highly generally connected nodes, while the periphery countries represent nodes with only few specific connections.



The core countries are the main hubs in the EBU, enabling significant economic flows and having a lot of regulatory power. The regulatory frameworks that these countries' NCAs create often influence policies across the whole union. This power affects more than just

[481] Andrew G. Haldane, Executive Director, Financial Stability, Bank of England, 'Why Institutions Matter (More than Ever)' Speech at the Centre for Research on Socio-Cultural Change (CRESC) Annual Conference, School of Oriental and African Studies, London 3 (Sept. 4, 2013), available at https://www.bis.org/review/r130909b.pdf, accessed 27 October 2024.

economic measures, affecting how standards and compliance are understood and applied throughout the region. The core countries are a group of highly connected nodes, which means that besides the ECB, the regulations and policies the regulations and polices of NCAs of the core countries may be important for the periphery countries.

The economic impact of these core nations cannot be overstated. As primary conduits of capital and financial services, they often dictate the pace and direction of economic trends within the EBU. Any major fiscal adjustments or economic downturns originating from these core countries can ripple across the entire network, affecting both direct and indirect connections. This interconnectedness, while beneficial in terms of integrated market strength and collective stability, also poses a risk of rapid dissemination of economic shocks. As chapter 1 demonstrated, the Eurozone sovereign debt crisis has underscored how intertwined economies can exacerbate localized issues, transforming them into widespread challenges within the network.

On the other side of this network lie the periphery countries, characterized by their fewer and more selective banking connections.[482] These nations experience a different set of challenges compared to their core counterparts. One of the most significant challenges is their vulnerability to economic shocks. With fewer connections, these countries often have limited access to the emergency flows of capital that can stabilize economies during crises. Their financial systems, being less integrated, might face greater impacts from local or systemic economic downturns without the buffering provided by a more diversified connection network. The regulatory standards and economic policies in periphery countries are frequently influenced by the core, yet these nations often need to adapt these standards to fit local contexts. This adaptation can sometimes lag, resulting in a regulatory framework that might not perfectly align with their economic needs or capabilities.

Despite the common classification of EU member states into core and periphery, it is important to recognize that the interests of core EU member states will not always be aligned. These interests often diverge due to the unique economic structures, political climates and strategic priorities of each state. While core states are central to the EU's banking market functioning, their domestic imperatives can lead to conflicting positions on

[482] Daron Acemoglu, Asuman Ozdaglar & Alireza Tahbaz-Salehi, 'Systemic Risk and Stability in Financial Networks' (2015) 105 AM. ECON. REV. 564, 566.

various policy matters. This divergence is a natural consequence of their different national contexts and political realities. However, negotiations among these core states are conducted on an equal footing, with each state recognising the necessity of compromise and collaboration. Such negotiations typically involve a give-and-take approach where each state concedes on certain issues in exchange for gains in others, ensuring that the final outcomes reflect a balance of interests.

This dynamic was prominently evident during the Eurozone sovereign debt crisis, where France and Germany, despite initially opposing stances on several issues, managed to shape the direction of the EU's response through extensive bilateral negotiations.[483] During the crisis, these two nations frequently held bilateral talks to address their divergent views on fiscal policies and financial support mechanisms.[484] For example, Germany's insistence on fiscal discipline clashed with France's preference for more growth-oriented measures.[485] To reconcile these differences, high-profile meetings between leaders such as Chancellor Angela Merkel and President Nicolas Sarkozy were convened.[486] These meetings often resulted in compromises that shaped key initiatives like the ESM and the Fiscal Compact, reflecting a blend of their policy preferences.

In stark contrast, periphery states, which were most affected by the sovereign debt crisis, had minimal influence over these key decisions. France and Germany's pre-negotiated positions often became the de facto policies that periphery states had to accept. For instance, decisions regarding financial aid packages and fiscal reforms were largely driven by the compromises reached between Germany and France, with little input from debtor countries like Greece, which were directly impacted. This exclusion underscores the imbalance in the EU's decision-making process, where core states leverage their power to set the agenda while periphery states are left with little choice but to conform to these predetermined policies.

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[483] Hanno Degner and Dirk Leuffen, 'The role of France and Germany in rescuing of the Eurozone' (2019) 20(1) European Union Politics 89.

[484] For a comprehensive overview of the negotiations between Greece and the Eurozone creditors, including details on how Greece was often presented with a pre-agreed agenda, see Yanis Varoufakis, *Adults in the Room: My Battle With Europe's Deep Establishment* (London, The Bodley Head 2017).

[485] For an overview of how Germany's and France's different ideologies shaped the responses to the Eurozone sovereign debt crisis, see Brunnermeier et al. (n 471).

[486] ibid.

4.7 CONCLUSION

This chapter presented the idea that the EBU can be seen as a broad network of regulatory bodies that, while initially agreeing to work together for the financial stability of the Eurozone, often encounter conflicts due to varying national interests and goals. These differences lead to strong motivations for defection ex post. Resolving these conflicts and selecting among various policy alternatives within the EBU depends on the power dynamics among the supervisory entities involved in bank regulation. It is crucial, therefore, to study how power is distributed within the EBU's institutional structure and to assess whether all member states are equally constrained in influencing policy outcomes to their advantage.

To achieve this, the chapter developed a framework for analyzing power, emphasizing its various manifestations: *instrumental power*, which relates to the ability of actors to dominate in decision-making settings, *institutional power*, which reflects how specific procedural norms and goals systematically advantage certain actors and structural power, stemming from the roles actors hold within the organizational network, which shapes their capabilities and interests. These types of power manifestations should be viewed not as competing ideas, but as different ways that power functions in the formulation, oversight and enforcement of financial regulations under the EBU. According to this framework, member states in the EBU can be divided into 'core' and 'periphery,' where core states typically have more control over regulatory practices and decision-making. The following chapter will apply this power framework to the institutions of the EBU to investigate whether all member states are similarly limited in their ability to shape policy outcomes in their favour *ex post*.

5 APPLICATION OF THE POWER FRAMEWORK TO THE EBU INSTITUTIONS

5.1 INTRODUCTION

This thesis has argued so far that the rules that govern the EBU are incomplete due to various reasons, allowing a lot of room for EBU actors to use *ex post* discretion. This may prove problematic as the NCAs that participate in the EU decision-making processes may have different national interests and try to achieve different outcomes *ex post*. Although the EBU has various mechanisms to ensure that such discretion is aligned with the EBU's objectives, there will still be cases where the interests of member states will conflict forcing member states to promote different policy paths. Therefore, we need to analyse the role of power in the EBU context and determine whether all member states have the same constraints in advancing their policy preferences in the EBU setting.

As explained in chapter 4 (*The Power Framework*) above, power can be understood as the ability of actors to influence others even against their opposition to get the outcomes they want. To provide a better insight into how power operates in the context of regulatory organisations, chapter 4 (*The Power Framework*) presented three types of power: *instrumental power*, which refers to the ability of actors to dominate in decision-making situations, *institutional power*, which reflects how specific procedural norms and goals systematically favour certain actors and *structural power*, stemming from the roles actors hold within the organisational network, which shapes their capabilities and interests.

This chapter applies the power framework to the EBU institutions and examines whether all member states have the same constraints in promoting their interests in the EBU forums. The *structure* of the SSM shows that although supervisory responsibilities have been assigned to the ECB, the ECB is still subject to the rule-making powers of the EBA and national bodies. In the EBA, core member states have traditionally played a significant role in promoting rules and standards that align with their national interests, while they can resort to national law to implement EU directives and apply the options set out in therein. In addition, the *representation* of NCAs in the Supervisory Board means that collective decision-making will be influenced by national interests, with NCAs interpreting policy outcomes through the lens of their national preferences. The *objectives* of the SSM have shifted the attention to group level and the importance of local consequences affecting solely

periphery states has been reduced. This means that Eurozone periphery states may be more exposed to risks coming from the core, particularly when credit institutions expand into the periphery and aim to reduce compliance costs by not establishing subsidiaries with capital buffers. Finally, the *decision-making process* under the SSM relies a lot on the coordination between the NCAs and the ECB, which gives core states the ability to engage in *boundary management* by not disclosing information about systemic risks that may affect periphery states or by framing them in a way that serves their interests.

In terms of the SRM, the EBU regime provides many opportunities for core member states to opt for exceptions and reorganise a failing bank under national laws through precautionary recapitalisation without considering spill-over effects to periphery member states. The *over-representation* of NCAs in the SRB means that the decision-making process will be driven by national interests without prioritising the EU common interest. When the resolution process is actually triggered, the *objectives* of the SRM are not hierarchical and are conflicted in nature, allowing the actors involved in the decision-making process to reframe the mandate as they see fit. The *instruments* available to the SRB are insufficient for resolving systemic failing credit institutions, making it is unlikely that systemic banks will be resolved at EU level. In addition, the *decision-making process* may be influenced by politics, as it involves politicians who have other agendas and a shorter time horizon for measuring the outcome of decisions than regulators. Finally, the core states and the credit institutions established in their jurisdictions continue to *exert significant control over EU public funds*, leaving periphery countries vulnerable to core states' policy preferences and national parliaments.

As this chapter demonstrates, it becomes evident that periphery states are at a significant disadvantage in terms of influencing policy outcomes within the EBU. These states, due to their limited power and influence, find themselves particularly vulnerable to the priorities and policy agendas of the more dominant core Eurozone countries. This imbalance not only affects their ability to safeguard their own financial interests but also restricts their capacity to advocate for regulations that cater to their unique economic conditions. As a result, periphery states may face challenges in securing financial stability and fostering economic growth, as they will be often compelled to align with policies that may not necessarily reflect their best interests or the specific needs of their financial systems.

5.2 THE SSM

5.2.1 *Rule-making powers*

The EBU regulatory regime is implemented at three levels in line with the conventional regulatory process in EU financial services.[487] At level 1, the EU institutions set out the basic framework under Treaty procedures, which requires a proposal from the Commission to be discussed and approved by EU Parliament. At level 2, the Commission, after receiving proposals developed by the EBA, makes rules on the basis of mandates which are set in Level 1 legislation and foresee the issuance of delegated acts and regulatory technical standards. The rulebook includes numerous delegated or implementing measures. At level 3, the EBA has the power to issue guidelines and recommendations specifying the rules set at the other levels.

Of the three types of rules, the level 1 procedure is usually the most complex and time-consuming process. For this reason, EU policy makers recommend that it be used only for stipulating framework principles. Level 2 regulations can change without having to involve the cumbersome process for changing the Level 1 text and enable the Commission to adapt and update technical implementing measures with the help of EU countries representatives. Level 3 measures comprise non-binding tools such as Guidelines and Recommendations, in relation to which national competent authorities are required to "comply or explain".[488] Level 3 measures make it possible to harmonize aspects of the EBU framework, while at the same time leaving room for supervisory judgement and not engaging the legislative process for Level 1 or Level 2 rules. Therefore, this process ensures that, in case a rule turns to be *ex post* inefficient, the Commission, in collaboration with the EBA, has the flexibility to adapt to the circumstances in light of new information.

The transfer of supervisory responsibilities to the ECB under the EBU regime led to the modification of the EBA Regulation to clarify that the "competent authorities" involved in

[487] For an overview of the legislative process and how it developed, see Niamh Moloney, *EU Securities and Financial Markets Regulation* (Oxford, 3rd edn, OUP 2014), 861-866.

[488] EBA Regulation, Article 16.

the EBA decision-making processes includes the ECB.[489] In addition, following the establishment of the EBU, the adoption of decisions by EBA require the majority of both participating and non-participating member states.[490] Despite these changes, the ECB has limited regulatory powers. It can adopt guidelines and regulations only to the extent necessary to carry out supervisory tasks.[491] The adoption of prudential rules, however, is in principle excluded and the ECB remains subject to the decisions adopted by EBA. In addition, the ECB lacks voting power within EBA.[492]

The EBA, in turn, is heavily dependent on national supervisors for its operations. Some observers questioned whether EBA can be truly called 'authority' given its limited power and the fact that it is just a 'club' of supervisors.[493] More importantly, although EBA is required "to act independently and objectively in the sole interest of the Union as a whole" and it must not "seek or take instructions from national governments or public or private bodies",[494] there is evidence that this is not happening.[495] During the meetings with EBA representatives and national supervisors, the Court of Auditors observed that most member states participating in decision making processes mainly represented their national positions rather than proposing a position for the EU.[496]

The largest and most developed European financial centres, including France, Germany, Italy and Spain, are the key players in shaping the agenda for the adoption of EU regulatory

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[489] Regulation (EU) No 1022/2013 of the European Parliament and of the Council of 22 October 2013 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards the conferral of specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions [2013] OJ L287/5 (the "**EBA Amending Regulation**").

[490] ibid., see para (24) amending Article 44 of the EBA Regulation.

[491] SSM Regulation, Article 4(3).

[492] EBA Amending Regulation, see para (24) amending Article 44 of the EBA Regulation.

[493] House of Lords European Union Committee, 'Genuine Economic and Monetary Union and the Implications for the UK' (2014-15, HL Paper 103) available at: <https://publications.parliament.uk/pa/ld201415/ldselect/ldeucom/103/103.pdf> accessed 27 October 2024, 36.

[494] EBA Regulation, Article 42.

[495] European Court of Auditors, 'Special report No 29/2016: Single Supervisory Mechanism - Good start but further improvements needed' (eca.europa.eu, 18 October 2016) available at: < https://www.eca.europa.eu/Lists/ECADocuments/SR16_29/SR_SSM_EN.pdf> accessed 26 October 2024, para. 38; Mazars, 'Study on the Review of the European Supervisory Authorities (ESAs)' (mazars.com, 2013) accessed <https://gcc.mazars.com/group/en/who-we-are/news-publications/latest-news/study-on-the-review-of-the-esas> accessed 10 October 2023, 34 -35.

[496] ibid.

rules.[497] In terms of instrumental power, the institutional capacity and regulatory expertise of these member states are important sources of power in EU regulatory politics. For example, the Bundesbank and the Bank of Italy have traditionally played a strong economic role in economic research within the Eurosystem.[498] On the contrary, since Eurozone periphery states lack such expertise in relative terms, the incumbent network of well-resourced regulators from the Eurozone core dominates the regulatory debate. The supervisory agencies in the Eurozone periphery are often small departments without sufficient funds, information technology and skilled human resources to design international regulatory frameworks applicable to a large number of countries. The Central Bank of Latvia, for example, employed a total of only 498 people in 2018 (down from 528 at the end of 2017).[499] In 2023 and 2022 respectively, this authority's combined budget for education and training amounted to €303,000 and €203,000 respectively. This is perhaps, an extreme example, given that Latvia is a very small country, even by the standards of Eurozone periphery countries, but the point can be generalised: regulatory officials of periphery countries lack the necessary expertise to propose regulatory frameworks.

EU financial standards, however, can be a poor match for the idiosyncratic conditions of Eurozone periphery financial markets, particularly at the early stage of their development. Prudential rules have become much more complex and costly for regulators and banks to implement, particularly for smaller banks in the Eurozone periphery.[500] More importantly, core states are often keen to set EU rules that are in line with their domestic regulatory approach and do not create comparative disadvantages or adjustment costs to national

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[497] Lucia Quaglia, 'The Old and New Politics of Financial Services Regulation int the European Union' (2012) 17(4) New Political Economy 515. There is also evidence suggesting that the structural positioning of actors within the network of EU financial regulation significantly influences the member states' roles in the regulatory process, Dimitrios Christopoulos and Lucia Quaglia, 'Network Constraints in EU Banking Regulation: The Capital requirements Directive' 29(2) Journal of Public Policy 179.

[498] Kenneth Dyson, 'German Bundesbank: Europeanization and the Paradoxes of Power' in Kenneth Dyson and Martin Marcussen (eds), *Central Banks in the Age of the Euro: Europeanization, Convergence and Power* (Oxford, OUP 2009); Lucia Quaglia, 'The Banca d'Italia: Between Europeanization and Globalisation' in in Kenneth Dyson and Martin Marcussen (eds), *Central Banks in the Age of the Euro: Europeanization, Convergence and Power* (Oxford, OUP 2009); David Howarth, 'Defending the Euro: Unity and Disunity Among Europe's Central Bankers' in Hayward, J. and Würzel, R. (eds), *European Disunion*: *Between Unity and Solidarity* (Basingstoke, Palgrave MacMillan 2012).

[499] Latvijas Banka, 'Annual Report 2023' (datnes.latvijasbanka.lv, 2023) available at: https://datnes.latvijasbanka.lv/ar/AR/LB_AR_2023.pdf?_gl=1*103aihi*_ga*NjM3NDI3NDE1LjE3MzAwNDA0MDI.*_ga_F8V1V8BEFY*MTczMDA0MDQwMi4xLjAuMTczMDA0MDQwMi42MC4wLjA.,153.

[500] Emily Jones and Alexandra O. Zeitz, 'Financial Convergence in the Financial Periphery: How Interdependence Shapes Regulators' Decisions (geg.ox.ac.uk, May 2019) GEG Working Paper 141 available at: < GEG WP 141 Financial convergence in the financial periphery Jones & Zeitz> accessed 27 October 2024, 6.

industry and the public authorities.[501] As section 3.4.1 (*The Incompleteness of the Supervisory and Resolution Framework*) of Chapter 3 demonstrated, French and German policy makers lobbied against the exclusion of the calculation of hybrid instruments towards CET1 capital requirements to protect the competitiveness of domestic banking sectors. Little attention was paid, however, to the limited capacity of hybrid instruments to provide sufficient level of loss-absorption capacity on a going-concern basis and the potential risks for periphery states in case of bank failures in core jurisdictions.

That being said, it can be argued that the capability of Eurozone periphery states to avoid adverse effects of Eurozone financial standards is likely to be strengthened due to their formal participation in the EU rule making process. Although Eurozone periphery economies do not have regulatory expertise strong enough to propose regulatory frameworks they have the ability to assess the potential impact of the regulatory proposals initiated by Eurozone core countries. They can therefore demand during the process of designing eurozone regulatory standards the adjustment or revision of particular provisions expected to have substantial negative impacts on their domestic banking markets.

Nonetheless, the significance of their participation in EU policy fora should not be exaggerated. Eurozone periphery states' ability to actively pursue their preferences in Eurozone financial standards still remains severely constrained. The *structural power* of Eurozone member states, emanating from their position in the European banking network is a primary factor influencing the ability of states to control the regulatory process. A country with a core position in the Eurozone banking market can control foreign access to its important financial markets. It is thus able to pose threat of market closure to financial institutional from non-cooperative Eurozone countries and thereby bend the international negotiations on international financial standards in its favour.[502]

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[501] There is evidence that existing regulatory practices, level of financial sector development and the power of local banking elites shape regulators' decisions over international standards, see Andrew Walter, *Governing Finance: East Asia's Adoption of International Standards* (Cornell Studies in Money, Ithaca, Cornell University Press 2008); Quaglia (n 497).

[502] Daniel W Drezner, *All Politics is Global: Explaining International Regulatory Regimes* (Princeton, Princeton University Press 2007); Tomas Oatley and Robert Nabors, 'Redistributive Cooperation: Market Failure, Wealth Transfers, and the Basle Accord' (1998) 52(1) International Organization 35; Hyoung-Kyu Chey, 'Do markets enhance convergence on international standards? The case of financial regulation' (2007) 1(4) Regulation & Governance 1 295; Jones and Zeitz (n 500), 12.

In addition, Eurozone periphery states are often looking to attract international capital and stay on good terms with international financial institutions.[503] When international banks enter a host jurisdiction and operate as subsidiaries, they need to comply with the rules of the host jurisdiction, incurring transaction costs. They have, therefore, strong incentives to champion regulatory harmonization between home and host countries. In such contexts, periphery states face strong pressures to accommodate the interests of international financial actors established in core jurisdictions.

If Eurozone core member states are unable to influence policy outcomes in their favour at EU level, they can still exercise a high degree of control of the ECB's actions through national parliaments. As illustrated in section 2.3.2 (*The SSM*) of chapter 2, national law continues to play an important role in the carrying of the ECB's supervisory tasks. Where a supervisory power enshrined in national law is intended to underpin a supervisory function under EU law, the ECB will be capable of exercising such power within the limits of its supervisory tasks. On the contrary, where a supervisory power enshrined in national law is purely provided to underpin functions that an NCA has under national law, the power should be exercised by the NCA.[504] This arrangement confers institutional power on core member states in which the vast majority of credit institutions with cross-border subsidiaries and branches are established. As section 4.5 (*Structural Power*) of Chapter 4 illustrated, core countries represent a group of highly connected nodes, which means that in addition to the ECB, the regulations and policies of core member states affect periphery countries, but not vice versa.[505]

To summarize, the ECB has limited regulatory powers and remains subject to both EU and national law.[506] More specifically, it remains subject to the powers of EBA with regards to regulatory technical standards, dispute settlement, emergency decisions and breaches of EU

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[503] ibid.

[504] European Commission, 'Commission Staff Working Document Accompanying the Document Report From the Commission to the European Parliament and the Council on the Single Supervisory Mechanism established pursuant to Regulation (EU) No 1024/2013 COM (11 October 2017) 591 final available at: <eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017SC0336> accessed 27 October 2024, 27.

[505] The ECB may instruct NCAs to exercise their powers if and insofar this proves necessary to carry out the tasks conferred on the ECB under Articles 4 and 5 of the SSM Regulation. Nevertheless, the exercise of such ECB's powers will have political repercussions and may cut against the objective of promoting dep cross-border coordination between NCAs and the ECB.

[506] Ignazio Angeloni, 'The ECB and national supervisory authorities: cooperation and common challenges' (banking.supervision.europa.eu, 22 September 2017) available at: < The ECB and national supervisory authorities: cooperation and common challenges (europa.eu)> accessed 26 October 2024.

law. In addition, the ECB remains subject to national laws and discretions. These institutional arrangements confer power on core member states to constrain the ECB's actions in their favour. At EU level, core member states have the *instrumental* and *structural* power to shape the EBA's agenda for the adoption of EU financial standards and effectively exercise a high degree of control over a counter-organisations to the ECB. At national level, as the vast majority of subsidiaries and branches are established in core member states, the regulations and policies of core states can affect periphery states, but not vice versa.

5.2.2 *Representation*

The appointment process is a mechanism through which particular interest groups can choose decision makers who they trust and believe to share their objectives to exercise discretion in their favour. The composition of the Supervisory Board is, however, for most part made of NCAs of participating member states. There seems to be a contradiction: one the one hand, supervisory tasks have been taken away from NCAs because they were carried out with a focus on national interests. On the other hand, the planning and execution of supervision is shifted to a supranational body which is composed by a majority of national authorities.

This composition leaves too much scope for nationally oriented perspectives and creates tensions both between national interests and national interests and the interests of the European Union as a whole.[507] This structure has the potential to create internal conflicts as representatives may naturally advocate for policies that favour their home countries' specific economic and regulatory environments. Such nationally focused attitudes risk overshadowing the broader objectives of the EU, leading to tensions as well as fragmented and inconsistent regulatory practices across member states. For instance, as discussed in section 2.2 (*Challenges Arising from the Division of Supervisory Responsibilities in the Pre-EBU Period*) of Chapter 2, during the European debt crisis, national supervisors were more inclined to protect their domestic banks, even if this stance was misaligned with the collective financial stability goals of the EU.

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[507] On how representation by National Competent Authorities (NCAs) can shape perspectives regarding decisions made by the SRB in the context of resolution of banks, see Tobias H. Troeger and Anastasia Kotovskaia, 'National Interests and Supranational Resolution in the European Banking Union' (2023) SAFE Working Paper No 340 European Banking Institute Working Paper Series 2022 no 114 available at: < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4024343> accessed 27 October 2024.

The over-representation of national interests in the Supervisory Board works to the detriment of periphery countries. In most situations, the credit institutions established in the core member states have operations that will be considered systemically important for the Eurozone periphery, while foreign entities will be small relative to the parent group. The NCAs of core member states have weak incentives to exercise strong consolidated supervision to ensure systemic stability in the Eurozone periphery.

The inclusion of six independent members, namely the Chair, the Vice-Chair and the four ECB representatives, is meant to help overcome the domination of national interests in the decisions of the Supervisory Board. The appointment of the independent members, however, is not free from political pressures by member states, which have generally been keen on getting their nationals elected in the governing structures of the euro area, particularly the ECB.[508] Member states face different constraints on having their voices heard in the appointment process. The structural power of member states is an important factor influencing the ability of member states to exercise control over the appointment process. The top officials in regulatory agencies established in the Eurozone periphery often lack the experience in supervising international banks that regulators in core member states gain.

Furthermore, the central position of core countries in the EBU supervisory network gives politicians and top officials of core countries more opportunities to engage in cross-national networking, which increases their chances of landing top EU banking positions.[509] As the domestic policy decisions of core member states affect many Eurozone markets, the officials of core countries are invited to the meetings of various EU committees, policy fora and interest groups. The central bankers and policy officials in the core of the EU network enter into political bargains long before the formal process begins. The shortlist of nominees is drawn on the basis of political compromises between core member states, which makes the

[508] Jean Pisany-Ferry, 'There is Room for Improvement in the Appointment of ECB Executive Board' (bruegel.org, 30 May 2006) available at: <https://www.bruegel.org/policy-brief/there-room-improvement-appointment-ecb-executive-board-members> accessed 27 October 2024.

[509] One factor influencing the appointment of Mario Draghi as the President of the ECB was the cross-border networking activities of the Bank of Italy, see Kenneth Dyson and Lucia Quaglia 'The Italian Candidate: the Appointment of Mario Draghi on the Presidency of the ECB' (2012) 27 Italian Politics: From Berlusconi to Monti 155.

process anything but transparent.[510] This cross-border collaboration fosters the establishment of a power elite characterised by a highly interconnected structure with common relationships.[511]

In addition to structural power, member states have the institutional power to influence the appointment of the Supervisory Board's independent members in their favour. As set out in section 2.3.2 (*The SSM*) of Chapter 2, the Council has the final say in the selection of the Chair of the Supervisory Board and must decide by qualified majority voting. This voting arrangement means that Germany and France, acting in coalition with either Spain or Italy and an additional member state can block the appointment of any candidate. The Vice-Chair of the Supervisory Board is chosen following a similar appointment process among the members of the Executive Board of the ECB.

In addition, the Supervisory Board cannot initiate the appointment process or agree on a list of potential candidates without warning, but must instead notify the Council of the pool of applicants and the method used to screen them. As discussed in section 4.4.3(iii) of Chapter 4, these notice provisions ensure that the Council, and consequently the core states, are informed about the relevant candidates and the associated costs and benefits of their appointment. In addition, these notification obligations afford numerous opportunities to the Council to respond when the ECB seeks to move in a direction that core member states do not like. An important consequence is that this *decision-making process* allows political reaction by core states prior to the appointment of a candidate. Four out of six seats of the Executive Board have been informally attributed to Germany, France, Italy and Spain since the establishment of the ECB.[512]

Influence over who becomes the head or senior management in organization plays a vital role in shaping the relevant institutions, although, certainly it does not amount to hands-on control. The heads of organisations are responsible for important functions in the

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[510] The European Parliament has often expressed concerns about the political compromises surrounding the nomination process for senior positions at the ECB, see Drazen Rakic 'European Central Bank Appointments: Role of the European Parliament (europarl.europa.eu, July 2019) available at: < https://www.europarl.europa.eu/RegData/etudes/STUD/2019/638413/IPOL_STU(2019)638413_EN.pdf> accessed 27 October 2024.

[511] There is evidence that the four core countries, namely France, Germany, Italy and Spain, have a reserved seat in the executive positions of the ECB, see Francesco Giavazzi and Charles Wyplosz, 'Selection of the Central Bank Board is a Fait Accompli' (FT.com, 9 Feb 2006) accessed 3 July 2022.

[512] Pissany Ferry (n 508).

organizations and participate in informal meetings comprised of the top officials in which important decisions are made. The big size of the Supervisory Board, i.e. 25 participants, means that there will be no time for diving deep into analysing supervisory matters. The large volume of supervisory decisions further exacerbates such time constraints.[513] The analysis of supervisory issues and the adoption of the preferred course of action, especially in times of crisis, will be carried out in informal meetings comprised of the top officials, sometimes within a subset of members.[514] Influence over the appointment of top policy officials ensures that there are internal groups committed to one side of the conflict and are likely to take action to promote and defend it.

In summary, core member states have structural and institutional power to ensure the representation of their domestic interests in the Supervisory Board. The composition of the Supervisory Board is for most part made of NCAs with weak incentives to take into account of cross-border externalities of bank failures in the Eurozone periphery. In addition, the structural position of core member states in the EBU supervisory network gives them the opportunity to lobby for the appointment of their preferred candidates as independent members of the Supervisory Board. In addition to structural power, the formal appointment procedures further entrench existing power imbalances between core and periphery states.

5.2.3 *Micro-prudential Requirements*

As noted in chapter 3 *(The Heated Negotiations Over the EBU*), international banks with cross-border operations were the primary proponents of centralisation of bank supervision. They argued that the transfer of responsibilities to the ECB would reduce the compliance costs associated with their cross-border business and enable takeovers of weaker competitors.[515] In addition, the exercise of supervisory powers by a single authority would be conducive to ensuring the most efficient allocation of intra-group capital and liquidity

[513] Between November 2014 and November 2015, the ECB's Supervisory Board made a total of 1,450 decisions, see European Court of Auditors (n 495), para. 36.

[514] During the Eurozone sovereign debt crisis, the analysis of issues affecting the Eurozone banking market and the determination of the preferred course of action were commonly conducted in informal meetings comprising top officials. For instance, the former President of the ECB frequently met with such officials from core states to discuss developments, see Varoufakis (n 484) and Brunnermeier et al. (n 471).

[515] Montalbano (n 222); Culpepper (n 226); Alexandra Hennessy, 'Redesigning financial supervision in the European Union (2009–2013)' (2014) Journal of European Public Policy 21; David Howarth and Lucia Quaglia, 'Banking Union as Holy Grail: Rebuilding the Single Market in Financial Services, Stabilizing Europe's Banks and 'Completing' Economic and Monetary Union' (2013) Journal of Common Market Studies 51; Rachel Epstein, 'Choosing the Lesser of Two Evils: Explaining Multilateral Banking Groups' 2014 Montréal: Centre d'études et de recherches internationales.

and lead to consolidation of the Eurozone banking system.[516] On the other hand, smaller banks expected neither cost-saving nor competitive advantages from centralised supervision.[517]

The centralization of banking oversight under the ECB raises important considerations regarding the national interests of individual member states. While the ECB's primary mandate is to ensure the overall stability and integrity of the banking system in the Eurozone, its supranational perspective inherently carries the risk of overlooking or underweighting specific domestic concerns related to financial stability. National authorities, which traditionally had control over their banking systems, often take into account localized economic conditions, regional market dynamics and the unique characteristics of domestic financial institutions. However, the ECB's broader and more uniform approach to licensing may not be as sensitive to these issues, potentially leading to decisions that benefit the overall Eurozone but may not align with the interests or preferences of individual countries.

This perspective suggests that banks, particularly those with a strong financial footing and cross-border ambitions, may indeed find it easier to convince the ECB to grant licenses and approve mergers or acquisitions. Given that the ECB's evaluations are likely to be centered on financial stability and prudential concerns on a Eurozone-wide scale, large banks could present their cases for expansion with an emphasis on contributing to a more integrated and efficient European banking market. The emphasis on systemic concerns may inadvertently disadvantage smaller or domestically-focused institutions whose strengths and contributions to local economies might be less apparent in a centralized review process. Therefore, the ECB's role in facilitating the consolidation of the banking sector could unintentionally prioritize the growth and reach of large banks at the expense of smaller, regional banks that play pivotal roles within their local contexts. The head of the large French bank BNP Paribas, Jean-Laurent Bonnafé, revealed the strategic interest behind the banking union project. When asked about its consolidation effects, he replied that: ‘the strongest part of the banking system could be part of some form of consolidation — either

[516] Vitor Constancio, ‘Towards the Banking Union’ (bis.org, 12 February 2013) available at: <https://www.bis.org/review/r130213b.pdf > accessed 27 October 2024, 4; Guido Ferrarini (n 32), 203.

[517] The centralisation provides incentives for further consolidation. As the Head of BNP Paribas states, “Consolidation will just take out the weaker players who are unable to strengthen their positions either because of their own situation or because of their jurisdiction.” See Culpepper (n 226), page 3.

through an acquisition or through organic development plans. In the end, consolidation will just take out the weaker players who were unable to strengthen their positions either because of their own situation or because of their jurisdiction'.[518]

The primary objective of the SSM is to set up an "efficient and effective framework for the exercise of specific supervisory tasks…and ensuring the consistent application of the single rulebook to credit institutions"[519] and "ensure the safety and soundness of credit institutions".[520] The SSM mandate also provides that the ECB's decisions shall be based on the situation in the euro area countries as a whole and that targeting the needs of individual countries is prohibited.[521] Some economists argue that one of the anticipated effects of the EBU would be that banks would function better, as they would be able to optimize their internal management of capital and liquidity and reduce compliance costs.[522]

Nevertheless, the objectives of the SSM work against the interests of the Eurozone periphery states, as they shift supervisory attention to the group level. Many supervisory processes are performed at the consolidated level, i.e., SREP, stress-testing and while they also cover Eurozone subsidiaries, the attention paid to the sub-consolidated level has decreased significantly.[523] Many host Eurozone authorities may consider that the liquidity or capital levels of the subsidiaries are unsatisfactory, that the liquidity and funding model of the group is not in interests of the subsidiary or that the dividend policies of subsidiaries are too aggressive.[524]

The centralisation of supervision has influenced the possibility of granting capital and liquidity waivers to cross-border Eurozone subsidiaries (currently available for liquidity but not for capital) and, more importantly the conversion of subsidiaries into branches across Eurozone countries.[525] There is evidence that the ECB has applied capital and liquidity

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[518] Culpepper (n. 226); Fildes (n 258).

[519] SSM Regulation, Recital 87.

[520] SSM Regulation, Article 1.

[521] SSM Regulation, Article 19.

[522] Constancio (n. 516).

[523] Ismael Ahmad Fontán, Thorsten Beck, Katia D'Hulster, Pamela Lintner and D. Filiz Unsal 'Banking Supervision and Resolution in the EU – Effects on Small Host Countries in Central, Eastern and South Eastern Europe" (worldbank.org, April 2019) World Bank Working Paper available at: <https://thedocs.worldbank.org/en/doc/589991557325278014-0130022019/original/FinSACBREffectsonSmallHostCountriesEurope.pdf> accessed 27 October 2024, 30.

[524] ibid, 31.

[525] ibid, 30.

waivers relatively frequently following the definition of such waivers in the ECB Guide on options and discretions.[526] The Commission welcomed the application of such waivers and called for the further facilitation of the condition for their exercise when this leads to more efficient capital or liquidity management.[527] More recently, the eurozone core countries, led by France, Berlin and Luxembourg, tried to persuade the EU Commission to moderate the minimum level of capital requirements to help banks support businesses.[528]

While the integration of banking operations can bring about more efficient capital and liquidity management, it also means that periphery countries might not have the same level of control over their own financial systems.[529] This reduced control can be particularly detrimental in times of financial crises. Since resolution funds are not fully mutualised at the EU level, the burden of resolving failing banks falls on the national governments of periphery countries.[530] These countries often have weaker economies and less robust financial resources compared to their core counterparts, making it challenging to support failing banking institutions without significant external aid. Furthermore, the conversion of subsidiaries into branches exacerbates this issue. When subsidiaries become branches, the parent banks, often headquartered in core Eurozone countries, gain greater control over capital and liquidity. This centralisation can lead to decision-making that prioritises the interests of the parent banks and their home countries, potentially to the detriment of the host periphery state. In times of crisis, this shift in control may result in less favourable outcomes for the periphery states, as the primary concern of the banks might not be aligned with the stability and needs of the host economies.

The manner in which the ECB has conducted its assessments and evaluations of Eurozone banks, especially significant cross-border banks, reveals a pattern that has significant implications for periphery states. Recent findings suggest that the ECB showed a tendency to protect significant cross-border banks within the Eurozone when evaluating their capital

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[526] European Commission (n 504), 5.

[527] European Commission, 'Report From the Commission to the European Parliament and the Council on the Single Supervisory Mechanism Established Pursuant to Regulation (EU) No 1024/2013' (eur-lex.europa.eu, 11 October 2017) COM (2017) 591 Final available at: < https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2017:0591:FIN:EN:PDF > accessed at 27 October 2024, 12.

[528] Alex Barker and Brooke Masters, 'Paris and Berlin seek to dilute bank rules' (FT.com, 22 January 2012) available at: https://www.ft.com/content/7f8485a8-4500-11e1-a719-00144feabdc0 accessed 27 October 2024).

[529] Fontán et al. (n 523), 31.

[530] For the analysis in respect of member states' control over the EU resolution funds, see section 5.3.3 (*Control of Scarce Resources*) below.

quality.[531] The ECB's methodology during its "comprehensive assessment"[532] of Eurozone banks' asset health has been heavily criticized.[533] This evaluation was primarily based on the ratio of bank capital to risk-weighted assets, a methodology that Andrew Haldane, a Chief Economist at the Bank of England, argues is overly complex and inadequate, especially during crises.[534] Haldane supports using a simpler leverage ratio, which highlights the capital adequacy deficiencies in core universal banks.[535]

Deutsche Bank, Germany's largest banking entity, easily passed the ECB's comprehensive assessment in 2014 and performed well in the EU stress tests in the summer of 2016. It is important to highlight that Deutsche Bank's favourable results in these stress tests were aided by a special concession granted by the ECB.[536] This positive evaluation stands in stark contrast to the financial troubles Deutsche Bank has faced since early 2016, including failing stress tests administered by both the IMF and the Federal Reserve.[537] The inadequate highlighting of capital adequacy deficiencies in core banks can result in a misallocation of confidence and resources. If core banks are perceived to be more stable than they actually are due to favourable assessments, it increases systemic risk. In times of financial stress, this could lead to contagion effects, where the instability of a seemingly robust core banking institution has widespread negative impacts across the Eurozone, including in periphery states that are less equipped to handle financial shocks.

In summary, the centralisation of bank supervision under the ECB can benefit international banks with cross-border operations by reducing compliance costs and facilitating takeovers of weaker competitors, enabling more efficient allocation of intra-group capital and

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[531] Clement Fontan, 'Frankfurt's double standard: the politics of the European Central Bank during the Eurozone crisis' (2018) 31 (2) Cambridge Review of International Affairs 162, 177.

[532] In cooperation with national supervisors, the ECB carries out financial health checks for the banks it supervises directly. These checks are called 'comprehensive assessments.' See European Central Bank, "Comprehensive Assessments" (bankingsupervision.europa.eu, 2024) available at: < https://www.bankingsupervision.europa.eu/banking/tasks/comprehensive_assessment/html/index.en.html> accessed 27 October 2024.

[533] Fontan (n 531), 177.

[534] Haldane (n 275).

[535] Tom Braithwaite, 'Alternative Stress Tests Find French Banks are Weakest In Europe (FT.com, 27 October 2014) available at: <https://www.ft.com/content/fad2c772-5dd7-11e4-b7a2-00144feabdc0> accessed 27 October 2024.

[536] Laura Noonan, Caroline Binham and James Shotter, 'Deutsche Bank Received Speacial Treatment in EU Stress Tests' (FT.com, 10 October 2016) available at: <https://www.ft.com/content/44768ea8-8c71-11e6-8aa5-f79f5696c731> accessed 27 October 2024.

[537] Friedrich Geiger and Ryan Tracy, 'Deutsche Bank Shares Hit Over 30-Year Low After Fed, IMF Rebuke' (wsj.com, 30 June 2016) available at: <https://www.wsj.com/articles/deutsche-bank-shares-tumbled-to-a-30-year-low-after-fed-imf-rebuke-1467278856?msockid=3d5bf70f8820602f1be1e214892661c2> accessed 27 October 2024.

liquidity. However, this centralised oversight raises concerns about the potential impact of such expansion on periphery states, as the ECB's broad approach might overlook specific domestic financial stability concerns traditionally addressed by national authorities. Consequently, large banks with cross-border ambitions may find it easier to obtain licences and approvals from the ECB, potentially disadvantaging smaller or domestically focused institutions. The ECB's supervisory framework, designed to apply uniformly across the Eurozone, focuses on group-level assessments, often neglecting the specific needs of Eurozone periphery states and their subsidiaries. This has led to frequent applications of capital and liquidity waivers benefiting cross-border banking groups. In recent years, the ECB's protective stance towards significant cross-border banks and its use of complex methodologies for asset evaluation highlight the advantages for large banks.

5.2.4 *Macro-prudential objective*

One of the primary reasons for the transfer of supervisory responsibilities to the ECB stemmed from the evidence that keeping supervision at national level in both Eurozone core and periphery states contributed to large imbalances. More specifically, the Eurozone sovereign debt crisis demonstrated that no individual banks can be safe if significant systemic risks loom large in the economy.[538] Even well-capitalised banks may become insolvent due to systemic shocks that lead to a sudden seizure of funding markets. The SSM Regulation assigns responsibility for the imposition of macroprudential powers to NCAs.[539] Nevertheless, there is provision for the ECB, if necessary, to apply more stringent measures than these applied by NCAs.[540]

The allocation of primary responsibility to NCAs is in line with the CRDV package which recognizes that those closest to local idiosyncrasies in domestic economies may be best placed to make these determinations.[541] The use of macro-prudential tools may have potential destabilising effects in periphery jurisdictions. For example, core banks established in core jurisdictions may respond to tight/lax macroprudential standards by

[538] David Green, 'The Relationship Between Micro-Macro-Prudential Supervision and Central Banking' in Eddy Wymeersch, Klaus J. Hopt and Guido Ferrarini, *Financial Regulation and Supervision: A Post-Crisis Analysis* (Oxford, OUP 2012).

[539] SSM Regulation, Article 5.

[540] ibid, Article 5(2).

[541] In particular, the 'CRDV package' provides that capital buffers should be set in order to reflect specific macroprudential or systemic risks at national level, see CRDIV, Article. 133-134 and Article 130.

increasing/decreasing inter-bank lending abroad, making it difficult for NCAs in periphery jurisdictions to successfully stabilise domestic credit. NCAs in core countries have weak incentives to intervene and take measures against risks that may affect host jurisdictions.

Although the CRR/CRDV framework provides for EU level coordination of national capital buffers, which includes the possibility of ESRB guidance on setting countercyclical capital buffers and the involvement of the EBA, ESRB and the Commission, there is evidence that the assessment of systemic risks was impeded by limited access to information and cumbersome decision-making processes.[542] In addition, the ECB's powers to apply more stringent measures than national authorities should not be overestimated. First, the ECB lacks the powers to relax macro-prudential measures. Second, the macroprudential objectives are difficult to implement. While the costs of restrictive macro-prudential measures may appear rapidly, the benefits in terms of systemic risk mitigation are hard to gauge for the regulator.[543]

5.2.5 *Decision-making process*

The decision-making process in the SSM was illustrated in section 2.3.2 (*The SSM*) of Chapter 2 above. JSTs are responsible for acquiring and assessing information related to the credit institutions under their supervision. Having assessed such information, JSTs submit their draft decisions to the Supervisory Board for review. The Steering Committee is responsible for coordinating the decision-making process and preparing the meetings of the Supervisory Board.[544] The Supervisory Board reviews the JSTs' decisions and submits its decisions to the Governing Council, which is deemed to have accepted them unless it objects within a specified timeframe.

The ECB is heavily reliant on JSTs to perform its operations, yet it has little control over NCAs' resources.[545] JSTs are largely stuffed by nationals of the originating NCAs with the

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[542] Samuel McPhilemy and John Roche, 'Review of the New European System of Financial Supervision (ESFS) – Part 2: The Work of the European Systemic Risk Board – The ESFS's Macro-Prudential Pillar' (europarl.europa.eu, October 2013) available at: https://www.europarl.europa.eu/RegData/etudes/etudes/join/2013/507490/IPOL-ECON_ET(2013)507490_EN.pdf accessed 28 October 2024.

[543] Piergiorgio Alessandri and Fabio Panetta, 'The Coordination of Micro and Macro-Prudential Supervision in Europe' (european-economy.eu, 2 March 2016) available at: < https://european-economy.eu/leading-articles/the-coordination-of-micro-and-macro-prudential-supervision-in-europe/> accessed 27 October 2024.

[544] European Court of Auditors (n 495), para 33 and Annex III.

[545] European Commission (n 504), 56.

composition ratio being 2/3 NCA stuff and 1/3 ECB stuff.[546] According to the ECB's Guide to banking supervision, the JST coordinator should in general not be a national of the bank's home country. Nevertheless, some coordinators are from the country in which the corresponding staff has its head office.[547]

Most of the JST staff performing supervisory actions is located within departments organisationally separated from the ECB, facing conflicting reporting lines.[548] For JST work they reported to the JST coordinator, while for any other work they reported to the NCA line managers.[549] Moreover, on all matters of hierarchy and human resources, they only reported to the NCA management.[550] Some JST coordinators in the largest JSTs reported that they had little knowledge about task allocation at NCA level.[551] The work of on-site inspections is likewise the ECB's responsibility, but on-site teams typically contain very few ECB staff. Moreover, in most cases on-site inspection teams were headed by the bank's home supervisor.[552] The ECB furnished 8% of the stuff for all on-site inspections in 2015 with 92% coming from NCAs.[553] In general, the ECB involvement is surprisingly low and not in keeping with the spirit of the regulation.[554]

The composition of JSTs primarily by NCA stuff means that there is a risk that NCAs will prioritize NCA work over JSTs responsibilities.[555] The absence of binding performance appraisals of NCAs' JST staff could create incentive and performance problems. The SSM Regulation does not provide for formal procedures for the ECB to officially report to NCA management on the performance of the NCA staff in JSTs. Although some feedback was given, it remained unofficial, with no obligation on the part of NCAs to either accept or make use of it. Moreover, NCAs may even be prevented from national legislation to use the ECB feedback. In addition, the SSM Regulation fails to specify to whom supervisory reports should be sent. The JST Coordinator has discretion to decide when and to whom to flag

[546] European Court of Auditors (n 495), paras 129-130.
[547] ibid, para 123.
[548] European Commission (n 504), 9.
[549] European Court of Auditors (n 495), para 140.
[550] ibid.
[551] ibid, para 141.
[552] ibid, para 154.
[553] ibid, para 154.
[554] ibid, para 55.
[555] ibid, 60-65.

specific issues depending on the severity and materiality of the corresponding findings. Although the ECB set out some instructions in the supervisory manual, there is no guidance on the concepts of severity and materiality of findings.

The decision-making process is rather complex and relies on a high degree of information flow between NCAs and the ECB. Information sharing and communication was identified as a problem in some JSTs.[556] The process for the communication of supervisory findings to the ECB is lengthy and there is a risk that findings are out-of-date when they reach the relevant stakeholders.[557] In addition, the complexity and high number of decisions puts at risk the ECB's mission to carry out intrusive and effective banking supervision. As of November 2015, the ECB's Supervisory Board was required to take 1,450 supervisory decisions and 119 SREP decisions.[558] There is evidence that the Supervisory Board does not have time to review decisions, as the documents are often sent late and committee members are insufficiently prepared to discuss the agenda.[559] The former Chair of the Board, Danièle Nouy, has publicly commented that, owing to the volume of supervisory decisions forwarded to the Governing Council, the latter has to trust the Board's conclusions.[560] The ECB recently introduced a new organisational process which allows bunding of similar procedures. Despite some positive effects the volume of decision making remains very high.[561]

This multi-layered decision-making process entails the risk that the Eurozone periphery will receive poor information about systemic risks that affect them. The incentives of NCAs and the ECB differ, as the ECB will take into account cross-border externalities when performing supervisory tasks. When this conflict is severe enough, it may distort NCAs' incentives to collect information (prefer to remain ignorant) rather than having to provide the ECB with information that would lead to decisions that are against their interests.[562] In

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[556] ibid, para 141.

[557] ibid, para 183.

[558] ibid, para 36.

[559] ibid, paras 37-39.

[560] Danièle Nouy, 'Süddeutsche Zeitung Interview with Danièle Nouy, Chair of the Supervisory Board of the Single Supervisory Mechanism, published on 24 January 2016' (bankingsupervision.europa.eu, 24 January 2026) available at: < https://www.bankingsupervision.europa.eu/press/interviews/date/2016/html/sn160125.en.html> accessed 27 October 2024.

[561] European Court of Auditors (n 495); European Commission (n 527), 6.

[562] Elena Carletti, Giovanni Dell'Ariccia and Robert Marquez, 'Supervisory Incentives in a Banking Union' (imf.org, 2016) IMF Working Paper WP/16/86 available at: <https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Supervisory-Incentives-in-a-Banking-Union-44273> accessed 26 October 2024.

addition, the introduction of the ECB in the decision-making process creates stronger incentives for banks to hide problems that they would have revealed had they faced a more lenient local supervisor. Then, in equilibrium less accurate information might be collected than under fully independent local supervisors or under a centralised agency that collects information directly.[563]

The diverging interests become even clearer during times of distress.[564] If the problem arises in the parent bank, the home jurisdiction has strong incentives to delay information sharing, while the host country has strong incentives to prevent local assets from being up-streamed to offset losses in the parent bank's financial position or in other parts of the group.[565] The differences in interest are particularly striking for Eurozone periphery states, for whom the subsidiaries of multinational parent banks established in the Eurozone core are often of systemic importance and thus the stability of the bank a high priority, while the operations of the bank in the Eurozone periphery are not material for the parent bank and thus of lower priority for the Eurozone core NCAs.

Even when the information reaches the ECB, core countries can engage in effective *boundary management* to shape the agenda of the Supervisory Board. The Steering Committee plays an important role in decision-making, as it is responsible for preparing the documentation, procedures and meetings of the Supervisory Board and takes care of any follow-up actions.[566] The Steering Committee is composed of the Chair and Vice-Chair of the Supervisory Board, one ECB representative and five representatives of NCAs. The five representatives are appointed based on a rotation system that ensures representation of countries depending on the size of their banking system. Based on this system, two of Germany, France, Italy and Spain will always have a representative in the Steering Committee. In addition, as noted in section 5.2.2, the core countries have historically played a major role in the appointment of executive roles in the ECB.

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563 ibid; Jean Tirole and Philippe Aghion, 'Formal and Real Authority in Organizations' (1997) 105(1) Journal of Political Economy 1.

564 D' Hulster (n 46).

565 Fontán et al. (n 523), 11.

566 European Court of Auditors (n 495), para 35. The Supervisory Board Secretariat plays a crucial role in the decision-making process. It is responsible for coordinating this process efficiently and effectively. To facilitate this, the Secretariat has issued comprehensive checklists, templates, and flowcharts.

Even when the Supervisory Board becomes aware of adverse information in respect of systemic cross-border banks, in the face of uncertainty, it has strong incentives to refrain from adopting early intervention measures to avoid introducing more volatility to the market.[567] To cover past supervisory failures, the ECB can frame specific issues as liquidity problems and relax its monetary policy to continue lending to weak banks for fear that winding up would trigger losses.[568] To protect against such effects, the SSM stipulates that the ECB should carry out its supervisory tasks separately from its tasks relating to monetary policy.[569] Nevertheless, the European Court of Auditors have reported that there are risks to the independence of monetary policy and supervisory functions, as some ECB departments provide services to both functions without clear rules and reporting lines that would minimize potential conflicts of objectives.[570]

More importantly, the same regulation explicitly provides that the Governing Council can object to draft decisions made by the Supervisory Board by stating its reasons in writing, including in particular any monetary concerns.[571] These concerns will come front and center in case of systemic failures affecting the Eurozone interbank market as a whole, as the interbank market cannot be relied upon to link the economies of different countries. Past experience shows that in such situations the ECB was ready to provide large injections of liquidity to distressed banks to achieve "the singleness of the monetary policy."[572] In this context, the ECB announced that monetary policy decisions would be based on the situation in the euro area countries as a whole and that targeting the needs of individual countries was out of the question.[573]

On the other hand, in the case of smaller credit institutions established in the Eurozone periphery, the impact on the ECB's monetary transmission mechanism, while still present, is generally more contained and less likely to precipitate widespread systemic risk for various reasons. First, in terms of credit availability, the failure of a small credit institution may not significantly reduce the overall credit availability within the larger economy. Given

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[567] Admati and Hellwig (n 288), 77.

[568] Benoît Cœuré, 'Monetary Policy and Banking Supervision' (ecb.europa.eu, 7 February 2013) available at: < https://www.ecb.europa.eu/press/key/date/2013/html/sp130207.en.html> accessed 27 October 2024.

[569] SSM Regulation, Article 25(2).

[570] European Court of Auditors (n 495), paras 40-52.

[571] SSM Regulation, Article 26(8).

[572] Case C-62/14 *Gauweiler and Others v Deutscher Bundestag* [2015] ECLI:EU:C:2015:400.

[573] Pissany-Ferry (n 10), 50.

that the lending activities of such institutions typically constitute a fraction of those conducted by larger banks, the resultant disruption to the credit channel tends to be less pronounced. Second, in terms of market confidence, the resolution of a smaller bank may not substantially erode market confidence unless it is perceived as indicative of broader sectoral weaknesses. The localized nature of the distress typically does not resonate with the same intensity as would the failure of a systemic bank. Third, in the context of the interbank market, smaller banks often have less engagement in the interbank lending market. Therefore, their resolution is less likely to freeze interbank activities. The liquidity channel of monetary policy largely remains unaffected in this scenario. Fourth, in terms of asset prices, the asset disposition of a smaller institution would unlikely move the market materially. The wealth effect on consumption and investment is thus negligible in the broader economic context. Fifth, while bail-in actions can impact local depositors and creditors, the aggregate effect on spending and investment is minimal relative to the overall economy. The corresponding monetary transmission mechanism is correspondingly limited. Finally, the potential for contagion from a small bank is limited due to its relatively insular operations and smaller network of interbank relationships. The spill-over effects are typically geographically and sectorally restricted.

To conclude, the multi-layered decision-making process entails the risk that Eurozone periphery countries will not receive information about systemic risks that affect them in a timely manner. The NCAs in core jurisdictions have weak incentives to collect and provide the ECB with information that would lead to decisions that are against their interests. Even if such information is disclosed, core states have the ability to engage in boundary management by downplaying the importance of such information in the Steering Committee. Finally, in the face of uncertainty, the Supervisory Board and the Governing Council have stronger incentives to forbear on systemic credit institutions with significant cross-border operations whose failure will affect the Eurozone financial system as a whole.

5.3 The SRM

5.3.1 *Rule making powers*

Notwithstanding the transfer of resolution powers to the SRB, national law continues to play an important role in the resolution of failing credit institutions in the Eurozone. The SRB must have regard of national laws transposing the BRRD and any other relevant national

law provisions when issuing legal instruments.[574] National differences, however, remain in important areas of the EBU resolution framework, including conditions to determine that a bank is "failing or likely to fail" and protection of creditors.[575] In principle, when facing a liquidation or resolution of a bank operating in different countries, creditors may be treated differently and different ranking of claims are applied in the EU.

In addition, following the adoption of resolution schemes by the SRB, national authorities shall implement all SRB decisions addressed to them in accordance with the conditions laid down in national law.[576] There is evidence that the SRB is facing challenges in applying the existing framework in the same way across the EBU. The Chair of the SRB, Elke König, noted that in the case of Sberbank,[577] the SRB had to deal with different legal frameworks simultaneously.[578] She also highlighted that these challenges would be amplified for larger banking groups operating in more Eurozone countries.[579]

The retention of rule-making powers by Member States leads to heterogeneous creditor priority frameworks within the Eurozone, creating significant competitive disadvantages for banks in periphery states. Core Eurozone countries possess the legislative flexibility to redefine national resolution rules, which can affect the hierarchy of creditor repayments.[580] In times of financial distress, these core states might prioritize domestic creditors, creating uncertainty for creditors in periphery states about their position in the repayment waterfall. This disparity may result in higher perceived risks for creditors in periphery states, leading

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574 Decision of the Single Resolution Board of 17 December 2018 establishing the framework for the practical arrangements for the cooperation within the Single Resolution Mechanism between the Single Resolution Board and National Resolution Authorities (SRB/PS/2018/15) available at: <https://www.srb.europa.eu/system/files/media/document/decision_of_the_srb_on_cofra.pdf> accessed 27 October 2024, recitals (11) and (12).

575 Elke König, 'Resolution and Liquidation: closing the gaps' (srb.europa.eu, 7 April 2019) available at: <https://www.srb.europa.eu/en/content/eurofi-article-elke-konig-resolution-and-liquidation-closing-gaps-bucharest-april-2019> accessed 27 October 2024.

576 SRM Regulation, Article 29.

577 The entities which fell within the scope of the European Banking Union were Sberabank Austra, Sberbank Slovenia and Sberbank Croatia. The SRB applied resolution actions to Sberbank Slovenia and Sberbank Croatia whereas Sberbank Austria was liquidated pursuant to Austrian insolvency law. See discussion of this case below in section 5.3.2(v) of this chapter.

578 Elke König, 'Closing Remarks by SRB Chair, Elke König at the SRB and ECB Joint Conference "The Test of Time: Banking Union a decade on' (srb.europa.eu, 24 June 2022) available at: <https://www.srb.europa.eu/en/content/closing-remarks-srb-chair-elke-konig-srb-and-ecb-joint-conference-test-time-banking-union> accessed 27 October 2024. For a discussion of the resolution decisions in respect of the Sberbank entities, please refer to section 5.3.2(v) (*Instruments*) of this chapter below.

579 ibid.

580 Refer to the discussion on the resolution of the failing Venetian banks for further context and examples in chapter 6 (*Bank Resolution Cases In Practice under the EBU*) below.

to elevated funding costs for banks operating in these regions.[581] Consequently, banks in periphery states face more expensive and less stable funding sources compared to their counterparts in core states, undermining their competitive position. Investors, wary of the potential for asymmetric loss distribution, may be deterred from investing in banks heavily operating within periphery states, further exacerbating the competitive edge enjoyed by banks in core states, which are perceived as safer investments.

The systemic risks and resolution costs associated with multinational banks operating across various jurisdictions are distributed asymmetrically between Eurozone core and periphery states. While multinational banks may be systemically important in periphery states, they often represent only a small fraction of the overall banking group's operations. This discrepancy means that the failure of such a bank has a more severe impact on the economic stability of periphery states than on the broader banking group, which can manage the failure more effectively. In crisis situations, core Member States might resort to national resolutions that focus on protecting their domestic financial markets, often leaving periphery states to bear the brunt of the resolution costs. Because periphery economies typically have smaller GDPs and fewer financial buffers, these disproportionate costs inflict more damage on their economic stability. Furthermore, core states may enact national rules that prioritize their domestic interests and preferred creditors in times of financial distress, increasing the systemic risks for creditors and financial institutions in more fragile periphery states. This protective stance by core states further elevates the exposure and vulnerability of periphery states to systemic risks, creating an uneven and unstable financial landscape within the Eurozone.

5.3.2 *Control of decision-making processes*

(i) Representation

As noted in section 2.3.3 (*The SRM*) of Chapter 2, the SRB may adopt decisions in its executive or plenary sessions. The executive session is comprised of the national resolution authorities of the member states in which the failing credit institution is established and the

[581] The Dutch nationalisation framework offers greater flexibility regarding the classes of creditors subject to mandatory bail-in, in comparison to the BRRD., see Danny Busch, Mirik B. J. van Rijn and Marije Louisse, 'How Single is the Single Resolution Mechanism? (2019) EBI Working Papers Series 2019 no. 30 available at: < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3309189> accessed 27 October 2024.

executive board members. It can only adopt resolution schemes by consensus if the use of the SRF does not exceed €5 billion in capital or €10 billion in liquidity.[582] Given the low SRF threshold, most resolution decisions are expected to be made by the Plenary Board. The Plenary Board is comprised of the national resolution authorities of all member states and the executive board members.

The composition of the Plenary Board is, for most part, made of NCAs of participating member states. NCAs, however, have incentives to take into account domestic interests when making resolution decisions. The appointment of the executive members of the SRB follows a similar procedure to the appointment of the Chair and Vice-Chair of the ECB's Supervisory Board. As noted above in the context of the SSM, core member states have more structural and institutional power to ensure the representation of their domestic interests in the executive positions of the SRB.

(ii) Triggering the Resolution Process

As set out in section 2.3.3 (*The SRM*) of Chapter 2, the ECB triggers the resolution process by determining that a credit institution under its supervision is "failing or likely to fail".[583] A credit institution is deemed to be failing or likely to fail when:

(i) it is, or likely in the near future to be in breach of its prudential requirements for continuing authorisation;
(ii) it is balance sheet insolvent;
(iii) it is unable to pay its debts as they become due; or
(iv) it is in need of extraordinary public support, except when, in order to remedy a serious disturbance in the economy of a Member State and preserve financial stability, the extraordinary public support takes any of the following forms:
    a. the provision of a State guarantee to issue new liabilities;
    b. the provision of a State guarantee to access central bank refinancing or;

[582] SRM Regulation, Articles 50(1)(c) and 50(1)(d).
[583] SRM Regulation, Article 18(1).

c. an injection of own funds or purchase of capital instruments at prices and on terms that do not confer an advantage upon the institution."[584]

The provision also states that such precautionary recapitalisation is reserved for solvent institutions and is conditional on final approval under the Union State aid framework.[585] The state aid granted also has to be of a precautionary and temporary nature and proportionate to remedy the consequences of the serious disturbance in the economy and "shall not be used to offset losses that the institution has incurred or is likely to incur in the future."[586]

The SRB can initiate the resolution process on its own initiative, but it must first inform the ECB of its intention to undertake the assessment of whether an institution is failing or likely to fail and only if the ECB does not itself conduct the assessment within three days, may the SRB advance on its own.[587] Once the determination that an institution is failing or likely to fail is made, the SRB must then evaluate (i) whether there is reasonable prospect of a private sector solution within a reasonable timeframe and (ii) whether a resolution is in the public interest.[588]

It is clear that the wording of the provision relating to the assessment of whether an "institution is failing or likely to fail" gives EBU officials room for manoeuvre. In the absence of clear definitions of "serious disturbance" and "financial stability", the EBU officials involved in the resolution process must exercise discretion in ascertaining the meaning of the above terms and determining whether state aid should be granted and what form it should take.[589] Such interpretation can, however, be used as a political tool by Member States to exert pressures on EU officials to forbear on failing credit institutions. It is, therefore, important to examine whether the EBU institutions provide a system of check and balances to prevent such political opportunism.

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[584] BRRD, Article 32(4)

[585] ibid.

[586] ibid.

[587] SRM Regulation, Article 18(1).

[588] ibid.

[589] See section 3.4.1(ii)(a) of Chapter 3 above.

Due to the high interconnectedness of the Eurozone financial system, there is a significant threat that private sector contributions in the context of banks established in the Eurozone core will bring systemic risk.[590] Since the holders of bail-in-able liabilities of credit institutions established in the Eurozone core are other financial institutions, the tool might transfer the losses from one institution to others and increase the risk of contagion.[591] This approach may undermine the effectiveness of the bail-in tool, as authorities might opt against its use, particularly in scenarios involving large systemic institutions where legal uncertainties are significant.[592]

More importantly, precautionary recapitalisation is currently granted at member state level, which means that the banks depend on the political and fiscal position of their government for a recapitalisation. This might create inequalities between banks and distort competition as credit institutions in a similar situation may receive capital support in one member state and not in the other. In addition, the domestic authorities which are responsible for providing precautionary recapitalisation to credit institutions will not take into account the impact that a bank's restructuring plan may have on other jurisdictions. The involvement of the European Commission in its role to approve such plans and state aid is not panacea, as it often endorsed measures by core member states in connection with prohibitions to use public funds in foreign markets during the sovereign debt crisis:[593]

> "Financial institutions participating in the recapitalisation will be required […] to take account of the borrowing requirements of domestic industry and in particular to small and medium-sized enterprises."[594]

In sum, past experience shows that member states do not face fierce opposition by the European Commission when they decide to make use of precautionary recapitalisation measures. The European Commission has acknowledged that financial stability takes

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590 Charles Goodhart and Emilios Avgouleas, 'Critical Reflections on Bank Bail-ins' (2015) 1(1) Journal of Financial Regulation 3.

591 ibid.

592 ibid.

593 Epstein (n 207), 52.

594 European Commission, 'The Recapitalisation of Financial Institutions in the Current Financial Crisis: Limitation of Aid to the Minimum Necessary and Safeguards Against Undue Distortions of Competition' (2008), 6.

precedence over competition and consumer welfare objectives and endorsed domestic bank restructuring plans prohibiting the use of state funds in foreign jurisdictions.[595]

(iii) Incentives of EU officials to trigger the resolution process in respect of systemic banks in the Eurozone core

The option of precautionary recapitalisation generates the wrong incentives primarily to member states and banks, which will seek to make use of this clause before entering into resolution. It is not a coincidence that before the BRRD was enacted may countries rushed to rescue their banks.[596] The transfer of supervisory responsibilities to the ECB and SRB aimed at creating a level playing field in the Eurozone banking market and ensuring that regulatory authorities will take timely measures against failing banks without recourse to public funds. Nevertheless, under the current EBU framework the ECB and SRB officials continue to face significant political and institutional constraints to put systemic banks established in core jurisdictions into resolution.

First, as noted in section 5.2.5 (*Decision-making processes*), the complexity of the EBU supervisory architecture is sufficiently great that the ECB officials are not likely to receive information until late in a credit institution's decline that the time of supervisory intervention has come. The NCAs do not have strong incentives to inform the ECB about risks emanating from their domestic systems, as the ECB will take into account cross-border externalities from a bank's failure. In other words, the ECB will internalise all the losses triggered by the bank's default which makes it a tougher supervisor. Although central supervision is preferable *ex post*, a more lenient local supervisor gives bank managers, who are likely to have the best information about the company's condition, weaker incentives to hide problems *ex ante*.[597] Such conflicts of incentives between local NCAs and the ECB is expected to be greater for systemic banks with significant cross-border activities.[598]

Even if the ECB receives information in a timely manner, in the face of uncertainty around the complications associated with the resolution of systemic credit institutions, there are

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[595] 2013 Banking Communication, paras 7-8.

[596] Donnelly and Asimakopoulos (n. 349), 865.

[597] Jean-Eduard Colliard, 'Optimal Supervisory Architecture and Financial Integration in a Banking Union' (2020) 24(1) Review of Finance 129.

[598] Giovanni Dell'Aricia, 'Governance and Policy Challenges of Forming and Running a Supervisory and Regulatory Banking Union: A Theoretical perspective' (2015) European Economy 73.

serious doubts that it will actually trigger the resolution process if a systemic institution is deemed to be "failing or likely to fail".[599] Bureaucrats are often averse to the risks of taking the blame or be held legally liable for taking the wrong actions.[600] The policy officials in the ECB will have strong incentives to cover past supervisory failures and support the ECB's reputation. These incentives are stronger in case of systemic banks whose failure could have an impact on the financial stability of the Eurozone as a whole. The ECB can, thus, withhold information to avoid having to deal with failures of systemic banks and shape the agenda with respect to the initiation of resolution processes at the EU level.

As far as the SRB officials are concerned, the SRB executive members will have weak incentives to trigger the resolution process in respect of systemic banks. The SRB is a newly established EU agency with no prior record of dealing with systemic crises. A report published by the European Court of Auditors concluded that the SRB was heavily understaffed which significantly affected the resolution planning process.[601] In addition, the same report indicated that finding resolution experts proved to be a challenging task and most staff recruited to resolution planning needed to acquire knowledge on the job.[602]

More importantly, putting systemic banks into resolution and imposing losses on shareholders, creditors and depositors is politically unpopular.[603] The SRB will face significant political constraints in its efforts to resolve systemic failing institutions which are likely to affect multiple jurisdictions. Politicians are more likely to focus on immediate, short-term and direct electoral payoffs and will prefer to allow failing banks to continue to

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599 Admati and Hellwig (n 288), 77. See also Daniel Indiviglio, 'Will the FDIC's New Power End "Too Big Still Can't Fail" (theatlantic.com, 10 January 2011) available at: < https://www.theatlantic.com/business/archive/2011/01/will-the-fdics-new-power-end-too-big-to-fail/69975/> accessed 27 October 2024.

600 ibid.

601 European Court of Auditors, 'Single Resolution Board: Work on a Challenging Banking Union Task Started, But Still a Long Way to Go' (eca.europa.eu, 2017) available at: <https://www.eca.europa.eu/Lists/ECADocuments/SR17_23/SR_SRB-BU_EN.pdf> accessed 26 October 2024, para 28 and paragraphs 107-129. Although staffing has increase since the date of this report, issues with the composition of IRTs still remain, see European Court of Auditors, 'Special Report – Resolution Planning in the Single Resolution Mechanism' (eca.europa.eu, 2021) available at: <Special report 01/2021: Resolution planning in the Single Resolution Mechanism > accessed 26 October 2024, para 107.

602 ibid.

603 Christopher Gandrud and Mark Hallerberg, 'Who decides? Resolving Banks in a European Framework' (bruegel.org, 29 November 2013) available at: <https://www.bruegel.org/policy-brief/who-decides-resolving-failed-banks-european-framework> accessed 27 October 2024.

operate to resolutions.[604] The policy officials of the SRB will have strong incentives to avoid the ordeal of balancing national interests in the plenary session.[605]

The literature on the incentives of public officials supports this observation.[606] According to this literature, bureaucrats are driven by a desire to increase their personal power and to augment their prestige.[607] They will look to discharge their duties in a way that allows them to acquire a favourable reputation among their peers, the general public and the media. Moreover, opportunities to advance their future careers in administration, politics or the private sector motivate their behaviour, which makes them prone to promoting the interests of regulated entities who are more likely to offer the most desirable job offers in the long term.

Against this background, an uncompromising stance of the SRB officials to push through contested resolution schemes against the resistance of national politicians and NCAs of core jurisdictions does not promote their personal utility. Indeed, such a stance would harm their future job opportunities and damage their reputation among the media and the general public as opposing politicians may campaign to call their competences into question and portray them as scapegoats.[608] Such political backing would encourage plaintiffs to initiate litigation proceedings against the decisions of the SRB and trigger efforts to reduce the SRB's remit. The SRB officials who would anticipate such actions in respect of unfavourable resolutions of systemic banks will adapt their behaviour and look ways to avoid meritless confrontation.

Finally, the SRB has weak incentives to trigger the resolution process in respect of systemic institutions established in the core because it does not have the required *instruments* and

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[604] Gadinis (n 453), 331.

[605] The SRB will have strong incentives to manage failing banks by organising rescue mergers that may seem like private transactions but are significantly influenced by supervisory authorities through moral suasion. It may leverage public measures as "carrots" (offering a more favourable supervisory stance in the future) or "sticks" (threatening supervisory actions that could negatively impact a bank's profitability and growth). Typical examples of threats include capital adequacy reassessments, regulatory investigations, and restrictions on the scope of authorized activities. Conversely, examples of informal subsidies include merger assistance, facilitated market access, and leniency in compliance.

[606] Gordon Tullock, *The Politics of Bureaucracy* (Public Affairs Press 1965); Luca Enriques and Gerard Hertig, 'Improving the Governance of Financial Supervisors' (2011) 12(3) European Business Organization Law Review 357.

[607] ibid.

[608] Although not directly pertaining to the Single Resolution Board but of relevance, Martin Wheatley, the former chief executive of the UK's Financial Conduct Authority (FCA), was not offered a contract renewal following criticism over his approach to banking regulation, which some in the industry and government saw as too aggressive. This resulted in a narrative that Wheatley was difficult to work with, potentially affecting his future opportunities, see Lindsay Fortado, George Parker, Martin Arnold and Caroline Binham, 'Martin Wheatley Resigns as Chief of Financial Conduct Authority' (FT.com, 17 July 2015) available at: < https://www.ft.com/content/61f867fa-2c76-11e5-8613-e7aedbb7bdb7> accessed 27 October 2024.

financial resources at its disposal to deal with systemic crises. As explained in section 5.3.2(v)(*Resolution Tools*) below, the resolution tools available to the SRB are not fit for dealing with systemic crises. In terms of resolution funds, the SRF amounts to approximately EUR 78 billion as of 31 December 2023, which will be insufficient to deal with the failure of the biggest banks in the Eurozone, particularly as long as the SRF is also responsible for providing liquidity to the resolved entity. Under these circumstances, the SRB will be dependent on support from the core Eurozone governments to close funding gaps.

Under these circumstances, although the ECB does not have unconditional authority to make extraordinary loans, there are several ways it could step in, particularly in a systemic crisis. The ECB may be able to circumvent the prohibition on monetary financing by establishing broad based programs that just so happen to benefit a systemically important institution that is stumbling. The programme could include restrictions that exclude nearly every firm other than the troubled institution, for instance, or the ECB could bail-out the industry more broadly. As the Eurozone sovereign debt crisis revealed, regulatory creativity is at its height when regulators are cobbling together a bail-out. More importantly, the European Court of Justice ruled that the prohibition of monetary financing does not prevent the ECB from establishing such programmes, provided that sufficient safeguards are put in place in such interventions.[609]

In summary, the policy officials involved in decision-making in the EBU have weak incentives to trigger the resolution process in respect of systemic banks established in core jurisdictions. In the face of uncertainty around complications associated with the resolution of systemic credit institutions, the ECB officials will think twice before they determine that a systemic bank is failing or likely to fail. Although the SRB can make the "failing or likely to fail" assessment at its own initiative, it relies on the ECB to have access to the relevant information. Even if the SRB gains access to such information, the policy officials will have weak incentives to act on it, as the SRB lacks the resources and the required instruments to deal with systemic failures. As a result, the resolution process will eventually be initiated in respect of few small banks established in the Eurozone periphery.

[609] C-62/14 *Gauweiler* (n 572).

As recent experience with bank resolutions under the EBU framework shows, NCAs will exert pressures on EU policy officials to allow for precautionary recapitalisation measures without involving contributions from the wider scope of creditors. Nevertheless, decisions with respect to precautionary recapitalisation are currently made at member state level, which means that the banks depend on the fiscal and political position of their government for a recapitalisation. More importantly, national authorities will not take into account cross-border externalities when making such decisions which leaves periphery jurisdictions exposed to risks emanating from the core.

(iv) Objectives

Following the ECB's determination that a credit institution is failing or likely to fail, the SRB must decide whether resolution is in the public interest. A resolution is deemed to be in the public interest if it is necessary for the achievement of the resolution objectives which include (i) ensuring the continuity of the failing credit institution's critical functions, (ii) avoiding significant adverse effects on financial stability, (iii) protecting public funds by minimizing reliance on extraordinary public financial support and (iv) protecting deposits or client assets. [610] A failing bank which does not meet these conditions must be liquidated under domestic law.

The SRM does not stipulate a clear hierarchy of these objectives, which offers policy makers the chance to *frame the mandate* as they see fit. This discretion of policy officials is important given there will be situations where the above objectives will come into conflict. For example, avoiding adverse effects on financial stability may require the injection of public funds to support a failing credit institution. As a result, policy makers will have to decide which objectives to prioritize when faced with failing credit institutions.

The ECB's formal position is that financial stability considerations should take precedence over other resolution objectives.[611] The ECB was a strong supporter of this view during the Eurozone sovereign debt crisis, when it opposed to any form of mandatory private sector

[610] BRRD, Article 32.

[611] Despite financial stability not being prominently featured in the EU Treaty mandate of the European Central Bank (ECB), concerns over financial stability have significantly risen to prominence since the Eurozone sovereign debt crisis, see Agnieszka Smoleńska and Tomas Beukers, 'The ECB and Financial Stability' in Thomas Beukers, Diane Fromage and Giorgio Monti (eds), *The New European Central Bank: Taking Stock and Looking Ahead* (Oxford, OUP 2022).

involvement to avoid the risk of contagion.[612] For example, during the Greek sovereign debt crisis, the ECB threatened suspension of the eligibility of Greek bonds as collateral in the banks' refinancing operations in case the Greek government imposed forced restructuring. In the case of Ireland, the ECB threatened to cut ELA to Irish financial institutions if the Irish government decided not to honour its guarantee to bail-out Irish banks' depositors and bondholders.[613]

Financial stability considerations will be front and centre in the event of failures of systemic banks with significant cross-border operations. In such scenarios, putting a systemic bank into resolution may create adverse effects on financial stability. In systemic crises it might be difficult to impose losses on banks without needlessly destroying bank value, while announcing bail-ins may lead to investor flight putting European financial stability in jeopardy.[614] More importantly, the SRB policy officials lack experience in resolutions of systemic banks and do not have access to EU funds large enough to support such resolutions.[615] For the above reasons, the Chair of the SRB, Elke König, is of the opinion that because of the public interest assessment, resolution actions will eventually apply only to a few small banks, as most banks will be wound up under national law.[616]

However, the triggers to initiate liquidation of banks under national laws in most countries are not aligned and particularly the conditions that justify a determination that a bank is failing or likely to fail differ.[617] In addition, burden sharing arrangements differ under national laws, as in many jurisdictions senior bondholders are not required to contribute to recapitalisations of failing banks before public funds are used to support the liquidation process.[618]

In other words, *the choice of venue* for resolving failing credit institutions within the EBU is far from a straightforward technical decision. On the contrary, it is deeply entwined with

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612 Pissany-Ferry (n 10), 90-96.

613 Stigliz (n 20), 156; Stephen Castle (n 60).

614 Gandrud and Hallerberg (n 603).

615 For control over financial resources, see section 5.3.3 (*Control of scarce resources*) below.

616 European Court of Auditors (n 601), para 39; Elke König, 'Why we need an EU liquidation regime for banks' (srb.europa.eu, 5 September 2018) available at: <https://www.srb.europa.eu/en/content/eurofi-article-elke-konig-why-we-need-eu-liquidation-regime-banks-vienna-september-2018> accessed 27 October 2024.

617 ibid.

618 Busch et al. (n. 581).

complex and politically sensitive questions about the distribution of *formal authority* between European institutions and individual member states. This dynamic inherently provides member states with the opportunity to engage in forum shopping, strategically framing issues to allow for resolutions under national laws that best suit their interests. For periphery states, the stakes in this scenario are particularly high. When core states push for resolutions under national laws, periphery states might find themselves at a disadvantage, lacking the influence to assert their needs or protect their interests effectively. This can lead to scenarios where resolutions tailored to the needs of more dominant states impose negative externalities on periphery economies, such as increased financial instability or unfavorable economic conditions.

In sum, applying resolution measures to a failing credit institution is the exception to the rule of national liquidation. The SRB can trigger the resolution process only if it determines that the resolution objectives cannot be accommodated to the same extent by national liquidations. The SRM does not establish a clear hierarchy of objectives, which means that EU policy officials can frame the mandate as they see fit. The ECB's formal position is that financial stability concerns should take precedence over other objectives. The application of resolution tools vis-à-vis credit systemic credit institutions seems unlikely, as they may jeopardize Eurozone financial stability. Therefore, such institutions are expected to be restructured at national level pursuant to domestic laws. As most systemic cross-border credit institutions are established in the Eurozone core, Eurozone periphery countries shall be affected by the policies and regulations of NCAs established in the core, but not vice versa.

(v) Instruments

The SRB does not have the required instruments at its disposal to deal with systemic crises affecting the Eurozone as a whole. Some of the elements of the new toolbox – in particular, the sale of business and bridge institution tools – have been modelled after instruments in U.S. American banking regulation that have, in fact, frequently been applied to large numbers of smaller and medium sized institutions and not to large cross-border banks both

before and after the financial crisis.[619] The use of these tools in the context of systemic crisis involving cross-border banks established in the Eurozone core is going to be rather limited.

The success of the sale of business tool critically depends on the availability of a private sector purchaser who is not only prepare to acquire the relevant business, but also financially and logistically capable to be entrusted with the operation. The large size of a failing systemic bank means that there will be few private financial institutions large enough to purchase the failing bank's assets. In addition, in case of systemic crises, potential private sector purchasers will likely face liquidity problems and not be willing to participate in any rescue operations without public sector guarantees.[620] It comes as no surprise, in this context, that transfer to private sector competitors under the functional equivalent of sale of business transactions in pre-crisis US regulations appear to have been confined to insolvencies of small or medium-sized institutions within rather simple group structures and not overly complex business activities.[621]

Similarly, the use of the bridge institution tool as a functional alternative to the sale of business tool in the context of systemic financial institutions should not be over-estimated. To begin with, the decision of using the bridge institution as a resolution tool is taken at European level, but the administration and dissolution is carried out by national resolution authorities ("**NRAs**") subject to monitoring by the SRB.[622] This may be particularly problematic in cases where a series of bank failures necessitates the simultaneous activation of a number of bridge institutions in the relevant member states. This will result in severe organisational and financial burdens for that member state and the NRAs, especially if a write down of capital instruments is not feasible to capitalise the failing institution. In such circumstances, the implications for national budgets may be difficult to foresee which makes the decision of the SRB to use the tool unlikely, given that the SRB needs to respect the budgetary sovereignty and fiscal responsibility of participating member states.[623] In

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[619] Jean-Hinrich Binder, 'Proportionality at the Resolution Stage: Calibration of Resolution Measures and the Public Interest Test' (ssrn.com, 2017) available at: < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2990379> accessed 27 October 2024.

[620] Public sector guarantees or transfers to public sector entities will in turn, have a negative impact on sovereign balance sheets, as EU resolution funding remains to a large extent fragmented along national lines.

[621] Jean-Hinrich Binder, 'The Relevance of Resolution Tools within the SRM' (2018) European Banking Institute Working Paper no 29 available at: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3274520> accessed 27 October 2024.

[622] SRM Regulation, Articles 28(1)(b)(i) and 29.

[623] SRM Regulation, Article 6(6).

addition, there is a statutory limitation that the NRAs shall sell the bridge institution to one or more private purchasers or terminate its operation as soon as possible and, in any event, within two years after the date on which the last transfer from the resolved institution to the bridge institution was made.[624] Although the NRAs can extend the time period for one or more one-year periods, it is unlikely that the resolution process of a systemic bank can be completed in such short timeframes.

Just like the bridge institution tool, the asset management tool would require member states (rather than the SRB) to establish asset management companies. It is difficult to foresee how the SRB could effectively devise a comprehensive activation of the tool without implications for national budgets, which in turn would conflict the SRM. Moreover, the requirements for the design of the asset management tool are basic leaving ample discretion to member states to adopt national rules with a view to protecting domestic interests.

Finally, the application of the bail-in tool will be difficult to implement vis-à-vis systemic banks with significance cross-border operations.[625] In many cases, the use of the tool may even create a crisis of confidence in the member state's banking system in which the failing bank is established. There are two lines of defence against investor panic, namely the prescription of a sufficiently large layer of bail-in-able debt that assures other creditors that their claims will not be written down and (ii) the existence of a government backstop for situations in which bail-in-able debt proves insufficient.[626]

With the implementation of the statutory minimum requirements for own funds and eligible liabilities still in process and legislative changes to adapt the requirements to the international standards on the total loss absorbing capacity imminent, buffers of bail-in-able debt still are being developed and it is an open question whether the incoming changes will be adequate and sufficient.[627] Even assuming that sufficient levels of bail-in-able debt my ultimately be in place, the conditions for successful bail-ins are ambitious and include, in particular, the need for reliable *ex ante* valuations as to the required amount of bail-in.

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[624] SRM Regulation, Article 25(2)(b); BRRD, Articles 41(5) and (6).

[625] Goodhart and Avgouleas (n 590).

[626] Tobias Troeger, 'Too Complex to Work: A Critical Assessment of the Bail-In Tool Under the European Bank Recovery and Resolution Regime' (ssrn.com, 2017) SAFE Working Paper No. 179 available at: < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3023184> accessed 27 October 2024, 10.

[627] Binder (n 621), 15.

In addition, in the context of systemic failures it is expected that a large proportion of bail-in-able debt will fall within the scope of discretionary exclusions from bail-in. The SRB may decide to exclude, ad hoc, additional classes of liabilities when (i) it is impossible for the relevant NRA to achieve their write-down or conversion within a reasonable timeframe, (ii) it is strictly necessary to the objective of ensuring the continuity of an institution's critical functions and core business lines, (iii) it is strictly necessary and proportionate to avoid giving rise to widespread contagion and (iv) it is necessary to the objective of avoiding destruction of value.[628] The Commission has specified when exclusion is necessary to achieve the above four purposes in Commission Delegated Regulation (EU) 2016/860.[629]

It is clear from the requirements set out in the Commission Delegated Regulation (EU) 2016/860 that the above exceptions are limited to banks with significant cross-border operations.[630] For example, factors that should be taken into account in determining what is reasonable timeframe include the need to publish the bail-in decision and determine the bail-in amount its allocation to various classes of creditors and the implications of delaying such a decision in terms of market confidence and the potential market reactions.[631] In many situations, this will suggest a particularly tight time-frame which would be difficult to comply with in respect of systemic banks.

The prevention of contagion requires the SRB to determine whether the losses suffered by counterparties of the institution under resolution due to the write-down of their claims are of such scale as to undermine those counterparties' own solvency and ability to continue their operations. In addition, the SRB must take into account second-order effects of information nature, as where bail-in is perceived by market participants at large as a signal of general financial distress, thus causing a wider loss of market confidence, or to relate to the bail-in's impact on the prevailing market conditions through second-order portfolio and pricing adjustments made by the affected parties and others.[632] As it was illustrated in section 4.5 (*Structural Power*) of Chapter 4, the EBU has a core-periphery structure with

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628 SRM Regulation, Article 27(5).

629 Commission Delegated Regulation (EU) 2016/860 of 4 February 2016 specifying further the circumstances where exclusion from the application of write-down or conversion powers is necessary under Article 44(3) of Directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms [2016] OJ L144/11.

630 ibid.

631 ibid. Article 6(2)

632 ibid, Recitals 24-25 and Article 3.

core countries representing a group of highly connected nodes. As there are more links between institutions established in these jurisdictions, financial shocks emanating from the core will propagate across the entire system making less likely the application of the bail-in too.[633]

In terms of resolution funding, the SRB has access to the SRF which has limited firepower to deal with systemic banks amounting to €78bn. The limited firepower becomes even more problematic once we take into account the need to provide struggling financial institutions with liquidity support during the resolution process. The Europe's largest banks have liabilities measured in the trillions of euros, a significant proportion of which is in the form of short-term debt. As demonstrated by the Eurozone sovereign debt crisis, these forms of short-term funding are vulnerable to destabilising runs where creditors have doubts about a financial institution solvency, thereby eliminating an important source of financing. The SRM does not include any real mechanism for providing ELA. Responsibility lies with national central banks and resolution authorities of member states.

One might seek to challenge this dire assessment by pointing out that the adoption of resolution plans will identify uncertainties and increase preparedness for resolution of systemic institutions. There is evidence, however, that there are delays in the adoption of resolution plans and some banks did not comply with legal requirements to update them.[634] In addition, there is no overarching policy on information that banks are required to provide to the SRB for the execution of resolution tools or support of asset valuations in the event of resolutions.[635] The levels of bail-in-able debt were determined solely at consolidated level without due regard to the need of individual entities. In general, resource constraints was an impediment to quality check.[636] The European Parliament indicated that none of the resolution plans had contained a fully developed assessment of impediments to resolvability

[633] Christos Hadjiemmanouil, 'Bail-in in the European Banking Union: A Close Reading of Article 27 of the Single Resolution Mechanism Regulation' (2022) European Banking Institute Working Paper Series no. 116 available at: < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4047044#:~:text=Bail%2Din%20enables%20a%20country%27s,common%20equity%20of%20their%20claims> accessed 27 October 2024.

[634] European Court of Auditors (n. 601), paras 76-77.

[635] ibid.

[636] ibid, para 75.

which raises concerns about the banks' readiness for potential resolution in the years to come.[637]

The resolution of Banco Popular highlights the constraints often faced by resolution plans.[638] The strategy set out in the resolution plan was predicated on the belief that the bank's collapse would stem from a decline in its capital base.[639] However, as detailed in Chapter 6 (*The Bank Resolution Cases in Practice Under the European Banking Union*), the actual catalyst for the bank's failure was its imminent inability to meet its debt obligations and other liabilities. This was primarily due to a rapid deterioration in the bank's liquidity position, rather than its capital. The SRB determined that using the bail-in tool, initially the preferred method in the resolution plan, would not sufficiently restore the bank's financial stability or long-term viability.[640] This was particularly true given Banco Popular's significant amount of encumbered assets. Considering these unique circumstances, the SRB opted for the sale of business tool as a more effective way to achieve the resolution objectives, diverging from the original resolution strategy outlined in the plan.[641]

In addition, the resolution of the Sberbank Europe Group ("**Sberbank Group**") serves as another good illustration of the limitations inherent to the resolution planning framework. The group's parent entity, Sberbank Europe AG ("**Sberbank Europe**"), situated in Austria, was wholly owned by Sberbank of Russia ("**Sberbank Russia**"). Boasting a network of 185 branches and 3,933 employees as of the end of 2020, the Sberbank Group represented a significant presence in the banking industry.[642] As a subject of supervision by the European Central Bank at a consolidated level, the bank was also subject to resolution planning requirements following the introduction of SRM. These requirements were overseen by both

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637 ibid, para 27; W.P. De Groen 'Impediments to Resolvability of Banks' (europarl.europa.eu, December 2019) available at: < https://www.europarl.europa.eu/RegData/etudes/IDAN/2019/634358/IPOL_IDA(2019)634358_EN.pdf> accessed 27 October 2024, 18.

638 For a discussion of the resolution of Banco Popular, see chapter 6 (*Bank Resolution Cases in Practice Under the EBU*) below.

639 Single Resolution Board, "Decision of the Single Resolution Board in its Executive Session of 7 June 2017 concerning the adoption of a resolution scheme in respect of Banco Popular Espanol S.A" (2017) available at: <https://www.srb.europa.eu/system/files/media/document/srb_decision_srb_ees_2017_08_non-confidential_scanned.pdf> accessed at 1 June 2024, para 44.

640 ibid, para 45.

641 ibid, para 46.

642 Single Resolution Board, 'Factsheet – Sberbank Europe AG' (srb.europa.eu, 2024) available at: < https://www.srb.europa.eu/system/files/media/document/20220302%20Factsheet%20QA.pdf> accessed 27 October 2024.

the SRB and the national resolution authorities. In virtue of its classification as a significant institution, the SRB was mandated to formulate resolution plans for the banking group.

In the wake of Russia's initiation of military operations in Ukraine on 24 February 2022, the liquidity position of Sberbank Europe and its subsidiaries underwent a substantial deterioration within a brief span.[643] The subsidiaries of Sberbank Europe witnessed a marked outflow of deposits, compelling Sberbank Europe to activate its group recovery plan.[644] This involved the initiation of measures such as emergency funding requests from its shareholder, Sberbank Russia, intra-group asset transfers of performing loans and efforts to attract additional retail deposits. However, Sberbank Russia's ability to provide financial support to Sberbank Europe was curtailed by a prohibition imposed by the Central Bank of the Russian Federation. In response to this, Sberbank Europe sought ELA from the Austrian National Bank and the European Central Bank. Despite these efforts, the Austrian National Bank informed Sberbank Europe that no ELA would be granted.

The subsequent course of action was marked by an announcement from the ECB that the Sberbank entities within the banking union were "failing or likely to fail".[645] The ECB had taken into consideration several factors that had adversely impacted Sberbank Europe. Among these were the negative reputational consequences stemming from geopolitical tensions that accelerated deposit withdrawals, the anticipation of financial support from Sberbank Europe and its subsidiaries, as well as the loss of access to USD correspondent banking and payments.[646] Furthermore, the option of external interbank funding had been eliminated, as financial institutions had severed their ties with Sberbank. Following the ECB's press release, the SRB also declared its "failing or likely to fail" assessment concerning the same entities. This included the application of resolution actions to the Sberbank entities within the banking union, namely, Sberbank Europe, Sberbank d.d.

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643 Single Resolution Board, 'Decision of 27 February 2022 concerning the exercise of powers under the national law transposing Article 33a of Directive 2014/59/EU in respect of Sberbank Europe AG' [2022] SRB/EES/2022/16 available at: <https://www.srb.europa.eu/system/files/media/document/2024-04-04_SRB-Non-confidential-version-Decision-EES_2022_16.pdf> accessed 27 October 2024, para 5.

644 ibid.

645 European Central Bank, 'Failing or Likely to Fail' Assessment of Sberbank d.d. Croatia (bankingsupervision.europa.eu, 27 February 2022) available at: <'Failing or Likely to Fail' Assessment of Sberbank banka d.d. (Croatia)> accessed 27 October 2024; European Central Bank, 'Failing or Likely to Fail' Assessment of Sberbank Europe AG (bankingsupervision.europa.eu, 27 February 2022) available at <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.FOLTF_assessment_of_Sberbank_Europe_AG~144fd77e46.en.pdf> accessed 27 October 2024.

646 ibid.

(referred to as "**Sberbank Croatia**") and Sberbank banka d.d. (referred to as "**Sberbank Slovenia**"). The SRB asserted that resolution actions were necessary in the public interest for Sberbank Croatia and Sberbank Slovenia, in order to circumvent significant adverse effects in both countries. As for the Austrian parent, Sberbank Europe, it was decided that no resolution action was required. Instead, insolvency procedures would be implemented in accordance with the stipulations of the national laws.[647]

It is indeed noteworthy that the resolution strategy implemented *ex post* by the SRB set out above deviated in a substantial manner from the *ex ante* preferred resolution strategy, which was enshrined in the resolution plan pertaining to the Sberbank Group.[648] The departure is particularly evident in two specific areas. The first area of divergence pertains to the group structure. In the original plan, it was envisaged that the resolution group would encompass the entirety of Sberbank's EBU subsidiaries. However, in the actual implementation, only Sberbank Slovenia and Sberbank Croatia were subjected to resolution, while the Austrian parent entity, Sberbank Europe, was relegated to national wind-down procedures. The second area of discrepancy lies in the implementation of resolution tools.[649] The tool of business sale was activated for Sberbank Slovenia and Sberbank Croatia. In stark contrast, due to the SRB's decision to abstain from resolution on Sberbank Europe, no bail-in was enacted at the level of Sberbank Europe. This occurred notwithstanding the fact that the losses incurred as a result of the resolution actions had a profound impact on the entities' capital base, thereby necessitating measures to bolster capital.

On 13th July 2022, the European Parliament press briefing addressed the ECON meeting, drawing a comparison between the resolution actions that were actually taken and those that were outlined in the resolution plans.[650] The briefing highlighted that the assumptions underpinning the resolution planning scenario bore little resemblance to the actions that were subsequently taken.[651] The briefing further underscored that the possibility of applying

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[647] Single Resolution Board, 'Sberbank Europe AG: Croatian and Slovenian Subsidiaries Resume Operations after Being Sold While No Resolution Action Is Required for Austrian Parent Company" (srb.europa.eu, 1 March 2022) available at: <<https://www.srb.europa.eu/en/content/sberbank-europe-ag-croatian-and-slovenian-subsidiaries-resume-operations-after-being-sold> accessed 27 October 2024

[648] Elke König, 'Public Hearing With Elke König' (europarl.europa.eu, 13 July 2022) available at: < https://www.europarl.europa.eu/RegData/etudes/BRIE/2022/699515/IPOL_BRI(2022)699515_EN.pdf> accessed 27 October 2024.

[649] ibid, 3-4.

[650] ibid.

[651] ibid.

national insolvency proceedings to the institution was regarded as lacking credibility, yet paradoxically, this is precisely what transpired. Moreover, it was predicted that the subsidiaries would be incapable of surviving an abrupt separation from their Austrian parent, given the high degree of dependency.[652] Despite these forecasts and the rapidly unfolding events, five subsidiaries managed to secure buyers and successfully continued their operations.[653] The resolution plan also made provisions for the application of the bail-in tool at the group level, a provision which, in actuality, did not come to fruition.[654]

The efficacy of the resolution planning framework, inclusive of the guidance provided by the SRB, is brought into question in light of the above events.[655] The document "SRB Expectations for Banks", published in March 2020 stands as the primary directive outlining the authorities' expectations for implementing effective resolution plans by addressing measures in specified areas, commonly referred to as the seven dimensions of resolvability.[656]

Two dimensions of this guidance are particularly pertinent to the resolution of Sberbank Europe. The first relates to liquidity and funding in resolution. As per section 2.3.1 of the guidance, resolution plans should establish processes and capabilities to estimate liquidity needs for the implementation of the resolution strategy, measure and report the liquidity position in resolution and identify and mobilise available collateral for funding post-resolution. [657] The case of Sberbank indicates a probable failure to meaningfully implement these requirements within the resolution planning framework. If Sberbank had been able to estimate these liquidity needs *ex ante*, it would have anticipated the need for a shift in the preferred resolution strategy. However, the resolution framework does not provide a dedicated resolution tool for managing liquidity crises, the ability to impose longer-term

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652 ibid.

653 ibid.

654 ibid.

655 Leonhard Riebl, 'Resolution Planning Framework Constraints: An Analysis Based on the Sberbank Europe AG Resolution Case" (2023) 15(2) Journal of Securities Operations and Custody 154.

656 Single Resolution Board, "Expectations for Banks' (srb.europa.eu, March 2020) available at: < https://www.srb.europa.eu/system/files/media/document/efb_main_doc_final_web_0_0.pdf > accessed 27 October 2024.

657 ibid, see principles 3.1, 3.2. and 3.3 on pages 23-25 of the SRB guidance.

moratoria, nor any specific measures for institutions to prepare for such a liquidity event, thereby significantly limiting resolution planning options.[658]

The second dimension requires credit institutions to establish adequate operational arrangements to ensure continuity of services vital for implementing the resolution strategy and to maximise the likelihood of maintaining access to financial market infrastructures.[659] This includes a broad range of activities such as ensuring contract resolvability, mapping critical and essential intra-group interconnections and establishing retention plans for services, IT systems and financial market infrastructure access. As per paragraph 2.4.2 of the guidance, resolution plans should identify and map all relevant interdependencies.[660] However, the assessment of such interdependencies in Sberbank Group's resolution plan appears, in retrospect, to have been flawed.

Indeed, the European Parliament's press briefing cites high dependence on the parent institution as a significant risk to the operational continuity of its subsidiaries.[661] Yet, five subsidiaries of the group found buyers and continued their operations.[662] The SRB's decision regarding Sberbank Austria reflects a change in the criticality assessment for certain services and the interpretation of the Austrian Insolvency Code, shifting the separability assessment.[663] This change, with no apparent alteration in underlying facts, raises substantial questions about the effectiveness of resolution planning activities under the resolvability dimension.

As a result, Sberbank Europe's resolution plan may not only have failed to facilitate resolvability but may have even created obstacles, leading to the implementation of an incorrect resolution strategy. It further necessitates a critical examination of whether the substitutability assessment of intra-group providers, conducted by the institutions themselves, might be subject to a process design error, given that institutions may not

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658 Andreas Dombret and Patrick S. Kenadjian, 'Resolution in Europe: The Unresolved Questions' (2019) available at: <preview-9783110644067_A37527616.pdf> accessed 27 October 2024, 40.

659 Single Resolution Board (n 656), 25.

660 ibid, 26.

661 König (n 648), 3-4.

662 ibid, 4.

663 Single Resolution Board, 'Decision of the Single Resolution Board Concerning the Assessment of the Conditions for Resolution in Respect of Sberbank Europe AG (SRB/EES/2022/19)' (srb.europa.eu, 21 December 2023) available at <https://www.srb.europa.eu/system/files/media/document/2023-12-21_SRB%20Non-confidential-version-of-the-decision-in-respect-of-Sberbank-Europe-AG.pdf> accessed 27 October 2024, 12-13.

always possess the necessary information that authorities would require for an accurate assessment at the resolution planning phase.

In general, a critical observation to consider is the contextual nature of resolution actions and the potential unpreparedness of resolution authorities for unforeseen events. The rapid downfall of the Sberbank Group was significantly influenced by geopolitical risks, which were challenging to predict in advance. The Group and its subsidiaries faced substantial deposit withdrawals and severe liquidity gaps within days surrounding the Russian invasion of Ukraine, ultimately leading to their failure. This instance clearly illustrates how unpredicted crises, in this case geopolitical, can catalyse the failure of otherwise stable financial institutions.

Significantly, the severity of this geopolitical crisis undermined Sberbank Europe's recovery plans, which relied heavily on financial support from Sberbank Russia. If risks like these, which are unforeseen and thus, unaddressed in resolution plans, can destabilise an entity like Sberbank Europe, it is likely that larger cross-border financial institutions operating within the European Banking Union would face even more formidable challenges. Sberbank Group, though not insignificant, only represented a small fraction of the balance sheet of larger credit institutions. In such scenarios, not only would resolution plans fail to identify potential risks, but the task of managing these risks would also become significantly more challenging for resolution authorities.

In conclusion, it is evident that the SRB lacks the necessary tools to effectively handle the resolution of systemic credit institutions. While the resolution mechanisms outlined in the EU resolution framework are sufficient for smaller credit institutions, their suitability for systemic ones is questionable. A significant gap in the framework is its lack of provisions for handling liquidity crises. Furthermore, the resolution plans are insufficiently robust to equip resolution authorities to proactively manage the failure of credit institutions. The Sberbank case serves as a case in point. The resolution plan failed to anticipate the source of the risk and did not outline a clear strategy for managing the crisis. The EU Parliament noted that the resolution measures enacted differed significantly from those outlined in the plan, due to an inaccurate estimation of liquidity needs and a misunderstanding of the criticality of intra-group functions. These risks are exacerbated in the context of systemic

cross-border banks, which possess a complexity and scale that far surpass that of the Sberbank group.

(vi) Voting Power and Sequence of Decision-making

The Board's decision that a resolution action is in the public interest involves the assessment of highly important and competing policy interests that could hardly be left to be decided by a body of experts. Core member states control the resolution process through two ways: (i) the participation of core NCAs in the plenary session of the SRB and (ii) the involvement of the Council in the decision-making process if the Commission modifies the SRB proposal on the SRF financing.

Specifically, the SRB will decide whether the criteria for placing a credit institution into resolution are met and adopt the resolution scheme either in its plenary or executive session. As described in section 2.3.3 (*The SRM*) of Chapter 2 above, the executive session, which is comprised of the six independent executive members and the NRAs of the member states in which the failing credit institution is established is responsible for adopting the resolution schemes where the use of the SRF is less than €5 billion in capital or €10 billion in liquidity.[664] The plenary session, which is comprised of the six independent members and national resolution authorities of all member states is responsible for adopting the resolution schemes where the use of the SRF exceeds the above thresholds.

The low threshold adopted for the use of the SRF means that the vast majority of resolution decisions will be made by the Plenary Board. The Plenary Board of the SRB makes decisions by a simple majority representing 30 per cent. of contributions to the SRF. As illustrated in "Table 6: Current Size of National Compartments" in Chapter 2 above, four core member states, Germany, France, Spain and Italy represent cumulatively 76% of the SRF. As a result, these core countries acting in coalition can block any resolution decision and will have the voting power to decide how a failing bank will be reorganised.

As noted in section 2.3.3 of Chapter 2, following the adoption of the resolution scheme, the SRB must transmit it immediately to the Commission. The Commission must then either

[664] SRM Regulation, Article 50(1)(d).

endorse the resolution scheme or object its discretionary aspects.[665] If the objections relate to a material modification of the use of the SRF (amounting to 5 per cent. or more of the SRF funds to be used) or the "public interest" assessment, the Council will decide by simple majority.

The involvement of the Council makes the decision-making process more political, as member states will try to protect their national interests. Electoral timing and adverse public opinion introduce considerations into politicians' decision making that have little to do with the health of the financial system.[666] Politicians are more likely to focus on immediate, short-term and direct electoral payoffs.[667] As support is funded by the SRF, the interests of member states will be divided: failing banks and their creditors would require more generous support from the SRF. Healthy banks which contribute to the SRF but are not significant creditors of the failing bank would prefer strenuous bail-in type resolutions as they would effectively pay for generous support through *ex ante* and *ex post* contributions to the SRF. Therefore, in case of systemic crises affecting the majority of Eurozone member states, it will be difficult for the SRB to overrule politicians' preferences for less stringent measures. On the contrary, in case of idiosyncratic shocks affecting the Eurozone periphery, the Council will insist on strict resolution plans.

In terms of the public interest assessment, it gives core countries the chance to block resolution schemes that the SRB deems efficient. The option to oppose to the public interest assessment in resolution allows core countries to avoid the supranational framework altogether and deal with failing banks under national laws. It will not be difficult for core countries to form coalitions and win a majority in the Council in case of systemic failures affecting multiple jurisdictions. The proclivity of other member states to join such coalitions can result from fear of losing control over decisions affecting domestic economies. The Commission's role as a gatekeeper, which involves the power to start the Council's decision-making process, should not be too difficult to overcome.[668] This is especially true if most of

[665] SRM Regulation, Article 18.

[666] Gadinis (n 453), 331.

[667] Ibid.

[668] Troeger and Kotovskaia (n 507), 7-8.

the member states are determined to push the Commission to propose an action for the Council to consider.[669]

Notwithstanding the adoption of resolution schemes at the EU level, NRAs continue to play an important role in the implementation of the adopted schemes locally. NRAs enjoy discretion in deciding which specific resolution measures to apply in implementing the resolution schemes adopted by the SRB.[670] They may even specify resolution actions, ultimately even inducing the SRB to adopt changes to the resolution scheme.[671] The involvement of NRAs in the implementation stage can lead to another inroad for national interests in supranational resolution. As noted in section 2.3.3 (*The SRM*) of Chapter 2 above, the SRB monitors the execution of the resolution schemes by NRAs.[672] Yet national resistance, especially from politicians and NCAs established in the Eurozone core, creates another layer of incentives for the SRB members to avoid resolution cases already in the initial triggering stages, if the resolution scheme prospectively requires the execution to be forced past resisting NRAs.

In sum, the decision-making process enables core member states to control the resolution of failing credit institutions through (i) the participation of core NCAs in the plenary session of the SRB and (ii) the involvement of the Council in the decision-making process. The vast majority of decisions will be made by the SRB in its plenary session, which allows the Eurozone core countries acting in coalition to block any resolution decision. If the Commission objects to the "public interest" assessment or the use of the SRF, the Council must decide by simple majority. The involvement of the Council makes the resolution process subject to the wishes of the credit institutions and electorate in core countries.

5.3.3 *Control of scarce resources*

The SRM legislation includes prescriptive rules specifically aimed at (i) ensuring that the use of the EU common funds in bank resolutions is used only under exceptional circumstances and restricted to the minimum extent possible through an application of a

669 ibid.

670 Ibid, 18.

671 SRM, Article 6(7).

672 SRM Regulation, Article 31(1) subparagraph 2(d).

bail-in approach and (b) maintaining the primary fiscal responsibility for resolution at the national level with the SRF and the ESM serving as an absolutely last resort.

As indicated in section 2.3 (*The European Banking Union*) of Chapter 2, the SRF was established by an intergovernmental agreement (the "**IGA**") and was progressively capitalized over its initial eight-year tenure from 2016 to 2023.[673] As of 1 January 2024, the SRF is no longer compartmentalized, signifying that all resources have been mutualized to form a common financial safety net for the banking sector across the Eurozone.[674] This milestone achievement also signifies the fund's attainment of the targeted level of at least 1 percent of covered deposits, which aligns with the regulatory requirements intended to ensure that the SRF has sufficient capacity to deal with bank failures without recourse to public funding.[675]

Nonetheless, a retrospective examination of the institutional procedures that prevailed during the transitional phase is critical to understand the current decision-making dynamics. Such an analysis reveals that domestic interests are likely to be given precedence in the event of a bank's failure, with individual member states assessing the potential impact on their jurisdiction. Should a specific bank's failure not impinge upon their territory, pressure may be exerted upon the SRB to refrain from employing the common funds. Therefore, understanding the institutional context throughout the transition phase is paramount for an informed perspective on contemporary resolution decision-making processes within the SRM framework.

(i) Objectives

The purpose of the SRF is to ensure the efficient execution of resolution tools as part of a banking resolution process. The SRF's primary functions include: (a) preserving the value of the assets or liabilities of a bank undergoing resolution, (b) extending loans to the bank in resolution or purchasing its assets, (c) directing resources towards both a temporary bridge institution and an asset management vehicle and (d) injecting funds directly into the bank in resolution as a replacement for the downscaling or conversion of particular creditor

[673] Single Resolution Board, 'Single Resolution Fund' (srb.europa.eu, 2024) <https://www.srb.europa.eu/en/single-resolution-fund> accessed 7 November 2024.

[674] ibid.

[675] ibid.

claims, in line with the bail-in rules, subject to clearly defined conditions.[676] Moreover, the SRF can be used to compensate shareholders and creditors to the extent that their losses exceed what would have occurred under ordinary insolvency procedures.[677] This ensures that these stakeholders do not face undue losses during the resolution process as opposed to what they would incur in a traditional liquidation scenario.

The SRF is not designed to absorb the losses of financial institutions, nor is it a vehicle for their recapitalization.[678] The primary function of the SRF is to safeguard the overall stability of the banking system during the resolution process. Under the resolution framework, the financial burden of a failing bank's distress must first be borne by its internal stakeholders.[679] This includes shareholders and subordinated debtholders, who will encounter losses through a write-down of their shares and debt. In certain cases, even senior creditors and depositors holding funds exceeding €100,000 can be expected to share in the loss absorption and contribute to the recapitalization efforts.[680] Furthermore, the involvement of national deposit guarantee schemes in the resolution process is mandated. These schemes are called upon to contribute funds, but their contribution is limited. The maximum amount they are required to provide is equivalent to what would be paid out if the concerned bank had been liquidated under regular insolvency proceedings.[681]

If the above contributions from the various stakeholders and national deposit guarantee scheme are not enough, the SRF can step in after a contribution amounting to no less than 8 per cent. of total liabilities has been made by stakeholders other than covered depositors by way of bail-in.[682] Moreover, there is a limitation on the SRF's intervention concerning the amount that can be used for the resolution. The SRF's financial support is restricted to providing only medium-term financing and can constitute no more than 5 percent of the total liabilities of the bank in question. This restriction can be lifted only under the stringent

[676] SRM Regulation, Article 76(1).

[677] SRM Regulation, Article 76(3).

[678] SRM Regulation, Article 76(3).

[679] SRM Regulation, Article 15(1).

[680] SRM Regulation, Article 15.

[681] SRM Regulation, recitals 81 and 110 and Article 79; BRRD, recitals 71 and 109.

[682] SRM Regulation, Article 27.

condition that all unsecured, non-preferred liabilities, with the exception of eligible deposits, have been fully written down or converted.[683]

Prior to the mutualisation of the SRF now in effect, the IGA laid out a framework for funding shortfalls in the resolution of cross-border banks. In cases where national compartments' reserves were inadequate for the application of the resolution tools, the IGA provided for additional *ex post* financial contributions from the banking sectors of the Member States in which the cross-border bank is headquartered.[684] Should the *ex post* contributions from credit institutions have been inaccessible on an immediate basis, including but not limited to reasons affecting the stability of the institutions in question, the SRB could either borrow the necessary funds or elect to carry out temporary intra-SRF compartment transfers, which were not fully mutualized, up to a cap of half the SRF's holdings.[685]

The SRB reserved the right to define the terms and conditions for intra-SRF compartment transfers, but it should exclude financing from contracting parties that objected to such transfers based on a number of reasons contemplated in the IGA. These reasons included: (a) the need for these financial resources to support an imminent resolution operation within the state; (b) the potential risk that the transfer could undermine an ongoing resolution action on its territory; (c) the transfer amount exceeding 25% of the member state's share of the national compartment that has not undergone mutualisation; or (d) concerns regarding the guarantee of reimbursement from national funds or the ESM, in adherence to established protocols, by the member state receiving the temporary transfer.[686] If a member state received a temporary transfer from another national compartment, it was obliged to return an equivalent sum to that which was received, including any accrued interest, to ensure the national compartment was fully replenished.[687] The SRB had the responsibility to set the interest rate, define the repayment period and establish additional terms and conditions pertaining to the transfer of financial means between compartments.[688]

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683 BRRD recitals 73 and 74 and articles 44(5)(b) and 44(7); SRM Regulation, recital 78 and article 27(7)(b).

684 IGA, Article 5(d).

685 IGA, Articles 5(d) and 5(e).

686 IGA, Article 7(4).

687 IGA, Article 7(1).

688 IGA, Article 7(3).

If the resources of the SRF are still inadequate for a given resolution measure and the required additional *ex post* contributions are not immediately accessible, the SRB is authorized to secure financing through borrowing from financial institutions or obtaining other kinds of support from third parties, provided that the terms offered are financially advantageous and timely, ensuring cost-effective funding.[689] In the event that such external financing options are not viable, the SRB may establish public financial arrangements.[690] This entails the SRB entering into agreements with the member states involved, soliciting the necessary funds to carry out the resolution process.

In summary, the table below outlines the multi-layered burden sharing cascade designed to manage financial crises within the Eurozone. It commences with contributions from existing stakeholders such as shareholders, junior creditors and potentially senior creditors or depositors with large deposits. If further support is necessary, National Deposit Guarantee Schemes step in, followed by the SRF, which intervenes only after stakeholders contribute at least 8% of the total liabilities and can only allocate up to 5% of the total liabilities. This intervention occurs in three phases, from utilizing national compartments to potentially requiring extraordinary *ex post* contributions from credit institutions. If these measures fail to cover resolution costs, the SRF may access temporary transfers between compartments or seek national financing as a last resort, with the ESM available as a final backstop.

Burden sharing cascade
Existing stakeholders, namely shareholders and junior creditors and depending on the circumstances, even senior creditors or depositors with deposits in excess of €100,000 National Deposit Guarantee Scheme up to the amount that it would be required to pay to covered depositors if the bank was wound up The SRF can step in (i) after a contribution amounting to no less than 8 per cent. of total liabilities has been made by stakeholders and (ii) only if intervention is limited to no more than 5 per cent. of total liabilities.

[689] IGA, Article 5(e).

[690] SRM Regulation, Article 74.

a. First phase: the resolution costs after bail-in will be covered by the national compartments of the member states in which the credit institution is established[691]

b. Second phase: if after the first phase, resolution costs are not covered, the SRB can draw on the compartments of other national compartments *subject to any objections raised by member states*[692]

c. Third phase: if resolution costs are still not covered, then the NRAs concerned will be required to raise *ex post* extraordinary *contributions from credit institutions established in the jurisdictions where the cross-border bank is incorporated*.[693]

d. Fourth phase: if resolution costs after the third phase are not covered and *ex post* contributions are not immediately accessible, including for reasons relating to the stability of the institutions concerned, the SRB may decide on temporary transfers between compartments of the SRF that are not yet mutualised,[694] up to a maximum of 50% of existing SRF funds.[695] The SRB should exclude financing from contracting parties that object based on a number of reasons.[696] For example, the objecting Member State might consider that it will need those financial resources in the near future or the objecting might consider that the borrower does not have the financial capacity to pay back the loan. [697]

If the means available to the SRF are still not sufficient to face a particular resolution action and where the *ex post* contributions that should be raised in order to cover the necessary additional amounts are not immediately available, the SRB can obtain financing from national sources.[698]

691 IGA, Article 5(1)(a).
692 IGA, Article 5(1)(b).
693 IGA, Article 5(1)(d).
694 IGA, Article 5(1)(e).
695 IGA, Article 7(2).
696 IGA, Article 7(4).
697 IGA, Article 7(4)(a) and Article 7(4)(c).
698 IGA, Recital 13.

In circumstances where the financial resources of the SRF are fully depleted and prove to be insufficient, the option to utilize the ESM may be considered as a measure of last resort.[699]

(ii) The ESM fiscal backstop

Following extensive negotiations, on 27 January and 8 February 2021, the Eurozone member states reached a unanimous agreement that in instances where other measures are insufficient, the ESM will provide a backstop to the SRF.[700] This pivotal decision has been taken to enhance the credibility of the SRF and promote the stability of the financial system. The agreed-upon common backstop is structured as a revolving credit line, which will be made available to the SRB when all the resources of the SRF have been fully utilized.[701]

The Eurogroup has provisionally established €68 billion as the ceiling for the revolving credit line that constitutes the shared safety net. Funds from this credit line will be allocated with the ESM's Board of Directors' approval on a per-case basis, engaging national parliaments where necessary.[702] The ESM Board of Directors has a streamlined procedure for activating the shared safety net for bank resolution cases. The Board commits to reaching a preliminary decision within 12 hours of the SRB's funding request.[703] In exceptional circumstances, particularly in the event of unusually complex resolutions, the ESM Managing Director is authorized to extend this period by an additional 12 hours, to a maximum of 24 hours.[704] This expedited decision-making process is designed to replicate the swift "over the weekend" actions typical of bank resolutions and is aligned with the SRM decision-making framework.

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699 ibid.

700 Agreement Amending the Treaty Establishing the European Stability Mechanism (adopted on 27 January and 8 February 2021) (n 204).

701 ibid, Article 18(A)(2).

702 ibid, Article 18(a)(5). The ESM is governed by its Board of Governors, Board of Directors and a Managing Director. The Board of Governors, primarily composed of Eurozone Finance Ministers is chaired by the Eurogroup President and consults with the European Commission and ECB, who attend as observers. Each member of the Board of Directors is chosen by a Governor for their economic and financial expertise and presided over by the Managing Director, who also joins the Board of Governors' meetings. Ultimately, the Managing Director's appointment is the responsibility of the Board of Governors.

703 ibid, Recital 15(b).

704 ibid.

The revised ESM Treaty introduces a structured procedure for the provision of a backstop facility to the SRB. In accordance with the treaty, the process commences with the Board of Governors' initial decision to extend the backstop facility to the SRB.[705] Subsequent to this decision, the SRB may activate the backstop for a particular bank resolution, conditional upon the ESM's Board of Directors' approval.[706] The Board of Governors is entrusted with several critical responsibilities. It is responsible for determining the key financial terms and conditions that will govern the backstop facility.[707] This includes setting the nominal cap and outlining the criteria for any potential adjustments.[708] Additionally, the Board of Governors is tasked with establishing procedures to ensure compliance with the condition that the legal framework for bank resolution remains permanent, as well as determining the repercussions for any deviation from this permanence on the backstop facility and its application.[709] Beyond these initial responsibilities, the Board of Governors also has the authority to decide on the cessation of the backstop facility.[710] This encompasses defining the conditions under which the facility may be terminated, as well as outlining the time frame for such a decision.[711] Should there be a need to continue the facility, the Board of Governors is likewise responsible for setting the terms and duration for the extension.[712]

In the event that the SRB requires activation of the backstop facility for a specific resolution, the ESM Board of Directors must reach a consensus to finalize a detailed backstop facility agreement with the SRB.[713] In urgent cases where the European Commission and the ECB independently assess that immediate action is essential to protect the Euro area's economic and financial sustainability, an emergency voting procedure is employed.[714] This procedure requires a qualified majority vote of 85% for decisions on loans and disbursements under the backstop facility.[715]

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[705] ibid, Article 18(A)(1).

[706] ibid, Article 18(A)(5).

[707] ibid, Article 18(A)(5); Annex IV.

[708] ibid, Article 2 of Annex IV.

[709] ibid, Article 18(a) and Article 1(d) of Annex IV.

[710] ibid, Article 18(A)(1) and Article 18(A)(8).

[711] ibid, Article 18(A)(1).

[712] ibid, Article 18(A)(1).

[713] ibid, Article 18(A)(3).

[714] ibid, Article 18(A)(6).

[715] ibid.

Activation of the backstop facility is subject to a set of criteria outlined in Annex IV of the revised ESM Treaty.[716] The Board of Directors must decide based on these factors, which include but are not limited to the following:[717]

(i) the backstop facility is activated solely as a measure of last resort, under conditions such as:

  (a) depletion of all financial resources of the SRF;

  (b) inadequacy or unavailability of *ex post* contributions on an immediate basis;

  (c) inability of the SRB to secure borrowing from private entities or member states on acceptable terms.

(ii) adherence to the principle of fiscal neutrality is upheld.[718]

(iii) availability of the requested funds from the ESM;

(iv) compliance by member states, in which the resolution is being implemented, with their mandatory SRF contribution transfers;

(v) absence of any ongoing default events on the SRB's borrowings;

(vi) the permanency of the legal framework governing bank resolutions is maintained; and

(vii) conformity of the resolution scheme with EU law.

The loans under the backstop will, in principle have a maturity of 3 years, extendable for a maximum of 2 years should the ESM Board of Directors so decide.

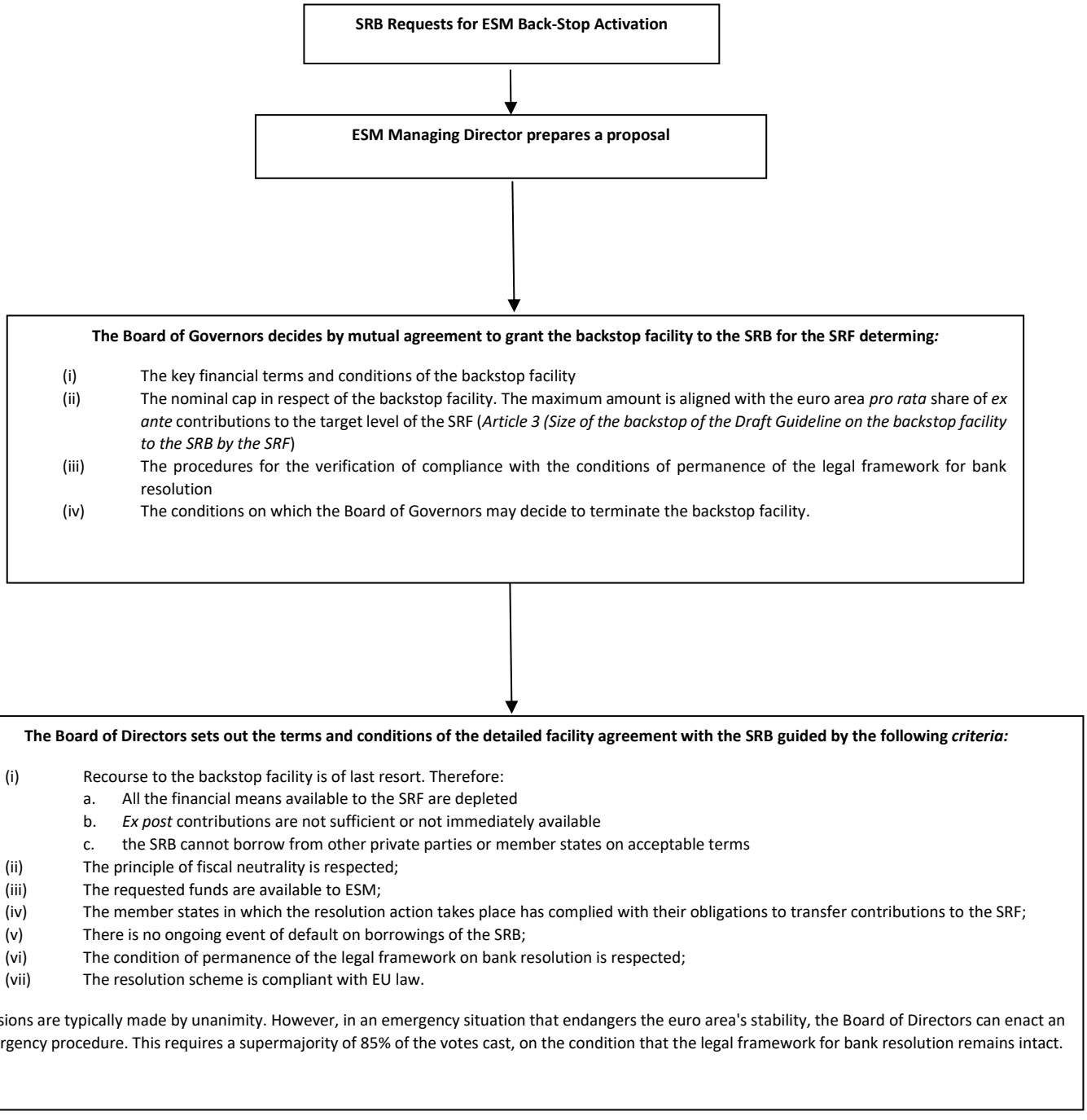
Diagram: *The below diagram outlines the process for activating the ESM as a backstop for the SRB. When the SRB requests ESM support, the ESM Managing Director must prepare a proposal for the Board of Governors, who then decide by mutual agreement whether to grant the backstop facility to the SRB for the SRF. This decision includes setting key financial terms and conditions, establishing a nominal cap and outlining compliance verification procedures for the bank*

[716] ibid, Annex IV.

[717] ibid, Article 18(A)(1).

[718] ibid, Article 12(1)(a). This means that loans disbursed from the backstop facility are intended strictly as a measure of last resort, ensuring that the activation of these loans only occurs when absolutely necessary, such as when the financial resources of the Single Resolution Fund (SRF) are depleted, ex post contributions are either insufficient or unavailable immediately, or the Single Resolution Board (SRB) is unable to secure borrowing under acceptable terms from private entities or member states. The approach mandates that the SRB must have a sufficient repayment capacity to ensure full repayment over the medium term, facilitating a fiscal neutral stance. Additionally, the replenishment of the SRF through contributions from the banking sector is central to maintaining the sustainability and robustness of the financial framework.

resolution legal framework. The Board of Directors is tasked with setting out the detailed terms of the facility agreement with the SRB. For the facility to be used, several criteria must be met: it should be used as a last resort, maintain fiscal neutrality, funds must be available in the ESM, the member state involved must have met its contribution obligations to the SRF, there should be no default on SRB borrowings, the legal framework for bank resolution must be permanent and the resolution scheme must comply with EU law. Activation is considered when all SRF means are depleted, ex-post contributions are insufficient or not immediately available and the SRB is unable to secure acceptable terms from private parties or member states. Decisions are typically unanimous, but in an emergency that threatens the euro area's stability, a supermajority of 85% can enact emergency procedures, provided that the bank resolution legal framework is upheld.



(iii) Incentives of member states when they make decisions in respect of EU common funds

Despite the full mutualisation of the SRF as of 1 January 2024, it would be naive to suggest that national interests will disappear from the decision-making process when it comes to supporting failing credit institutions. While the mutualisation implies a collective pooling of funds and risks, the prior negotiations and initially separate national compartments from which the SRF was built are indicative of the persistent national influence and the protective instincts of member states over their financial stability and their public finances. This cautious approach towards mutualisation can be seen as a legacy of the Eurozone sovereign debt crisis that starkly illuminated the dichotomy between national interests and collective European action. During the sovereign debt crisis, the establishment of mechanisms like the ESM presented a semblance of mutualised risk. However, as Fabbrini's analysis of adjustment programmes indicates, not all states stood on equal footing.[719] Some countries, burdened with stringent conditionalities, experienced significant losses in fiscal autonomy, while others retained relative independence.[720] This historical context is crucial in understanding why national preferences and interests remain deeply entrenched within the decision-making processes of the EBU.

Section 3.5 (*The Incompleteness of the EBU*) of Chapter 3 explained that one of the reasons why the EBU ended up incomplete was the political disagreement between member states over institutional matters that had risk-sharing financial implications.[721] It is expected that similar considerations will drive NCAs' and politicians' preferences in the context of bank resolutions. The conditions attached to the access to SRF financing will be influenced by the size of the failing credit institution and its strategic importance to core countries, as well, of course, as the country's position in the EBU network. Based on the experience of the Eurozone sovereign debt crisis, it has been observed that when EU authorities, are required to make critical decisions, they tend to allocate resources not necessarily to those in the greatest need or with the best record of rule compliance. Instead, they prioritise member

[719] Fabbrini (n 459).

[720] ibid.

[721] Debt mutualisation and fiscal transfers in the euro area, met with firm resistance from NCAs in Germany and the Nordic countries. These nations, being potential net contributors to such a European burden-sharing mechanism, voiced strong opposition to the proposed changes.

states and credit institutions whose financial difficulties are most likely to jeopardise the stability of the domestic financial systems in core countries.[722]

In addition, as *ex post* support to the SRF is funded by credit institutions, interests between creditors will be divided. The failing banks and their creditors would insist on bail-outs. Healthy banks which contribute to the SRF but are not significant creditors would prefer strenuous bail-in type resolutions, as they would effectively pay for generous support through *ex ante* and *ex post* contributions to the SRF. In terms of politicians, their incentives will be driven depending on the impact of the failing institution on domestic financial systems. They will be inclined to provide financial support to failing credit institutions and influence the resolution process in a way that minimizes costs for domestic jurisdictions.

As this section will demonstrate, the *control over financial resources* gives considerable power to core countries to control the resolution process of failing credit institutions in their favour. As noted, cooperation mechanisms fail in times of crises because NCAs and politicians promote national interests.[723] Legally, the SRM does not permit the SRB to take political considerations into account when making resolution decisions.[724] In practice, however, political pressures have played a key role in determining who has access to EU bail-out funds and on what terms in the past.[725] For example, during the Eurozone sovereign debt crisis there were heated negotiations between core and periphery countries in respect of the provision of EU financial assistance. Although ostensibly the decisions of the ESM to advance loans to countries in financial difficulty was based on technical considerations set out in Memoranda of Understanding, the record of lending strongly suggests a pattern of core countries' interests and preferences.[726] Indeed, right from the early days of the ESM the voice of core countries in the ESM was decisive. The practical question in those years,

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[722] See Hila Levi, 'It's (not only) the economy, stupid: examining the European Central Bank's marginal attention to the human and social implications of austerity during the euro-area crisis through the lens of organizational culture' (2024) Journal of European Integration available at: <https://www.tandfonline.com/doi/full/10.1080/07036337.2024.2329633#d1e119> accessed 29 October 2024.

[723] See section 2.2 (*Challenges Arising from the Division of Supervisory Responsibilities in the pre-EBU period*) of Chapter 2.

[724] SRM Regulation, Recital 39.

[725] For an overview of the Eurozone sovereign debt crisis and the various interests at stake, see Pisany-Ferry (n 10); Stiglitz (n 20); Varoufakis (n 484); Legrain (n 24).

[726] ibid.

in any prospective large use of the ESM resources, was whether core countries would agree.[727]

Although it can be argued that independent members of the SRB can provide objective criteria for convincing core member states, their decisions are ultimately subject to institutional constraints designed to confer more control and power to these core states. There are numerous institutional constraints as set out below that preclude periphery states from accessing the funds without succumbing to the demands of core states. These constraints include the size of the SRF, the voting rights allocated to member states, the legal basis on which the SRF is based, the exit options included in the SRF Treaty that grant member states the right to block the transfer of EU funds and the strict conditionality attached to ESM financing.

(iv) Size of the SRF

The size of the SRF has been a contentious issue, with concerns that it falls short of what is necessary to handle a systemic banking crisis.[728] This limited capacity means that the SRB is left without the requisite *instruments* to address a large-scale financial disruption effectively.[729] In recognizing this issue, Member States in December 2013 acknowledged that the funds likely to be available within the SRF during the transition and in its 'steady state' would be insufficient.[730] Consequently, as indicated above, to supplement the SRF, member states agreed that the ESM would serve as a financial safety net, providing up to €68 billion as a credit line in extraordinary circumstances. However, this sum would likely fall short in a crisis that affects the core of the European banking sector.[731]

Instead, there are two central scenarios for which the ESM was built:[732] first, a periphery state loses market access on its own.[733] Second, one or more periphery members states are

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[727] ibid.

[728] Asimakopoulos (n 376), 120.

[729] The availability of instruments to address specific policy issues is an important source of power, see section 4.4.4(vi)(*Instruments*) of Chapter 4.

[730] Eurogroup, 'Statement of Eurogroup and ECOFIN Ministers on the SRM Backstop' (consilium.europa.eu, 18 December 2013), available at: <https://www.consilium.europa.eu/media/21899/20131218-srm-backstop-statement.pdf> accessed 29 October 2024.

[731] Guttenberg (n 377), 2.

[732] ibid.

[733] ibid.

innocent bystanders affected by contagion coming from core member states.[734] In either scenario, core member states, owing to their significant structural power derived from their central economic roles and substantial financial contributions to the SRF, possess both the means and the incentives to dictate access conditions to the SRF. This dynamic could lead to a replay of the loss of autonomy experienced by periphery states during the ESM interventions, with the core dictating the terms and the periphery having to conform despite the possible domestic repercussions.

(v) Voting Power

The *structural power* of core member states in the EBU is compounded by their *institutional power* over decisions relating to the use of the SRF. As noted in section 5.3.2 (*Decision-making processes*) above, the SRB may adopt decisions in its executive or plenary sessions. The executive session is comprised of the national resolution authorities of the member states in which the failing credit institution is established and the executive board members. It can only adopt resolution schemes by consensus if the use of the SRF does not exceed €5 billion in capital or €10 billion in liquidity.[735] Given the low SRF threshold, most resolution decisions are expected to be made by the Plenary Board. The plenary session of the SRB is comprised of the national resolution authorities of all member states and the executive board members. In addition, the plenary session of the SRB will make decisions relating to the financing of the SRF, particularly if additional funds need to be raised to support resolutions of failing banks *ex post*.

The *decision-making process* in respect of decisions relating to *ex post* financing requires a two-thirds majority of the members of the plenary board representing at least 50 per cent. of contributions during the SRF's transitional period and 30 per cent. of contributions thereafter.[736] Germany and France represented more than 50 per cent. of the SRF contributions and, if they acted in coalition, they could block any decision during the SRF's transitional period. After the end of the transition phase, Germany, France, Italy and Spain acting in coalition control more than 70 per cent. of total contributions. Therefore, the

[734] ibid.

[735] SRM Regulation, Article 50(1)(d).

[736] SRM Regulation, Article 52(3).

consent of these core countries will be needed if the SRF needs to raise any financing *ex post*.

(vi) Establishment of the SRF based on an international treaty

In addition, the influence of core member states is further solidified through the creation of the SRF via an international treaty which falls outside the scope of EU law. As noted above, the SRM and SRF are unavoidably closely interrelated and interdependent. The IGA clearly states that the deployment of the SRF and the pooling of financial resources are dependent on the continuation of a resolution legal framework that is in alignment with, or produces outcomes at least as effective as, those established by the SRM.[737] Moreover, the IGA incorporates a 'fundamental change' clause that emphasizes this condition.[738] More specifically, there is a defined list of articles within the SRM Regulation that are deemed critical for the contracting parties' adherence to the Agreement.[739] This list outlines the procedural regulations for the creation of a resolution scheme,[740] the decision-making process of the SRB,[741] the overarching principles pertaining to resolution[742] and the tools used for resolution.[743] Although the core focus of the 'fundamental changes' clause is focused on bail-in regulations, its wording allows for a certain level of retrospective flexibility. This means that any amendments affecting the resolution framework could fall under the scope of the pertinent articles, providing a member state with the ability to argue that substantial shifts in circumstances justify their withdrawal from the agreement. As a result, the parties to the contract have effectively reserved a contingency mechanism for themselves, a means of exit, that, even if not intended for actual use, inherently strengthens the bargaining position of economically dominant nations such as Germany in private negotiations.[744]

The establishment of the SRF through an international treaty and its related mechanisms, create opportunities for judicial activism. Core member states have been granted the

[737] IGA, Article 9(1).

[738] IGA, Recital 18 and Article 9(2).

[739] IGA, Recital 17.

[740] SRM Regulation, Article 18.

[741] SRM Regulation, Articles 52 and 55.

[742] SRM Regulation, Article 15.

[743] SRM Regulation, Articles 22(2) and 27.

[744] Asimakopoulos (n 376).

discretion to engage *in forum shopping* and select the appropriate venues for raising issues that align with their interests. The Court of Justice of the European Union ("**CJEU**") has solidified its role as the de facto supreme constitutional court within the EU. It maintains this status by asserting its exclusive authority to adjudicate the legality of EU actions, thereby reinforcing the doctrine of EU law primacy and supremacy. Despite this, international agreements introduce the possibility of national courts interfering by reviewing measures pertinent to the economic policies of the Member States.[745] Such interventions carry the risk of treaties being temporarily halted or invalidated.

National courts have indeed engaged on multiple occasions, with the German Federal Constitutional Court playing a preeminent role.[746] This court's influence is particularly significant given that Germany is the principal contributor to the EU's funds. For instance, the court's decision on the first rescue package to Greece underscored the necessity of parliamentary approval for substantial financial aid under the European Financial Stability Facility. Continuing this trend, the court ruled that any increase in Germany's financial commitments to the ESM must be pre-approved by the Parliament.[747] The result of this judicial activism has been a considerable reinforcement of the role of the German Parliament, which has become a decisive factor in the development of the Economic and Monetary Union.[748] The government is thereby restrained and cannot bypass Parliament in these decisions. In the event that the government seeks to diminish parliamentary competencies in this domain, it is ultimately the German Constitutional Court that will have the final word.[749] This means that the timing of elections in core countries, like Germany, could impact decision-making in the EU and affect periphery countries. These periphery countries might find that the EU decisions that affect them are tied to when elections happen in the core countries of the EU.

(vii) Fiscal neutrality and principle of reciprocity provisions

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[745] ibid, 126

[746] ibid; Fabbrini (n 375).

[747] BVerfG, Judgment of the Second Senate of 12 September 2012, 2 BvR 1390/12.

[748] Manuela Moschella, 'When Some Are More Equal Than Others? National Parliaments and Intergovernmental Bailout Negotiations in the Eurozone' (2017) 52(2) Government and Opposition 239.

[749] Karsten Schneider, 'Yes, But…One More Thing: Karlsruhe's Ruling on the European Stability Mechanism' (2013) Geran Law Journal 14; Asimakopoulos (n 376), 128.

In addition, central to the institutional constraints faced by Eurozone periphery states is the fiscal neutrality provision, which precludes the SRB from mandating member states to inject additional public funds into failing banks.[750] This is rooted in the understanding that such a requirement would directly impact the national budget of the member states, potentially compromising their fiscal stability and imposing additional burdens on their taxpayers. The Plenary Board of the SRB, despite having the authority to decide on the use of the SRF, is bound by the sovereign prerogative of member states over their national budgets, thereby rendering it powerless in compelling the provision of extraordinary public financial support under resolution scenarios. Consequently, the delicate balance that the SRB must maintain between protecting the weaker economies of the periphery and respecting the fiscal sovereignty of member states underscores the intricate challenges inherent in aligning banking resolution strategies with broader economic interests across the EU.

Another controversial element of the SRF IGA is the introduction of the principle of reciprocity.[751] This means that if countries do not meet their obligations to transfer their contributions the SRF, they could potentially be denied access to the very liquidity meant to stabilize their financial systems in crisis.[752] Faced with such an obligation, a country in financial distress is confronted with a stark choice. It could treat the IGA as a one-time agreement and subsequently find itself outside the supportive framework of the SRM, which is hardly an ideal outcome. Alternatively, the country may decide to go to great lengths to fulfil its financial commitment, potentially having to borrow from the ESM. While this option ensures the country's standing within the SRM, it comes with the heavy price of increased sovereign debt, exacerbated by the ESM's conditionalities.[753]

(viii) The ESM conditionality

The disparity in *instrumental power* between core and periphery states is reflected in the treaty establishing the ESM.[754] The design of the ESM takes into account the financial contributions from the member states as the primary source of its funding, leading to an

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[750] Agreement Amending the Treaty Establishing the European Stability Mechanism (adopted on 27 January and 8 February 2021) (n 204), Annex IV Article 2(b).

[751] IGA, Recital 20 and Article 10(2).

[752] Agreement Amending the Treaty Establishing the European Stability Mechanism (adopted on 27 January and 8 February 2021) (n 204), Annex IV Article 2(d).

[753] Asimakopoulos (n 376), 128.

[754] Fabbrini (n 459).

increased financial input from core member states.[755] Therefore, countries such as Germany, France and Italy are responsible for a more significant portion of the ESM capital, contributing approximately 27%, 20% and 17% respectively. This contrasts with smaller nations like Malta and Estonia, which contribute merely 0.07% and 0.18% to the ESM capital.[756] Consequently, the ESM Treaty reflects this financial disparity by correlating it with an inequality in *instrumental power*, endowing the core member states with greater instrumental power compared to the periphery states.

The decision-making process of the ESM prominently highlights the more significant influence that core states have compared to periphery states. Typically, ESM decisions require a unanimous vote, which gives core member states the ability to block any decisions they disagree with.[757] As outlined in Article 4(3) of the ESM Treaty, the Board of Governors and the Board of Directors must reach decisions unanimously.[758] This setup gives core member states a notable advantage, especially in deciding whether to extend financial help to countries in crisis, tying crisis management closely to the political will of major member state capitals. Furthermore, several countries need their national parliaments to agree before they can support a decision.[759] While an emergency voting procedure can lower the majority needed to 85% if the European Commission and the ECB declare an immediate risk, it's uncertain whether this procedure can be effectively employed unless a government is explicitly obstructive.[760] In any event, even with the 85% threshold, the three largest core member states, namely Germany, France and Italy, retain the power to veto as votes are equal to the numbers of shares allocated in the authorised capital stock (each of them has a share of more than 15% of the ESM capital).[761] More importantly, the ratification of the ESM Treaty by the German Parliament came with explicit conditions as set forth by the German Constitutional Court.[762] It highlighted the necessity for Germany to adopt measures that ensure its veto power is preserved, even in scenarios where new member states join the

[755] ESM Treaty (n 30), Annex I.

[756] ibid, Annex I.

[757] ibid, Article 4(3).

[758] ibid.

[759] Guttenberg (n 452), 3.

[760] ESM Treaty (n 30), Article 4(4).

[761] ESM Treaty (n 30), Article 4(7).

[762] BVerfG (n 747).

ESM.[763] This stipulation is meant to secure Germany's proportional control within the system and prevent any dilution of its influence as the ESM expands.[764]

Moreover, Article 5(7) of the ESM Treaty stipulates that a qualified majority, constituting 80% of the voting power or capital shares, is requisite for the ESM Board of Governors to make pivotal decisions.[765] These include appointing or dismissing the ESM Managing Director, instituting by-laws, endorsing the annual accounts and resolving disputes related to the Treaty's interpretation.[766] This provision effectively augments the influence of Germany and France in the administration of the Eurozone's permanent stability mechanism. Consequently, the periphery states of the ESM experience a decrease in their voting influence compared to the more equitable distribution within EU structures, while the voting clout of larger member states correspondingly expands.[767]

The concept of the *instrumental power* associated with the veto takes on distinct significance when considering the potential impact of a crisis originating from the core of the Eurozone. Should a crisis emanate from the core, it could trigger a domino effect, adversely affecting other member states. To fortify the Eurozone, particularly the periphery states, against this risk of contagion, it may become necessary to employ mechanisms offered by the ESM, such as precautionary credit lines. Nevertheless, the ESM's capacity to safeguard periphery countries from the fallout of a core member state's actions is constrained by the requirement of that member state's consent. For core states like France, Germany, or Italy that possess veto power, the emergency procedure that typically applies is not available. Given this, it appears highly improbable that a core government, if embroiled in a conflict, would consent to ESM interventions designed to shield periphery member states.

In summary, the cooperation mechanisms often fail during crises as national interests take precedence and political pressures influence the distribution of EU bailout funds. The SRF bolstered by the ESM which serves as a backstop has primarily been established to deal with crises in periphery member states. The SRB will find itself lacking the required financial firepower to manage crises originating in the Eurozone core. Furthermore, the decision-

[763] ibid.

[764] Fabbrini (n 459).

[765] ESM (n 30), Article 5(7).

[766] ibid, Article 5(7)(m) and Article 37(2).

[767] Fabbrini (n 459), 19.

making process relating to the control of the SRF is skewed in favour of core states, who have the power to influence the resolution process and the allocation of SRF funds in their favour. The establishment of the SRF via an international treaty, which falls outside EU law, enables core member states to engage in forum shopping, a practice that allows domestic entities to intervene and sway the EU's policymaking process to align with their national agendas. Core member states, due to their structural power, hold a disproportionate level of control within institutions such as the ESM. This control allows them to dictate terms and conditions for accessing financial assistance, often at the cost of the sovereignty of periphery states. The ESM, as an example, is structured in a way that core states like Germany, France and Italy can effectively veto decisions due to the unanimous vote requirement or through a qualified majority that reflects their larger financial contributions. The recent amendments to the ESM Treaty and the creation of precautionary financial assistance instruments with stricter conditions exemplify the tightening of control by core member states over the financial stability mechanisms of the EU, potentially constraining the capacity of periphery countries to safeguard themselves in the event of a crisis originating from the core.

5.4 CONCLUSION

This chapter explored the complex interactions of the EBU, emphasizing the difficulties caused by the different national interests and objectives of its member states. The creation of the EBU was initially meant to encourage cooperation towards the shared goal of financial stability within the Eurozone. However, the situation shows a more complicated picture where clashing national agendas often result in incentives for deviation, weakening this unified goal. This chapter applied the power framework to the EBU institutions to examine whether all member states face similar institutional constraints in promoting their policy preferences in the context of the EBU. The application of the power framework revealed that core states have disproportionate influence, often guiding decisions and policies in their favour. This disparity shows the need for changes within the EBU to ensure a more equal power distribution and to enhance the union’s ability to achieve its foundational goal of keeping financial stability across all member states.

6 BANK RESOLUTION CASES IN PRACTICE UNDER THE EBU

6.1 INTRODUCTION

This thesis has thus far established that the EBU regime is incomplete and leaves significant room for member states to exercise *ex post* discretion. While the EBU regime has implemented multiple strategies to align this discretion with its overarching objectives, such strategies are not sufficient to deter the Eurozone member states from following their own interests. Given the often divergent interests between periphery and core states within the Eurozone, this thesis employed a power framework to demonstrate that core states have more power to leverage this discretion to support their national agendas.

This chapter examines how the practical implementation of the EBU resolution regime has faced several challenges and controversies, especially in its first years of operation. It examines some of the most prominent cases of bank resolution or restructuring under the EBU, focusing on the different outcomes and implications for the involved parties. The cases include the Cypriot banking crisis, which, although it occurred before the establishment of the EBU provides insights into the core-periphery power dynamics in the Eurozone, Banco Popular in Spain, which was the first bank to be resolved by the SRB and three Italian banks, Monte dei Paschi di Siena ("**MPS**"), Banco Popolare di Vicenza and Veneto Banca, which underwent different forms of public intervention and liquidation. These cases show how the application of the regime can vary significantly on a case-by-case basis leading to different policy outcomes depending on the interests at stake and the level of political support that the resolution of failing banks in specific jurisdictions will receive.

The Cypriot banking crisis, even though it predates the EBU framework, remains particularly informative regarding core-periphery dynamics within the Eurozone. The crisis involved significant bail-in measures, including imposing losses on large depositors, which set a precedent for the types of resolution tools formalized later under the BRRD. This crisis showcased the power asymmetry within the EU, where core states could dictate stringent conditions that Cyprus, a periphery state, had to accept. The reliance of Cyprus on financial assistance from core Eurozone countries and EU institutions underscores the influence core states wield in shaping resolution outcomes to stabilize the broader Eurozone financial system while often overlooking the specific economic conditions and potential adverse impacts on periphery states.

In the case of the Banco Popular in Spain, the bank was considered “failing or likely to fail” by the ECB and the SRB determined that resolution of the failing bank was in the public interest, leading to a bail-in of shareholders and creditors. This decision was influenced by the robust state of the Spanish banking system at the time, which reduced systemic risks and the nature of Banco Popular’s senior creditors, who were primarily international investors from outside the EU. This made the resolution politically feasible as there was minimal domestic fallout.

In contrast, in Italy, the scenario was different. The SRB determined that the resolution of the Italian failing banks was not in the public interest, leading to their precautionary recapitalisation and reorganisation under national law instead. The significant presence of Italian retail investors, many of whom were pensioners, in these banks' debt structures made a bail-in politically sensitive. The potential political repercussions of a potential resolution of the failing banks imposing losses on retail investors were deemed too great a risk. For this reason, the Bank of Italy and local politicians took advantage of the flexibility within the EBU legal framework, applying precautionary recapitalization measures under national law to protect local investors.

These differing outcomes between Cyprus, Spain and Italy demonstrate the complex interplay of factors that influence the resolution of failing banks within the EU. Political dynamics, particularly the potential domestic repercussions of a bail-in, play a crucial role in determining the approach to resolution. The contrasting resolutions of Bank of Cyprus and Marfin Popular Bank in Cyprus, Banco Popular in Spain and the Italian banks offer a compelling case study into how the balance of local interests versus broader EU mandates can significantly dictate the outcome of bank resolutions under the EBU regime. These examples demonstrate that the enforcement of EU rules, particularly regarding bail-ins and the resolution framework, can vary substantially depending on the political will and economic interests of core member states.

The bail-in measures implemented in Cyprus were driven largely by the reluctance of core Eurozone member states, particularly Germany, to support a bailout. Internal political pressures in Germany, especially during an election year, made it politically untenable to bail out what was perceived as a haven for Russian depositors. Additionally, Cyprus's limited institutional and structural power within the Eurozone meant that the imposition of a bail-in would not lead to significant contagion effects across the broader European

financial system. Consequently, core member states were able to enforce stringent bail-in measures on Cyprus, shifting the burden onto local depositors and stakeholders.

In the case of Banco Popular, the strict enforcement of the EU regime was possible primarily because the bail-in predominantly affected international creditors, who were less politically connected to the domestic interests within Spain. This situation was relatively non-contentious for Spanish authorities, as it lacked significant local political repercussions. This scenario suggests a precedent where core states, when detached from the immediate political costs within their jurisdictions, may adhere strictly to EU regulations, enforcing them even if the consequences are severe for periphery states or external stakeholders. Therefore, it can be inferred that in situations where core states are not directly affected by the political fallout, they might push for rigorous application of EBU rules, potentially overlooking the local consequences in periphery economies.

Conversely, the Italian approach to handling its failing banks illustrates a starkly different dynamic. Faced with the potential socio-economic impact on local retail investors and pensioners, Italy chose to circumvent the typical EBU resolution process, opting instead for liquidation under national laws and deploying precautionary recapitalization measures. This maneuver was strategically aimed at protecting domestic constituencies, showcasing how core states might selectively deviate from EU mandates when their local interests are at stake. Italy's response underlines a protective stance towards local interests, bending or even bypassing EU rules to shield domestic stakeholders from adverse outcomes.

These examples reveal a nuanced landscape of power and protectionism within the EBU, where the interests of core states can shape the enforcement or relaxation of banking resolution policies. The dual approach suggests a potential model for future resolutions: strict enforcement of EBU policies when core states' domestic interests are unaffected, versus more flexible, nationally-oriented resolutions when local political or economic stakes are high.

The different outcomes of the banking crises in Cyprus, Spain and Italy reveal a complex interplay of power, interests and rules within the EBU. While the EU resolution regime aims to provide a uniform and credible framework for dealing with failing banks, its application in practice may vary depending on the political and economic stakes involved. The Cypriot case shows demonstrates how core states may seek to impose stringent measures on

periphery states when they face domestic political constraints. Similarly, the case of Banco Popular shows how core states may enforce the EBU rules strictly when their domestic interests are not directly affected, imposing losses on external creditors and shareholders. The case of the Italian banks shows how core states may seek to protect their local interests by circumventing or bending the EBU rules, using national laws and precautionary measures to shield retail investors and pensioners and, in general, domestic interests. These cases suggest that the EBU is not a rigid and impartial system, but rather a flexible and political one, where core states may use their power to exert considerable influence and discretion over the resolution outcomes.

6.2 THE CYPRIOT BANKING CRISIS

The resolution of the Cypriot banking crisis remains important in the context of the EBU for several reasons, even though the SSM and the SRM were not operational at the time. First and foremost, the crisis serves as a real-world example of how banking failures in the Eurozone periphery will be managed, highlighting the practical challenges and consequences of various resolution strategies. Notably, the use of bail-in mechanisms during the Cypriot crisis, which involved imposing losses on large depositors, set a precedent for the types of resolution tools that would later be formalized under the BRRD.[768] As the former Dutch Finance Minister and President of the Eurogroup Jeroen Dijsselbloem aptly stated, "the Cyprus deal will serve as a template for future bank restructurings in the Eurozone."[769]

In addition, it is a key case study in understanding the influence and decision-making power of core EU states over periphery ones. During the crisis, Cyprus, a periphery state within the EU, found itself heavily reliant on the financial assistance and policy directives of core Eurozone countries and EU institutions.[770] This reliance underscores the power asymmetry that often characterizes interactions between economically stronger core states and

[768] For a comprehensive overview of the Cypriot banking crisis and the policy lessons learnt, see Alexandros Michaelides and Athanasios Orphanides, *The Cyprus Bail-In: Policy Lessons from the Cyprus Economic Crisis* (London, Imperial College Press 2016).

[769] Matthew Boesler, 'Eurogroup President Spooks Markets By Saying Cyprus Deal Is A New Template' (businessinsider.com, 25 March 2013) available at: <https://www.businessinsider.com/dijsselbloem-cyprus-deal-is-a-template-2013-3> accessed 29 October 2024.

[770] Mikis Hadjimichael, 'Anatomy of the Cyprus Economic and Banking Crisis 2008-2013: An Assessment of What Really Happened and Why' (2023) CES Discussion Paper 2011 available at: <https://cypruseconomicsociety.org/wp-content/uploads/2023/09/Discussion-paper-No11-Anatomy-of-the-Cypriot-Economic-and-Financial-Crisis-September-2023.pdf> accessed 29 October 2024.

economically weaker periphery states. The terms of the bailout negotiations and the consequential implementation of bail-in measures targeting large depositors showcase how core states can dictate stringent conditions that periphery states must accept, affecting their national banking systems and economies substantially.[771]

Although the decision-making fora will be different under the EBU, with the ECB and SRB playing central roles, the political dynamics will likely remain similar. When the SRB makes decisions, the Council will have the final say, meaning that EU finance ministers will ultimately influence these decisions, rendering them highly political. Furthermore, the representation of member states within the ECB and SRB comes from national authorities. This means that issues will often be analysed through the lens of national interests rather than with a purely European perspective. Notably, as highlighted in section 5.3.3 (*Control of scarce resources*) of Chapter 5, the SRF and ESM, which are crucial for supplying resolution funds during banking crises, essentially remain governed by core member states. These core countries, with their significant economic clout, have the *institutional power* to block any decisions that do not align with their interests. Therefore, national actors will still drive decision-making, and the same incentives will persist despite adopting the EBU regime. The fundamental intergovernmental power dynamics will continue to influence outcomes during crises under the EBU.

6.2.1 Background

In 2004, Cyprus joined the European Union and subsequently became a member of the Eurozone in 2008. Following a period of economic growth, weaknesses in Cyprus's economy became apparent, leading to the government losing access to international capital markets by 2011.[772]

Regarding the banking sector, in July 2011, the EBA published the results of stress tests in which Cyprus's two major banks, Marfin Popular Bank ("**MPB**") and Bank of Cyprus

[771] For a detailed overview of the economic adjustment program for Cyprus and the conditions imposed on Cyprus to gain access to the ESM funds, see European Commission, 'The Economic Adjustment Program for Cyprus' (europa.eu, May 2013) available at: <https://op.europa.eu/en/publication-detail/-/publication/9abde1cb-a369-4900-a4eb-d024cd8e5e02#:~:text=The%20programme%20was%20agreed%20by,1%20billion%20from%20the%20IMF> accessed 28 October 2024.

[772] Alexander Apostolides, 'Beware of German Gifts Near Elections: How Cyprus Got Here and Why It Is Currently More Out than In the Eurozone' (2013) 8(3) Capital Markets Law Journal 300, 302.

("**BoC**"), participated. Both banks passed, achieving Core Tier 1 capital ratios of 5.3%[773] and 6.2%[774], respectively, under adverse scenarios.

In an effort to address funding issues, the Cypriot government secured a €2.5 billion loan from Russia in September 2011.[775]

In December 2011, the EBA organized a capital exercise using actual figures, unlike the stress tests which used stressed figures based on adverse macroeconomic scenarios.[776] Both MPB and BoC were solvent with Tier 1 capital ratios of 6.8%[777] and 7.5%[778,] respectively. However, the EBA recommended that all banks increase their capital ratio to 9% by 30 June 2012.[779]

The solvency of MPB and BoC deteriorated after the Greek debt restructuring agreement in March and April 2012.[780] The agreement included a voluntary bond exchange imposing a 50% nominal discount on Greek debt, significantly impacting the balance sheets of the two banks due to their large exposures to Greek Government Bonds.[781] Consequently, neither MPB nor BoC met the 9% capital ratio by the June 2012 deadline set by the EBA.

On 25 June 2012, Cyprus requested support from the EU and IMF, but negotiations progressed slowly.[782] In March 2013, PIMCO, retained for an independent analysis of the

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[773] European Banking Authority, 'Results of the 2011 EBA EU-wide Stress Test: Summary- Marfin Popular Bank Public Company Co Ltd' (2011) available at: <https://www.eba.europa.eu/documents/10180/15935/e2f3605e-359a-4519-b15b-296ba0d0d2fd/CY006.pdf> accessed 29 October 2024.

[774] European Banking Authority, 'Results of the 2011 EBA EU-wide Stress Test: Summary- Bank of Cyprus Public Company LTD' (2011) available at: <https://www.eba.europa.eu/documents/10180/15935/1abc5e85-5271-4121-b486-601830f39cc5/CY007.pdf> accessed 29 October 2024

[775] Apostolides (n 772), 316.

[776] European Banking Authority, 'Questions and Answers' (eba.europa.eu, 3 October 2012), available at: < EBA Short Report > accessed 29 October 2024.

[777] European Banking Authority, 'Composition of Capital – Cyprus Popular Bank Co LTD' (eba.europa.eu, 2012), available at: <EBA_RECAP_2012 CY006.pdf> accessed 29 October 2024.

[778] European Banking Authority, 'Composition of Capital – Bank of Cyprus Public Co LTD' (eba.europa.eu, 2012), available at: < EBA_RECAP_2012 CY007.pdf > accessed 29 October 2024.

[779] European Banking Authority, 'Final Report on the Implementation of Capital Plans Following the EBA's 2011 Recommendation on the Creation of Temporary Capital Buffers to Restore Market Confidence' (eba.europa.eu October 2012) available at: < ECM letterhead> accessed 29 October 2024, 3.

[780] Jeromin Zettelmeyer, Christoph Trebesch and Mitu Gulati 'The Greek Debt Restructuring: An Autopsy' (scholarship.law.duke.edu, July 2013) available at < https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=5343&context=faculty_scholarship > accessed 29 October 2024, 5-8.

[781] ibid.

[782] European Commission (n 771), para 57.

Cypriot banking sector, revealed that the two largest Cypriot banks would fail to meet their capital requirements by June 2013 under both base and adverse scenarios.[783]

On 15 March 2013, the initial draft rescue package concluded between Cyprus, the EU and IMF included a one-time tax on bank deposits, charging 6.75% for deposits up to €100,000 and 9.9% for larger amounts.[784] This proposal was later rejected by the Cypriot Parliament.

On 21 March 2013, the ECB threatened to withdraw ELA if a bailout program was not implemented.[785]

On 22 March 2013, the Cypriot Parliament passed a law establishing a resolution framework for financial institutions, incorporating many provisions of the BRRD, which was under negotiation at the time.[786] This law empowered the Central Bank of Cyprus to implement the resolution tools set out in the BRRD like asset transfers, the bridge institution tool and bail-ins.[787]

On 25 March 2013, a new financial support plan was presented by the EU authorities, IMF and Cyprus. Under this plan: (i) the ESM and IMF would provide €10 billion to Cypriot authorities, (ii) the Greek branches of MPB and BoC would be transferred to Piraeus Bank in Greece and (iii) MPB and BoC would be resolved with contributions from shareholders, bondholders and uninsured depositors.[788]

Before banks reopened on 28 March 2013, a critical decision needed to be made regarding the imposition of capital controls, including potential limits on deposit withdrawals and the opening of new accounts at different banks. The primary concern was the possibility that depositors would transfer their funds from the bailed-in BoC to other institutions or move

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783 PIMCO, 'Independence Due Diligence of the Banking System of Cyprus' (FT.com, March 2023) available at: <https://ftalphaville-cdn.ft.com/wp-content/uploads/2013/04/reportasws.pdf.pdf> accessed 29 October 2024.

784 Alexander Michaelides "Bank of Cyprus (BoC) and Laiki: Resolution via Public Support and Bail-in, Including of Uninsured Depositors' in World Bank, *Bank Resolution and "Bail-in" in the EU: Selected Case Studies Pre- and Post-BRRD* (worldbank.org, 2013) available at: <https://documents1.worldbank.org/curated/en/731351485375133455/pdf/112265-REVISED-PUBLIC-FinSAC-BRRD-CaseStudies.pdf> accessed 29 October 2024.

785 European Central Bank, 'Governing Council decision on Emergency Liquidity Assistance requested by the Central Bank of Cyprus' (ecb.europa.eu, 21 March 2013) available at: <https://www.ecb.europa.eu/press/pr/date/2013/html/pr130321.en.html> accessed 29 October 2024.

786 Unofficial Translation of the Cypriot Resolution of Credit and Other Institutions Law of 2013 (Basic Law) (centralbank.cy, 2013) available at: <https://www.centralbank.cy/images/media/pdf_el/EN-CREDIT-INST-RESTR-LAW-UP-TO-(No2)-2013.pdf> accessed 29 October 2024.

787 ibid.

788 ibid.

them out of the country altogether once the banks resumed operations.[789] With ELA levels already significantly high and uncertainty about the ECB's willingness to extend further liquidity, decisive measures were necessary.[790] To mitigate these risks, the Central Bank of Cyprus implemented capital controls, permitting exceptions only for documented emergencies and trade-related needs and froze uninsured deposits for varying durations based on their size.[791] These restrictions were gradually eased over time and were entirely lifted approximately two years later.

The Cypriot experience remains the only fully-fledged bail-in case employed in resolving a banking crisis to date.

6.2.2 Analysis of the resolution of the Cypriot Banks in light of the power framework

The resolution of Cypriot banks during the Eurozone crisis illustrates how core states can exercise their *instrumental, institutional and structural power* to impose policies on periphery countries without adequately considering their unique economic conditions and potential adverse impacts. By leveraging their *financial expertise and regulatory dominance*, core states were able to dictate stringent recapitalisation and restructuring measures aimed at stabilising the broader Eurozone financial system. However, these measures, devised primarily through the lens of core states' economic realities, often overlooked the fragile financial environments of the Eurozone periphery.

The recapitalisation exercise, initiated without a euro area-wide consensus on capital provision, dealt a significant blow to banks in the Eurozone periphery. This plan, endorsed at the Euro Summit on 26 October 2011, mandated a heightened Core Tier 1 capital requirement of 9%, coupled with an additional capital buffer to account for the valuation risks of sovereign debt.[792] Crucially, banks were instructed to mark-to-market their sovereign bond holdings for the purposes of this assessment.[793] Furthermore, the feasibility of mandating a capital ratio adjustment within a mere nine-month period is deeply

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789 European Commission (n 771), 129-130.

790 Michaelides (n 784), 21.

791 European Commission (n 771), para 64.

792 European Council, 'Euro Summit Statement" (consilium.europa.eu, 26 October 2011) available at: < https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/125644.pdf> accessed 29 October 2024.

793 Demelza Jurcevic, Mario Quagliariello and Paolo Bisio, 'A short guide to the EBA's recapitalisation results' (cepr.org, 21 December 2011) available at: <https://cepr.org/voxeu/columns/short-guide-ebas-recapitalisation-results> accessed 30 October 2024.

questionable. When banks are required to adjust their financial positions on a rapid timeline, they often resort to deleveraging instead of raising new equity, which can exacerbate financial stress.[794] Indeed, there is strong empirical evidence indicating that the EBA capital exercise led to contraction in bank lending.[795]

While the EBA's *objective* was to prioritise financial stability across the Eurozone as a whole, it did so without adequately considering the economic conditions in periphery states. Banks in these regions were already burdened with significant holdings of sovereign debt from their own governments, which were viewed as increasingly risky, leading to potential losses and making it difficult to raise fresh capital.[796] In addition, raising new capital in distressed market conditions could be prohibitively expensive or unfeasible for these banks, potentially leading to a further erosion of confidence in the banking sector and increasing the dependence on emergency financial assistance, thereby exacerbating the crisis rather than alleviating it.[797] In contrast, banks in core states benefited from stronger state backing and found it easier to attract investors, highlighting the disparity in conditions across the Eurozone.[798] This one-size-fits-all approach did not account for the unique challenges faced by banks in different regions.

The EBA merely issued a non-legally binding recommendation for banks to raise more capital, leaving individual countries, such as Cyprus, with the discretion to adopt or reject

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[794] Samuel G. Hanson, Anil Kashyap and Jereny C. Stein, 'A Macroprudential Approach to Financial Regulation' (2011) 25(1) Journal of Economic Perspectives 3.

[795] Jean-stephane Mesonnier and Allen Monks, 'Did the EBA Capital Exercise Cause a Credit Crunch in the Euro Area?' (2015) International Journal of Central Banking 75; Reint Gropp, Thomas Mosk, Steven Ongena and Carlo Wix, 'Bank Response to Higher Capital Requirements: Evidence from a Quasi-Natural Experiment' (2019) 32 Review of Financial Studies 266.

[796] Angeloni and Wolff observed that banks' holdings of sovereign bonds from vulnerable countries decreased significantly between December 2010 and September 2011, amid efforts to raise capital. They noted that Greek debt holdings materially affected banks' market values from April to October 2011, with similar effects observed for Italian, Irish, and Portuguese debts in late 2011. Additionally, the authors highlight that the location of banks played a crucial role in their stock market performance, reflecting the intertwined nature of bank and sovereign risks within the broader economic context of the euro area. See Chiara Angeloni and Guntram B. Wolff, 'Are Banks Affected by Their Holdings of Government Debt?' (bruegel.org, March 2012) available at: <https://www.bruegel.org/sites/default/files/private/wp_attachments/WP_2012_07.pdf> accessed 1 November 2024; Leonardo Morlino and Cecilia Emma Sottilotta, 'Southern Europe and the Eurozone Crisis Negotiations: Preference Formation and Contested Issues' (2019) 24(1) South European Society and Politics 1, 7.

[797] Danièle Nouy has acknowledged in an interview with the Financial Times that it may not be optimal to alter the regulatory treatment of sovereign exposure during a crisis. She stated, "What I would admit is that maybe it's not the best moment in the middle of the crisis to change the rules – that's possible.", see 'Transcript of interview with Danièle Nouy' (FT.com, 9 February 2014) available at: < https://www.ft.com/content/3e0420e2-91a8-11e3-adde-00144feab7de> accessed 1 November 2024.

[798] In addition to being established in jurisdictions with greater fiscal capacity able to support their recapitalisation efforts, banks in core regions had also significantly reduced their exposure to sovereign debt from the Eurozone periphery, see Angeloni and Wolff (n 796).

it.[799] However, Cyprus lacked the *institutional and structural* power to oppose this recommendation. Any rejection of such recommendation would fall under the "comply or explain" mechanism, established by the EBA regulation, requiring member states that choose not to comply to publicly justify their decision.[800] For Cyprus, publicly admitting its inability to meet the capital requirements due to the dire state of its financial sector would significantly undermine investor confidence. In addition, the *regulatory expertise and influence* of core states supporting the EBA's decisions left Cyprus with little choice but to comply. Cyprus's *structural position* within the Eurozone banking network, as part of the economic periphery, made it imperative to attract investors and maintain financial credibility. As a periphery state, Cyprus could not afford to be the sole objector to such requirements, even if rejecting them might have been the right decision from a policy perspective.

The second severe impact on Cypriot banks came from the agreement reached in March 2012 to restructure Greek government debt.[801] This agreement included a voluntary bond exchange imposing a 50% nominal discount on Greek debt, significantly damaging the balance sheets of Cypriot banks due to their substantial exposure to Greek government bonds.[802] Larger member states and key EU institutions had the power to set the agenda and *frame issues* in ways that marginalized the concerns of smaller nations like Cyprus. While it was clear that the Cypriot banking system would be severely affected, Eurozone core states were largely unconcerned because the Cypriot banking system *was located in the periphery of the Eurozone banking system* and its collapse was not expected to have a significant impact on the stability of the Eurozone banking system as a whole. The *main objective* was to stabilize the broader Eurozone and mitigating systemic risks took precedence over individual country interests.

Some commentators argue that the Cypriot government could have exercised their *formal authority* to veto the decision on Greek debt restructuring at the Euro Summit.[803] However, this argument holds little weight, as Cyprus wielded minimal influence over EU-level

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[799] European Banking Authority (n 779).

[800] EBA Regulation, Article 16(3).

[801] Gong Cheng, 'The 2012 Private Sector Involvement in Greece' (esm.europa.eu, June 2020) Discussion Paper Series no. 11/Programme Evaluation Special available at: < https://www.esm.europa.eu/system/files/document/esmdp11.pdf> accessed 1 November 2024.

[802] Athanasios Orphanides (n 265), 26.

[803] ibid, 18.

decision-making processes. During the Eurozone sovereign debt crisis, the Euro Summit, composed of the Heads of State of the Eurozone and the Eurogroup, comprised of the Eurozone finance ministers, emerged as crucial actors in day-to-day decision-making.[804] Significant decisions related to EU crisis management were often resolved through the intervention of the Eurogroup and the European Council, which *set the agenda for decisions made by counter-organizations* such as the European Commission and NCAs by providing them directives based on their preferred policy outcomes.[805] The *representation* of member states by national actors in the European Council meant that issues were primarily viewed through the lens of national interests. Press conferences following European Council meetings regularly featured national leaders conducting separate briefings, portraying themselves as defenders of their respective national interests, ensuring that policy-making in Brussels did not overreach.[806] For Cyprus, *framing issues* in a manner that would resonate with politicians from core states was exceedingly challenging, as the impact on Cyprus' economic sector was not a concern for those core states.[807] The *overarching objective* was to promote European financial stability, with broader Eurozone stability and systemic risk mitigation taking precedence over the interests of individual countries.

Furthermore, as observed, core states, particularly France and Germany, significantly influenced the direction of the EU's response through extensive bilateral negotiations.[808] During the crisis, these nations frequently engaged in bilateral discussions to reconcile their differing perspectives on fiscal policies and financial support mechanisms.[809] Cyprus, holding a periphery position within the informal networks of EU policy-making, often did not have *access to crucial information* regarding the direction of the negotiations. This *lack of access to information* about where the negotiations were heading severely limited Cyprus' ability to raise issues timely and effectively. Matters concerning the EU periphery were often marginalized, making it difficult for Cyprus to include its national issues on the agenda. The *control of information flows* by the core states meant that Cyprus was

804 Uwe Puetter (n 112).

805 Sergio Fabbrini and Uwe Puetter, 'Integration Without Supranationalisation: Studying the Lead Roles of the European Council and the Council in post Lisbon EU Politics' (2016) 38(5) Journal of European integration 481.

806 ibid, 491.

807 Refer to Section 4.4.4(viii) (*Control of Counter-organisations*) of Chapter 4 for an in-depth discussion on how framing issues can serve as a powerful tool.

808 Degner and Leuffen (n 483).

809 ibid; Brunnermeier et al (n 471).

frequently presented with a pre-determined agenda, further inhibiting its influence in the decision-making process.[810]

Soon after the implementation of the Greek restructuring program, Cyprus formally requested an EU rescue program on 25 June 2012.[811] However, the prospect of facilitating a rescue package for Cyprus posed significant challenges for core Eurozone countries, particularly because of the island's reputation as a haven for Russian money.[812] Financially and politically, Cyprus relied heavily on Russia. According to Moody's, Russian corporate and banking deposits in Cyprus were valued at $31 billion at the end of 2012, constituting about a third of all deposits.[813] Furthermore, the financial relationship was mutual. Between 2007 and 2011, Cyprus provided $203 billion in loans to Russia, which accounted for 24% of total lending to the country, according to Morgan Stanley.[814]

Any potential Russian assistance was deemed unacceptable by Eurozone rescuers. Such aid would not only significantly expand Russian influence in the region but would also conflict with national political dynamics in core Eurozone states.[815] Germany, in particular, was averse to the idea of accepting Russian help in the form of a loan, fearing it would increase Cyprus's debt burden and undermine efforts to achieve financial sustainability.[816] The power dynamics were further complicated by domestic political considerations, including forthcoming elections in Germany, which made it politically untenable to advocate for a rescue package perceived as lenient towards Russian financial interests.[817] The influence of domestic politics in Germany effectively shaped the broader EU agenda, dictating the terms and conditions of bailout discussions and ensuring that any solutions were aligned with German national interests and electoral concerns.

Moreover, the perception of money-laundering and the idea of bailing out rich foreigners who might be engaged in money-laundering or even legitimate tax avoidance did not

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[810] In respect of control of information as a source of power, see section 4.5 (*Structural Power*) of Chapter 4.

[811] European Commission (n 771), para 57.

[812] The Economist, 'A Bungled Bank Raid – European Leaders Tear Up the Rules, with Unpredictable Consequences' (economis.com, 23 March 2013) available at: <https://www.economist.com/finance-and-economics/2013/03/23/a-bungled-bank-raid> accessed 1 November 2024.

[813] ibid.

[814] ibid.

[815] ibid.

[816] ibid.

[817] ibid.

generate any sympathy for Cyprus, especially from Germany. Germany, along with other core EU countries, deployed their *instrumental power* by pitting expertise against expertise to influence the debate on money laundering in Cyprus. For instance, the Eurogroup's decision to appoint Deloitte Italy to evaluate customer care diligence measures in the Cypriot banking sector was a direct response to growing scrutiny over the source of large deposits in Cyprus.[818] This move not only *set the agenda* for the discussion of potential issues within the banking sector but also laid the groundwork for considering drastic measures, such as the bail-in of depositors. Although the final report, published on the Cypriot Ministry of Finance's website on 24 April 2013, was relatively balanced, a condensed version released in the international press on 17 May 2013 took a much harsher stance.[819] This forced the Central Bank of Cyprus to counteract by highlighting discrepancies when compared with practices in other EU countries.[820]

Notably, the Basel Institute of Governance's anti-money laundering (AML) index for Cyprus was 4.93, significantly better than Italy's 5.49, Spain's 5.15, the Netherlands' 5.03, or Germany's 5.80.[821] Additionally, Cyprus had successfully passed assessments by EU watchdogs, the G20 Financial Task Force and the IMF.[822] The OECD's financial task force found that Cyprus partially or fully complied with all 49 of its recommendations, whereas Germany and Finland each failed to comply with five.[823] Despite these favourable reports and Cyprus' use of its *instrumental power* to counter these accusations, the international perception of Cyprus as a hub for money laundering persisted.[824] This perception served as

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[818] Moneyval and Deloitte, 'Cyprus – Effective Implementation of Customer Due Diligence Measures, Level of Implementation of Preventive Measures by Financial Institutions: Summary Report of Main Findings by Moneyval and the Independent Auditor' (icra.org.au, 10 May 2013) available at: < http://www.icra.org.au/sites/default/files/May16_Moneyval.pdf>.

[819] Charles Forelle, 'Report Raps Over Money Laundering' (icra.org.au, 2013) available at: <http://www.icra.org.au/report-raps-cyprus-over-money-laundering> accessed 1 November 2024.

[820] Alexander Michaelides, 'What happened in Cyprus' (economic-policy.org, 15 March 2014) available at: <https://www.economic-policy.org/wp-content/uploads/2014/06/MICHAELIDES-What-happened-in-Cyprus1.pdf> accessed 1 November 2024, 36-37.

[821] Basel Institute on Governance, 'The Basel AML Index 2012' (basel.governance.org, 2012) available at: <https://index.baselgovernance.org/api/assets/83944a64-a8ab-45c9-9952-408cc75c07e5 > accessed 1 November 2024, 13-17.

[822] Reuters, 'Cyprus Rejects Money Laundering Report' (reuters.com, 5 November 2012) available at: <https://www.reuters.com/article/world/cyprus-rejects-money-laundering-report-idUSBRE8A412C/> accessed 1 November 2024.

[823] Joschua Chaffin, 'Cyprus Rejects 'Dirty Money' Haven Claims' (FT.com, 17 January 2013) available at: < https://www.ft.com/content/d4024b44-60c8-11e2-b85b-00144feab49a> accessed 1 November 2014.

[824] Michaelides (n 820), 36-37.

an additional lever against Cypriot positions in March 2013, ultimately reflecting the internal political maneuvers within Germany and other core nations.

By *framing* the presence of Russian savers and the Cypriot banking crisis in a particular light, these core countries reinforced the narrative that Cyprus was a hub for illicit financial activities. In addition, there was a series of statements by public officials in Brussels and Berlin designed to pressure Cyprus into aligning its policy responses with the interests of more powerful EU member states. On 10 January 2013, the New York Times reported that officials in Brussels and Berlin were considering a controversial plan to require depositors in Cypriot banks to accept losses.[825] This was echoed in a 17 January 2013 report by Medley Global Advisors, which cited delays in negotiating a Troika program and emphasized the outsized presence of Russian savers in Cypriot banks.[826] Similarly, a confidential memorandum referenced in a 10 February 2013 Financial Times article suggested that the financial rescue of Cyprus might force losses on uninsured depositors and investors in sovereign bonds.[827] The significant outflows of deposits, likely influenced by these persistent negative perceptions, further weakened Cyprus's financial stability and compliance position, reinforcing its dependency on the core states.[828]

By the time the formal negotiations during the Eurogroup meeting on 15 March 2013 had started, where the tax on deposits was decided, the agenda was already set that recapitalization would be done using internal resources. The Cypriot finance minister Mr Sarris, recalled Cyprus's lack of *instrumental power*, stating, "We really had no negotiating power and no credibility."[829] He highlighted the severity of the situation, saying, "Basically they were telling us, 'Your banks have to close,'" and emphasized that the closure would be permanent.[830]

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825 Thomas London Jr, 'In Cyprus Bailout: Questions of Whether Depositors Should Shoulder the Bill' (nytimes.com, 10 January 2013) available at: < https://www.nytimes.com/2013/01/11/business/global/the-cyprus-bailout-question.html> accessed 2 November 2024.

826 Medley Global Advisors, 'EU Walking on Eggshells' Special Report (17 January 2013).

827 Peter Spiegel and Quentin Peel, 'Radical Rescue Proposed for Cyprus' (FT.com, 10 February 2013) available at: <https://www.ft.com/content/1d17a320-736f-11e2-9e92-00144feabdc0> accessed 2 November 2024.

828 Orphanides (n 265), 32.

829 European Stability Mechanism, 'Crisis in Cyprus, No Negotiating Power, No Credibility' (esm.europa.eu, 2014) available at: < 31. Crisis in Cyprus: 'no negotiating power, no credibility' | European Stability Mechanism> accessed 2 November 2024.

830 ibid.

The ECB's threat to withdraw ELA presented Cyprus with a stark ultimatum: apply for a bailout program or face the abandonment of the euro.[831] This *control over financial resources*, exemplified by the ECB's conditional ELA support, showcased the formidable power wielded at the EU level.[832] By leveraging the ESM and ELA, the ECB and core member states effectively dictated the terms of the bailout, demonstrating how *control over financial resources* can be a powerful mechanism to enforce compliance and shape policy decisions in favour of more powerful actors. As a periphery country, Cyprus's economic and financial stability was deemed less critical to the Eurozone's overall stability compared to core countries. This *structural power* dynamic allowed core countries, which have more significant influence within the ECB and other EU institutions, to exert pressure on Cyprus in ways they would not impose on themselves. This is evident when contrasting the ECB's response to liquidity issues during the Eurozone sovereign debt crisis, where measures such as Long-Term Refinancing Operations and Outright Monetary Transactions provided substantial liquidity to core countries like Germany, France, Italy and Spain.[833] Instead of threatening to cut ELA, the ECB extended significant financial support to safeguard the broader Eurozone's stability, highlighting the stark difference in treatment between core and periphery countries.

For the president of Cyprus, the outcome of the Eurogroup meeting on 15 March 2013 was decidedly humiliating.[834] He had pledged in his inauguration speech just two weeks earlier that under no circumstances would depositors suffer a "haircut." Yet, that is precisely what he was forced to concede, despite feeble arguments that a deposit tax was fundamentally different. This levy was necessitated to meet the German demand that the total bailout from the Europeans and the IMF be capped at €10 billion.[835] The resulting shortfall, amounting to over €7 billion, had to be covered by the Cypriots themselves.[836] With proceeds from privatizations contributing no more than €1.4 billion, the lion's share of €5.8 billion had to

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831 ibid.

832 European Central Bank, 'Governing Council Decision on Emergency Liquidity Assistance Requested by the Central Bank of Cyprus' (ecb.europa.eu, 21 March 2013) available at: <https://www.ecb.europa.eu/press/pr/date/2013/html/pr130321.en.html> accessed 2 November 2024.

833 The Long-Term Refinancing Operations programme is a type of monetary policy tool used by the ECB to provide liquidity to the banking system by offering loans with extended maturities, thereby supporting bank lending and liquidity in the euro area. The Outright Monetary Transactions program, introduced by the ECB in 2012, involved purchasing government bonds from eurozone countries on secondary markets to safeguard an appropriate monetary policy transmission and ensure the singleness of monetary policy, subject to specific conditions.

834 The Economist (n 812).

835 ibid.

836 ibid.

be sourced from the most readily available cash reserve: Cypriot bank deposits, which were valued at €68 billion at the end of January.[837]

The deal quickly began to unravel, revealing that politics played a crucial role not only in Germany but also in Cyprus. Cyprus leveraged its *rule-making power* to halt the implementation of the Troika program by requiring parliamentary approval for the initial rescue package, as the proposed deposit haircut was framed as a tax. The unprecedented move to touch deposits up to €100,000 incited enormous international criticism.[838] Through the rule-making process, the proposal was ultimately rejected. The measures involving the bank levy were more drastic than anything bank customers had experienced in modern times, prompting the Cypriot Parliament to reject the plan outright, without a single lawmaker voting in favour.[839] With Cypriot MPs unwilling to endorse the agreement and Germany steadfast in its terms, Cyprus turned once again to Russia for support.

Cyprus sought Russia as a potential savior, leveraging the connections between the two countries that had been strengthened by Russian depositors and previous loans. In 2011 and 2012, Russia had disbursed €2.5 billion to Cyprus in three tranches. However, during a critical trip in March 2013, Cypriot finance minister Sarris returned empty-handed, highlighting the limitations faced by Cyprus in *mobilizing financial resources either internally or* from Russia.[840] The *structural position* of Cyprus as a periphery country played a crucial role. Being a small island nation, Cyprus did not hold enough strategic importance to incentivize Russia to risk its relationship with the European Union by intervening more assertively. As already flagged, Eurozone policymakers were also keen to avoid Russian involvement, which could potentially complicate the already delicate geopolitical and financial landscape.[841] Consequently, Cyprus's periphery status meant that it struggled to convince others to help, further underscoring its limited leverage and the challenges it faced in mobilizing external resources to address its financial crisis.

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837 ibid.

838 Michele Kambas and Karolina Tagaris, 'Cyprus Lawmakers Reject Bank Tax: Bailout in Disarray' (reuters.com, 19 March 2013) available at: <https://www.reuters.com/article/business/cyprus-lawmakers-reject-bank-tax-bailout-in-disarray-idUSDEE92I0D2> accessed 1 November 2024.

839 ibid.

840 Reuters, 'Cyprus Seeks Russia Investments, Loan Extension: Finance Minister' (reuters.com, 21 March 2013) available at: <https://www.reuters.com/article/business/cyprus-seeks-russia-investment-loan-extension-finance-minister-idUSBRE92K092/> accessed 1 November 2024.

841 The Economist (n 812).

The combination of these factors left Cyprus with no alternative but to succumb to the demands of the Eurozone core states. The involvement of the Euro Summit and the Eurogroup in the *decision-making process* made the negotiations very political, subjecting the bailout programs to domestic political concerns in core countries. The *prolonged negotiations* exacerbated the situation for Cyprus. According to Michael Sarris, the then finance minister of Cyprus, the talks with the Troika focused on trivial issues rather than on moving forward. "We spent six months discussing things like a cost-of-living adjustment clause that the donors wanted to discontinue," he noted, emphasizing that detailed discussions took place while the broader crisis remained unaddressed.[842] As the power framework suggests, the *timing of decision-making* emerges as an important source of power.[843] The ability to delay or expedite decisions significantly influences the outcomes. As highlighted by Michaelides et al., discussions of the "bail-in" over the months leading up to its implementation resulted in depositors withdrawing their funds.[844] This capital flight, motivated by leaked information, led to further destabilization of the Cypriot banking system.[845]

The economic measures imposed on Cyprus, especially the bail-in of depositors, had profound and multifaceted impacts on the nation's economy. Initially, the decision to bail-in uninsured deposits at the BoC resulted in a significant haircut of 47.5%, which was set in July 2013.[846] Although the bank managed to exit resolution status and re-emerge with a good capital ratio, the repercussions were severe. The bail-in not only undermined public confidence in the banking sector but also led to a notable increase in non-performing loans.[847] The NPLs rose to alarming levels, reaching 50% of BoC's balance sheet and close to 150% of GDP.[848] This situation was exacerbated by the perceived unfairness of the bail-in, where deposits were targeted but not the loans, affecting households and businesses that

[842] European Stability Mechanism (n 829).

[843] At its last meeting under the then outgoing president of the Eurogroup, Jean-Claude Juncker, the Eurogroup announced that the programme would be delayed, see European Commission, “Speech: Vice-President Rehn’s remarks at the Eurogroup Press Conference’ (ec.europa.eu, 21 January 2013) available at: < ec.europa.eu/commission/presscorner/detail/en/SPEECH_13_41> accessed 2 November 2024.

[844] Michaelides (n 820), 38-39.

[845] Michaelides (n 784), 21.

[846] ibid.

[847] ibid.

[848] ibid.

held accounts at different banks. This discontent fostered public debates on whether loans should also be subject to bail-ins, further fuelling strategic loan defaults.[849]

The broader economic impact was devastating. The economy contracted sharply, with GDP declining by 3.4% in 2012, 6.6% in 2013 and 1.8% in 2014.[850] Unemployment rates remained persistently high, peaking at 16.4% by the end of 2014, with youth unemployment hitting 39.6% early in the year before declining to 33.7%.[851] These figures reflected not only the immediate economic fallout but also the longer-term damage, including a rise in long-term unemployment that active labour market policies failed to fully address.[852] Compensation per employee and unit labour costs continued to fall, indicating an ongoing strain on the labour market.[853]

The Central Bank of Cyprus highlighted various issues and lessons learned from the crisis in a May 2022 presentation.[854] One significant consequence was the slowdown in real economic activity, further compounded by new shareholders of Bank of Cyprus, who were dissatisfied former depositors.[855] The forced conversion of deposits into shares led to widespread defaults on loan repayments and triggered thousands of court actions against the Central Bank of Cyprus, Bank of Cyprus and the government.[856] These legal challenges and the strain on public confidence left the Cypriot economy struggling to recover sustainably even years after the immediate crisis had passed.

Many policy officials and commentators from the EU and Cyprus have argued that the severe measures were a consequence of the Cypriot government's delay in seeking financial assistance from the EU. As Wieser, the Eurogroup Working Group chairman during the crisis, stated: "The Cypriot government put us in a difficult spot by repeatedly refusing to

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849 Luigi Guiso, Paola Sapienza and Luigi Zingales, 'The Determinants of Attitudes Toward Strategic Default on Mortgages' (2013) 68(4) Journal of Finance 1473.

850 The Economist, 'The Bail-out is Working; the Bail-in Isn't' (economist.com, 6 may 2014) available at: <https://www.economist.com/finance-and-economics/2014/03/06/injured-island> accessed 2 November 2024.

851 European Commission, 'The Economic Adjustment Programme – Cyprus 6th Review – Spring 2015' (ec.europa.eu, July 2015) Institutional Paper 4 available at: <https://economy-finance.ec.europa.eu/document/download/607c367b-8f07-4423-9676-d60ac3fcca81_en?filename=ip007_en.pdf&prefLang=hu> accessed 2 November 2024, 11.

852 ibid.

853 ibid.

854 Michalis Stylianou, 'Experiences from the Implementation of Bail-In Resolution Measures in Cyprus' (worldbank.org, 17-18 May 2022) FinSAC Annual International Conference available at: < https://thedocs.worldbank.org/en/doc/8dea75f98f65a824e389bdbd422f06d8-0430012022/related/Michalis-Stylianou-Central-Bank-of-Cyprus.pdf> accessed November 2024.

855 ibid, 11.

856 ibid, 12.

apply for a programme. They would have got off considerably cheaper, easier and better if they had applied for a programme half a year earlier, or even a year earlier, as they should have."[857] Others have argued that the most critical mistake made by the Cypriot government was its hesitance to take timely action and request EU intervention, despite losing access to international capital markets since 2011.[858] The resultant cost to the real economy and the banking sector due to this procrastination was substantial. Michaelides argues that from around 8% in July 2011, unemployment exceeded 16% by March 2013, when the agreement with the Troika was finalized.[859] During this period, the health of banks' balance sheets further declined, non-performing loans proliferated and the overall economic situation deteriorated significantly.

However, it is crucial to recognize that the dire situation in Cyprus was more a result of decisions made by Eurozone officials and the structural deficiencies of the monetary union itself. The economic downturn in Cyprus was largely driven by structural deficiencies within the Eurozone and prevailing economic conditions marked by high uncertainty about the future. These factors were more exogenous than endogenous. Any financial assistance would have inevitably come with a stringent adjustment program and severe austerity measures imposed by core EU countries, which would have had a negative impact on macroeconomic indicators regardless of the timing of the request.

In addition, the banking crisis in Cyprus can be primarily attributed to two critical factors: the EBA capital exercise and the Greek debt restructuring. As already noted, the EBA's capital exercise required periphery banks to raise substantial capital within an unrealistically short timeframe. Additionally, Cypriot banks were heavily exposed to Greek government bonds, which exacerbated their vulnerability.[860] Even if Cypriot authorities had sought a bailout earlier, they could not have anticipated the Greek debt restructuring and its severe impact on Cypriot banks. This debt restructuring was an unforeseen event as it was implemented without prior anticipation. Prominent ECB and EU officials had argued

[857] European Stability Mechanism (n 829).

[858] Michaelides (n 820), 38-39; Dimitris Papademitriou and Adonis Pegasiou, 'From Bail-out to Bail-in: Explaining the Variegated Responses to the International Financial Aid Requests of Ireland and Cyprus' (2023) 28(6) New Political Economy 971, 979.

[859] Michaelides (n 820), 22.

[860] Orphanides (n 265), 26.

against it, further underscoring its unexpected nature.[861] Thus, while earlier intervention might have addressed some issues, it could not have prevented the banking crisis triggered by these specific unanticipated factors.

More importantly, negotiations with core EU countries would likely not have been different even if Cyprus had asked for help earlier. The island's geopolitical links to Russia and its limited relevance for the stability of the Eurozone as a whole were significant issues. Some argue that negotiating concurrently with Spain might have enhanced Cyprus's systemic relevance.[862] However, given *Cyprus's small size and periphery structural position*, its significance for Eurozone stability would not have increased substantially. EU authorities would have likely framed the issue to apply stricter rules to Cyprus compared to larger economies like Spain, ensuring a harsher treatment that would accommodate their interests.

The primary reason for the imposition of harsh measures on Cyprus was the exercise of *instrumental*, *institutional* and *structural* power by core Eurozone states, coupled with national politics. Core member states, leveraging their dominant positions within the Eurozone's institutional framework, exercised their power to protect their domestic interests. The involvement of core-state politicians in the decision-making process ensured that these preferences, aligned with their internal market priorities, were imposed on Cyprus. Cyprus, with its limited *instrumental power* to influence outcomes and its periphery *structural position* within the broader Eurozone banking system, became an easier target for stringent measures. When push comes to shove, national politics and the advantageous position of core states within the institutional and structural hierarchy often trump broader aspirations of promoting EU solidarity.

The EU policy officials' decision to undermine deposit insurance by recommending that deposits below €100,000 be bailed-in was a dangerous move for the banking systems in the Eurozone periphery. This decision failed to take into account the potential adverse impact on investor sentiment, threatening the stability of banks across these periphery

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[861] Although the IMF favoured debt restructuring and forgiveness over debt collection, this option was inconceivable for the ECB, see Cornel Ban and Bryan Patenaude, 'The Professional Politics of the Austerity Debate: A Comparative Field Analysis of the European Central Bank and the International Monetary Fund; (2018) 97(3) Public Administration 530. As explained by an ECB official, the then ECB president, Jean-Claude Trichet, argued: "for the IMF, restructuring Greece's debt was absolutely necessary from the very beginning … for Trichet, even to think about it was absolutely forbidden, it was a forbidden word, restructuring … He did not want this option to be discussed at the ECB", see Levi (n 722), 10.

[862] Stavros A. Zenios, 'Fairness and Reflexivity in the Cyprus Bail-in' (wharton.upenn.edu, 2014) Wharton Schol Working Paper 14-04, available at: < https://wifpr.wharton.upenn.edu/wp-content/uploads/2021/07/14-04.pdf> accessed 2 November 2024.

economies.[863] The ramifications extended far beyond Cyprus, as creditors to banks in other periphery economies faced a heightened risk of bank runs. By creating a precedent where senior creditors, including depositors, were not considered safe within the Eurozone periphery, this decision significantly undermined investor confidence.

6.3 THE CRISIS OF BANCO POPULAR

The case of Cyprus illustrates how the institutional and structural power dynamics within the Eurozone can shape the outcomes of banking crises, often with negative consequences for the affected countries. In particular, the imposition of a bail-in on the Cypriot depositors and creditors in 2013 was widely seen as a violation of the principle of deposit insurance and a breach of trust between the Eurozone authorities and the Cypriot government. This case has to be contrasted with the bank resolution in Spain, where a bail-in also occurred in 2017, but with the consent and cooperation of the Spanish authorities and the European institutions. In this section, I will examine the background, causes and resolution of Banco Popular, one of its largest banks, which collapsed and was sold to Banco Santander for a symbolic price of one euro.

6.3.1 Background

Banco Popular was founded in 1926 under the name of "Banco Popular de los Previsores del Porvenir."[864] Over the decades, it grew to become one of Spain's largest banking institutions, primarily focusing on small and medium enterprise and retail banking, including a significant share in the real estate lending market.[865] At the end of the first quarter of 2017, it was the sixth largest bank in Spain with total assets of €147.114bn, 1,644 branches and 10,364 employees.[866]

Throughout its history, Banco Popular was known for its conservative banking practices. However, the bank's fortunes changed adversely during the global financial crisis that began

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[863] Alexander Schaefer, Isabel Schnabel and Beatrice Weder di Mauro, 'Bail-in Expectations for European Banks: Actions Speak Louder than Words' (esrb.europa.eu, 2016) Working Paper Series no 7/April 2016 available at: <https://www.esrb.europa.eu/pub/pdf/wp/esrbwp7.en.pdf> accessed 2 November 2024.

[864] Guido Ferrarini and Alberto Musso Piantelli, 'Bank Resolution in Practice: Analysis of Early European Cases' in Danny Busch and Guido Ferrarini, *The European Banking Union* (Oxford, OUP 2023), 488-489.

[865] Single Resolution Board, 'Decision of the Single Resolution Board in its Executive Session of 7 June 2017 Concerning the Adoption of a Resolution Scheme in Respect of Banco Popular Espanol S.A' (srb.europa.eu, 17 June 2017) available at: <https://www.srb.europa.eu/system/files/media/document/srb_decision_srb_ees_2017_08_non-confidential_scanned.pdf> accessed at 1 June 2024, para 3.

[866] ibid, para 4.

in 2007.[867] Like many banks with exposure to real estate, Banco Popular suffered significant losses due to the crash in the property market.[868] Despite efforts to recover, the bank continued to struggle with a high portfolio of non-performing loans and diminishing capital reserves. The situation culminated in February 2017, when Banco Popular declared that it required a new capital injection of €5.7bn to offset losses of €3.5bn in 2016 and also replaced its long-standing chairman Angel Ron.[869]

The bank faced growing challenges as unexpected events strained its situation. DBRS lowered Banco Popular's rating to BBB as more customers visited bank branches and withdrew their deposits faster. On 3 April 2017, Banco Popular revealed that its internal audit had found some irregularities that could substantially affect the bank's financial statements, leading to the change of the CEO.[870] After that, Standard and Poor's and Moody's also reduced their ratings for Banco Popular. This forced the bank to stop paying dividends to shareholders and to admit the possible need for a capital increase or a corporate transaction due to the bank's tight capital position.[871]

Banco Popular tried different strategies to deal with its liquidity problems, such as starting a private sale process to find a strong competitor that could buy the bank.[872] The goal was to strengthen and enhance its financial position through this strategic partnership. However, these talks did not result in a successful outcome.[873] The situation worsened in May 2017 when the bank showed negative quarterly results. Despite efforts to reassure the public, ongoing negative media coverage continued to speed up the loss of deposits, especially after reports on 31 May 2017, that Banco Popular could face liquidation if the expected sale process was not completed quickly.[874] In an attempt to handle the situation, Banco Popular sought ways to generate liquidity.[875] On 5 and 6 June 2017, the bank obtained €3.6 billion

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867 Bank of Spain, 'Report on the Financial and Banking Crises in Spain, 2008-2014' (repositorio.bde.es, May 2017) available at: <https://repositorio.bde.es/bitstream/123456789/15112/1/InformeCrisis_Completo_web_en.pdf> accessed 2 November 2024.

868 ibid.

869 Ferrarini and Piantelli (n 864), 506-507.

870 European Central Bank, 'Failing or Likely to Fail' Assessment of Banco Popular Español' (bankingsupervision.europa.eu, June 2017) available at: <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.2017_FOLTF_ESPOP.pdf>, accessed 2 November 2024.

871 Single Resolution Board (n 865), para 24.

872 ibid, para 26.

873 ibid.

874 Ferrarini and Piantelli (n 864), 507.

875 ibid.

in ELA from the Bank of Spain to meet customer demands for their deposits, but this support lasted only a few hours.[876]

6.3.2 The Resolution of Banco Popular

On 6 June 2017, the ECB declared that Banco Popular was failing or likely to fail because there were clear reasons to determine that the bank would soon be unable to pay its debts when they became due.[877] In fact, ELA had not been enough and Banco Popular was not expected to obtain new funding from the market or from additional central bank funds.[878] Moreover, the recovery plan's measures were deemed inadequate and no early intervention seemed capable of improving the Bank's position as fast as it was needed to deal with the severe liquidity deterioration.[879] The ECB also took into account that Banco Popular was attempting to sell itself to a stronger competitor, but ruled out that a sale was realistically possible in a timeframe that allowed Banco Popular to meet its obligations.[880] Based on the provided assessment, the ECB determined that Banco Popular faced substantial limitations in securing funding through standard market transactions or central bank operations.[881] The ECB concluded that factors such as significant deposit withdrawals, rapid liquidity loss and the bank's inability to secure further liquidity clearly indicated that, in the near future, Banco Popular will likely be unable to meet its financial obligations.[882]

The SRB agreed with the ECB's judgment that Banco Popular was failing or likely to fail and no other solutions could save the bank from failing within a reasonable timeframe.[883] The SRB decided that the resolution of the failing bank would serve the public interest.[884] The SRB based its decision on the resolution's goal to preserve the bank’s critical functions and prevent serious consequences on financial stability, especially by avoiding contagion and keeping market discipline. The SRB concluded that winding up the bank under normal insolvency proceedings would not achieve the same results as resolution action. [885]

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[876] Single Resolution Board (n 865), paras 26-40.

[877] European Central Bank (n 870).

[878] ibid, para 14.

[879] ibid, para 17.

[880] ibid, para 18.

[881] ibid, para 19.

[882] ibid.

[883] Single Resolution Board (n 865), Article 2.

[884] ibid, Article 4.1.

[885] ibid. Articles 4.2-4.7.

More specifically, in the event of the initiation of insolvency proceedings and the withdrawal of Banco Popular's banking license, the SRB concluded that the institution would be unable to continue providing the critical functions of deposit taking, lending to SMEs and payment and cash services.[886] The SRB determined that these services were vital for the bank's customers and other stakeholders and that discontinuing them could have serious negative effects on the Spanish banking sector and the real economy.[887] More specifically, the discontinuance could result in increased uncertainty concerning other Spanish national banks, thereby raising the cost of funding for institutions with similar business models and liquidity profiles, as well as causing liquidity difficulties for other affected stakeholders.[888] Additionally, given Banco Popular's significant role in the Spanish corporate market segment, particularly among SMEs, ceasing these functions could negatively impact the real economy.[889]

Regarding other resolution objectives, namely (i) protecting public funds by minimizing reliance on extraordinary public support, (ii) protecting depositors and (iii) protecting client funds and assets, the SRB concluded that the resolution action would achieve these objectives at least to the same extent as insolvency proceedings.[890] Furthermore, the SRB determined that the resolution action would also help minimize the destruction of value.[891] The winding down of the institution under normal insolvency proceedings, which is a lengthy and complex process, would result in higher losses for creditors compared to resolution, as the liquidation of Banco Popular would lead to its assets being sold at a significantly low exit price.[892]

Consequently, the SRB adopted a resolution scheme utilizing the sale of business tool after the write-down and conversion of the bank's equity capital and subordinated debt.[893] The SRB initiated the marketing process with the assistance of the Spanish Fund for Orderly

[886] ibid, Article 4.4.

[887] ibid.

[888] ibid.

[889] ibid.

[890] ibid, Article 4.4.3.

[891] ibid, Article 4.5.

[892] ibid.

[893] ibid, Articles 5.1-5.3.

Restructuring ("**FROB**"), the Spanish Executive Resolution Authority.[894] On 3 June 2017, amid final checks on the ELA process by Banco Popular and Banco de España, the SRB and FROB reached out to Santander and BBVA, leveraging an earlier unsuccessful sale attempt by Banco Popular.[895]

On 4 June 2017, both potential buyers signed non-disclosure agreements.[896] At the same time, Deloitte was tasked with conducting an independent valuation to: (a) assess Banco Popular's assets and liabilities; (b) provide an estimate of the outcomes for shareholders and creditors under typical insolvency proceedings; and (c) inform the decision regarding the transfer of shares or other ownership instruments.[897]

On 7 June 2017, after the ECB classified Banco Popular as "failing or likely to fail," Santander and BBVA were invited to present binding offers.[898] Santander was the sole bidder, offering €1, on the condition that the holdings of shareholders, Additional Tier 1 holders and Tier 2 holders were written down.[899] The SRB accepted this offer, deciding to write off all of Banco Popular's existing shares, cumulatively worth €2.1 billion.[900] Additionally, the Additional Tier 1 instruments issued by Banco Popular were to be converted into shares and subsequently written off. Lastly, the Tier 2 capital instruments were to be converted into new share capital and sold to Banco Santander for the nominal price of €1.[901]

One month later, Santander initiated a capital injection of €7 billion to bolster Banco Popular's balance sheet and sustain adequate solvency levels.[902] This offer was successful, with total subscriptions surpassing €58 billion.[903] Post-acquisition, Santander ascended to

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894 European Parliament, 'The Resolution of Banco Popular' (europaral.europa.eu, 2017) available at: <https://www.europarl.europa.eu/RegData/etudes/BRIE/2017/602093/IPOL_BRI(2017)602093_EN.pdf> accessed 2 November 2024.

895 ibid, 3.

896 Ferrarini and Piantelli (n 864), 508-509.

897 ibid.

898 European Central Bank, 'ECB Determined Banco Popular Español S.A. Was Failing or Likely to Fail' (bankingsupervision.europa.eu, 7 June 2017) available at: < https://www.bankingsupervision.europa.eu/press/pr/date/2017/html/ssm.pr170607.en.html> accessed 2 November 2024.

899 Single Resolution Board (n 865), Article 6.

900 ibid.

901 ibid.

902 Ferrarini and Piantelli (n 864), 509.

903 ibid.

the top market position in both lending and deposits, serving over 17 million customers with a 20% credit market share and a dominant 25% share in SME lending in Spain.[904]

Additionally, Banco Santander launched a commercial initiative aimed at compensating retail clients who held shares and/or subordinated debt of Banco Popular and were impacted by the bank's resolution.[905] This offer, which was targeted solely at retail clients, involved the issuance of perpetual bonds by Banco Santander to these savers.[906] The initiative saw considerable success, achieving a 78% subscription rate for the bonds.[907]

In the resolution of Banco Popular, no State aid or support from the SRF was utilized. Consequently, the European Commission approved the resolution scheme without raising any objections.[908]

Timeline

Date	**Event**
April 2017	Banco Popular reveals internal audit irregularities and changes CEO. DBRS lowers Banco Popular's rating to BBB
May 2017	Banco Popular tries to find a buyer through a private sale process, but fails Banco Popular shows negative quarterly results and faces increased deposit withdrawals
6 June 2017	ECB declares Banco Popular as failing or likely to fail and notifies the SRB
7 June 2017	SRB adopts a resolution scheme using the sale of business tool and sells Banco Popular to Santander for €1
July 2017	Santander raises €7 billion in capital to strengthen Banco Popular's balance sheet

[904] ibid.
[905] ibid.
[906] ibid.
[907] ibid.
[908] ibid.

August 2017	Santander launches a commercial initiative to compensate retail clients affected by the resolution

6.3.3 Analysis of the SRB decision regarding the resolution of Banco Popular in light of the power framework

Putting aside the subsequent litigation,[909] the resolution of Banco Popular has been widely considered a success and a prime example of handling a 'significant' banking crisis under the new European resolution framework. Given the substantial impact of taxpayer-funded bailouts during the global financial and Eurozone crises, the successful resolution of Banco Popular contrasted positively with ongoing rescue operations of failing banks.

Various commentators argued that the institutional architecture operated efficiently, with all parties collaborating to develop and implement a resolution scheme within days, almost achieving a 'weekend resolution.'[910] Additionally, the entire operation maintained stability in both Spanish and European financial systems, as resolution costs were wholly borne by shareholders, subordinated debtholders and the market through Santander's issuance of new shares, thereby preserving public resources.[911] The resolution of Banco Popular underscored the feasibility of decision-making within the SRM and validated the innovative resolution tools provided under the SRM.[912] It was argued that Spain's successful resolution outcomes can be attributed not only to being hit earlier and harder by the financial crisis, and to acting swiftly, but also to a combination of robust state mechanisms, bolstered by binding agreements with and resources from the ESM, which were instrumental in accepting and

[909] After Banco Popular's resolution, shareholders and creditors filed lawsuits against the SRB. The CJEU upheld the legality of the SRB's actions and chose not to grant any compensation, see Single Resolution Board, 'SRB Statement on General Court Judgment on Banco Popular Decision not to Compensate Affected Shareholders and Creditors' (srb.europa.eu, 22 November 2023) available at: < SRB Statement on General Court judgment on Banco Popular decision not to compensate affected shareholders and creditors | Single Resolution Board> accessed 2 November 2024.

[910] Valdis Dombrovskis, the European Union's financial regulation head, described the sale of Banco Popular as a "successful" initial test of the eurozone's new mechanism for managing failing banks. For more information, see Jim Brunsden,'Banco Popular Sale a 'Successful Example' of Bank Resolution System – EU's Dombrovskis' (FT.com, 8 June 2017) available at: < https://www.ft.com/content/6577b696-b950-3a0b-a9bf-d0c429658cbb> accessed 2 November 2024.

[911] Commentators in the press deemed the collaboration between the SRB and Spain's regulatory bodies a success, in contrast to the drawn-out resolutions of several Italian banks between 2015 and 2017, see Jim Brunsden, 'Decisive Madrid Shows Edge over Sluggish Italians' (FT.com, 7 June 2017) available at: < https://www.ft.com/content/3dd61380-4b92-11e7-a3f4-c742b9791d43> accessed 2 November 2024.

[912] Brunsden (n 910).

enforcing resolution terms as outlined in the BRRD.[913] Furthermore, Spain severed the banks from their local political obligations and connections, contributing significantly to the efficacy of the resolution process.[914]

While the resolution of Banco Popular may have its merits, it is important for observers to exercise caution and avoid over-interpreting its implications.[915] In reality, the resolution was neither impartial nor does it offer a robust example of how the resolution mechanism should function. Instead, it demonstrates that a bank's resolution can occur when the institutional and political environment is favorable and when the domestic interests of core states remain unthreatened. Spanish authorities and the major Spanish banks did not have an incentive to exercise their power to prevent the resolution of Banco Popular. They saw limited benefits in doing so given Banco Popular was too small to have a systemic impact on the Spanish domestic financial system or the broader Eurozone economy.[916]

More specifically, the Spanish financial system had just emerged from a national crisis, having been fortified by extensive public interventions in preceding years.[917] This period of recovery had restored a degree of stability and strengthened the banking sector, leading to a resurgence in investor confidence. Such a context provided a less volatile environment for the resolution of Banco Popular.[918] When the financial system is perceived as more stable, the risks associated with the resolution of a significant financial institution are mitigated. Additionally, Banco Popular's *structural position* within the Spanish financial system was not critically important, meaning that its resolution did not disrupt the broader banking sector or the economy. This lack of critical importance meant that there were no significant conflicts or power struggles among stakeholders. This dynamic facilitated smoother interactions between regulatory bodies and market participants, allowing for a more controlled and less contentious resolution process. Therefore, the timing of this resolution

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913 Shawn Donnelly and Gaia Pometto, 'Banking Nationalism and Resolution in Italy and Spain' (2024) 59 Government and Opposition 187, 195.

914 ibid.

915 Jein-Hinrich Binder, 'Wunderkid is Walking? The Resolution of Banco Popular as a First Test for the Single Resolution Mechansim' (blogs.law.ox.ac.uk, 14 June 2017) available at: <https://blogs.law.ox.ac.uk/business-law-blog/blog/2017/06/wunderkind-walking-resolution-banco-popular-first-test-single> accessed 2 November 2024.

916 ibid.

917 Donnelly and Pometto (n 913), 195.

918 Binder (n 915).

in an environment freshly recovered from financial distress helped prevent widespread fear and systemic threats that could affect the Spanish financial system.

It is also worth flagging that the resolution of Banco Popular did not require tapping into EU public funds which significantly limited the financial implications for the fiscal policies across other EU member states. This approach ensured that member state budgets and core banks' finances were shielded from additional strain, a scenario that could have resulted from resorting to the SRF or EU funds. The absence of an EU-wide fiscal impact meant that there was no need to navigate the often contentious and divisive political debates surrounding the use of EU public funds. Such debates have historically polarized member states, pitting those advocating for mutual financial support against those championing fiscal conservatism.[919] The lack of conflict regarding the *control of financial resources* at the EU level meant that there was no necessity for other member states to exert their power. In addition, European banks did not have significant exposure to Banco Popular, ensuring that they would not face direct financial repercussions. More importantly, these banks were not compelled to make additional contributions to the SRF as a result of Banco Popular's resolution, as the SRF was not utilized.

The resolution of Banco Popular saw the bail-in of international investors who lacked significant political connections to Spain or other EU member states.[920] These investors were predominantly based outside the region and thus did not possess the leverage or influence to press for a change in the SRB's decision to resolve Banco Popular. As these investors did not have deep-rooted political ties within the EU, there was no substantial incentive for power players, either within Spain or across the EU, to intervene in the resolution process.[921] This lack of connection and influence insulated the resolution from potential political conflicts that might have arisen had politically influential domestic investors been affected. Domestic investors often have substantial political sway and can

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[919] For an overview of the Eurozone sovereign debt crisis and the various interests at stake between debtor and creditor countries, see Pisany-Ferry (n 10); Stiglitz (n 20); Varoufakis (n 484); Legrain (n 24).

[920] This has to be contrasted with the failure of the Italian banks, where the political costs associated with the failure forced Italian authorities and the SRB to opt for precautionary recapitalisation to protect *retail shareholders and bondholders*, *see* section 6.4 (*The Failure of the Venetian Banks*) of this chapter below.

[921] A significant portion of the Banco Popular's shareholders were non-European investors, particularly from Mexico and US. These investors initiated proceedings against the European authorities that oversaw the failure of Banco Popular, see Thomas Hale, 'Mexican Investors Ask ECJ to Overturn Banco Popular Sale' (FT.com, 4 August 2017) available at: < https://www.ft.com/content/a4a7691e-7901-11e7-90c0-90a9d1bc9691> accessed 2 November 2024.

exert pressure on local authorities, potentially complicating the resolution process.[922] This aspect of the resolution contributed to a smoother interaction between regulatory bodies and market participants, allowing the process to unfold in a more controlled and less conflicting manner.

In addition, the resolution process could effectively rely on the backing of rival credit institutions that were willing to acquire the failing bank and supported the policy decisions of the Spanish government and the SRB. These credit institutions, including Banco Santander, had no substantial exposure to Banco Popular, which freed them from concerns about potential losses. If these rival institutions had been at risk of incurring losses, the outcome could have been considerably different. Institutions with significant exposure would likely have resisted the resolution efforts, aiming to safeguard their own financial well-being. This resistance could have led to extended negotiations, legal disputes and tensions among different stakeholders. In such a complex scenario, the SRB would have encountered significant challenges in executing resolution measures efficiently. Balancing the conflicting interests would have complicated decision-making and potentially delayed the critical interventions needed to stabilize the financial system. Moreover, if these institutions had faced adverse impacts from the resolution, there could have been a broader loss of confidence in the financial sector. Stakeholders might have been wary of the resolution measures, fearing they could be similarly affected. This could have led to increased financial uncertainty and heightened systemic risk, further destabilizing the Spanish market.

Regarding the bail-in of domestic retail investors, Banco Santander took action to offset the impact on Spanish retail investors by providing them with compensation.[923] This move was pivotal in avoiding the political consequences that could have arisen within Spain, which may have impeded the resolution process. The influence of retail investors, particularly small-scale savers and local stakeholders is considerable. Their dissatisfaction could have led to significant political disruption, placing additional pressure on Spanish authorities.

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[922] For example, the resolution of the Banco Popular case has to be contrasted with the liquidation of the Venetian banks, see section 6.4 (*The Failure of Venetian Banks*) below.

[923] Thomas Hale, 'Santander Launches €1bn Scheme to Cover Retail Investors' Banco Popular Losses' (FT.com, 13 July 2017) available at: <https://www.ft.com/content/3d9a7114-1459-3d97-ab54-d82cbc8c4baf?mod=article_inline> accessed 2 November 2024.

Through the distribution of perpetual bonds as compensation, Banco Santander mitigated financial losses for these investors and quelled potential political dissent.[924] This intervention by Banco Santander and Spanish officials illustrates a firm dedication to protecting the economic interests of the Spanish populace.

The SRB did not only have to face a favourable political environment in Spain but also had significant incentives to take control over the resolution of Banco Popular, *employing the resolution tools* at its disposal. First and foremost, it is important to recognize that Banco Popular, while being Spain's sixth largest lender with subsidiaries and operations in the United States, was not of global systemic importance.[925] Its corporate structure and business model were relatively straightforward. Consequently, the *instruments* available to the SRB were particularly well-suited to manage a bank of Banco Popular's size and complexity, ensuring a resolution that safeguarded financial stability and minimized disruption. In this context, the SRB's resolution toolbox, which included mechanisms such as the bail-in and the sale of business tool, was more than adequate. These *instruments* proved effective in absorbing losses and facilitating the transfer of assets and operations.

In addition, the availability of a willing and capable purchaser, Banco Santander, was a crucial factor. With Santander assuming the whole business in the form of a share deal, the resolution was not only efficient but also ensured the continuity of Banco Popular's operations without any interruption, thereby maintaining financial stability. Had it not been possible to structure the resolution action so efficiently, i.e., if, for instance, no competitor like Banco Santander had been willing to acquire Banco Popular due to uncertainties regarding its real value and hidden risks, the resolution would have been far more challenging. The SRB would have had to devise and implement more complicated, costly strategies, possibly involving higher financial and systemic risks.

More importantly, the acquisition of Banco Popular by Banco Santander was a strategic move that aligned perfectly with Spain's national goals to create a banking powerhouse capable of competing on the European stage. This deal was much more than a simple business transaction; it was a strategic maneuver that positioned Santander as a national

[924] ibid.

[925] Binder (n 915).

champion with the potential to expand its influence abroad. Ana Botín, the head of Santander, highlighted that the acquisition was beneficial not only for Spain but also for Europe, Banco Popular's customers and shareholders.[926] This move solidified Santander's leadership in Spain and Portugal. The timing of this acquisition was crucial. Spain's economy was on the upswing and the acquisition significantly strengthened Santander's position in lending to small and medium-sized enterprises ("**SMEs**"). Banco Popular had a strong SME franchise, which made it an attractive target. Santander projected that the combined entity would command a 25% market share in SME lending in Spain. [927] Ana Botín stated that the merger of Santander and Banco Popular enhanced the group's geographic reach at a time when economic conditions were improving in both Spain and Portugal. [928]

Taking all the above into consideration, the acquisition of Banco Popular by Banco Santander was not so much a success resolution story as it was a fortunate outcome resulting from a specific set of favorable circumstances. This resolution was facilitated by the political and economic alignment between Spain and the EU, the non-reliance on EU resolution funds, the availability of a willing and capable buyer in Santander and the straightforward structure and business model of Banco Popular. These elements allowed the SRB to employ its resolution *instruments* efficiently and effectively, thereby avoiding financial instability and market disruption. However, this particular set of conditions is unlikely to be replicated in the resolution of larger, more complex banks, especially those with significant cross-border activities and intricate operational structures.

If Banco Popular had had significant cross-border activities involving various stakeholders across different Member States, the resolution process would have been exponentially more complex and politically charged. Cross-border operations often result in divergent national interests, creating conflicts that necessitate the exercise of power by multiple authorities. These conflicts could involve disputes over asset distribution, compensation for stakeholders, or jurisdictional control over different segments of the bank's operations. In such a scenario, various Member States would likely exert their influence to protect national

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926 The Economist, 'Banco Popular Fails and Is Bought by Santander. As European Bank Crises Ago, This Was An Orderly One' (economist.com, 10 June 2017) available at: <https://www.economist.com/finance-and-economics/2017/06/10/banco-popular-fails-and-is-bought-by-santander> accessed 2 November 2024.

927 ibid.

928 ibid.

interests, making the SRB's role exceedingly difficult. The involvement of multiple stakeholders with conflicting interests would lead to prolonged negotiations and legislative interventions, delaying the resolution process. It is in this type of environment that *power dynamics* truly come into play, exposing the underlying tensions and conflicts within the EBU.

To conclude, the resolution of Banco Popular provides a critical lesson: strict enforcement of the EU regime is more feasible when the political costs are minimal for core member states. Without significant local political repercussions, Spanish authorities could align closely with EU objectives and enforce strict regulatory measures. This scenario sets a precedent suggesting that core states, when insulated from immediate local political fallout, may adhere rigorously to EU regulations, even if the consequences are severe for periphery states or external stakeholders. Therefore, the key takeaway from the Banco Popular resolution is that when core states' national interests are not directly threatened, they are more likely to push for strict application of EBU rules, potentially overlooking the local consequences in periphery economies.

By adhering to the rigorous application of EBU rules in such situations, core states can maintain their commitment to EU financial stability while potentially overlooking the adverse impacts on less politically connected entities. This dynamic suggests that the alignment between domestic political interests and EU regulatory objectives is feasible when there is no substantial political fallout within the core states. Consequently, core states might advocate for stringent enforcement of EU rules under these circumstances, emphasizing broader financial stability and regulatory compliance over localized economic distress.

In stark contrast, the resolution of banking crises in Italy illustrates the challenges that emerge when core states' interests are entangled with significant local political consequences. While Spain successfully adhered to EU regulations in the resolution of Banco Popular due to the absence of significant local political costs, Italy's handling of its banking crises underscores how national political pressures can compel member states to diverge from EU rules. As the following section will demonstrate below, the resolutions of Banca Popolare di Vicenza and Veneto Banca were marked by political sensitivities and the need to mitigate local political fallout. In these cases, the Italian government opted to use taxpayer funds to support the banking sector, circumventing the strict bail-in rules laid out

by the EBU. This approach was driven by the necessity to appease domestic stakeholders and prevent widespread social and economic repercussions within Italy.

6.4 THE FAILURE OF THE VENETIAN BANKS

In contrast with the resolution of Banco Popular described above, the process followed for dealing with the Italian banking crisis was different. When the EU resolution regime was newly implemented in Member States, Italy faced significant crises involving Monte dei Paschi di Siena, Banca Popolare di Vicenza and Veneto Banca. In the cases of Banca Popolare di Vicenza and Veneto Banca, the SRB opted against taking resolution measures, citing the lack of critical functions provided by these institutions, the minimal risk of significant adverse effects on financial stability and thus, the absence of public interest fulfilment.[929] Consequently, these banks underwent insolvency proceedings in accordance with Italian law, during which the Italian government extended extraordinary financial assistance amounting to €17 billion.[930] This support aimed to facilitate the liquidation process and provide special protection for senior creditors holding debt securities issued by the two banks. In the highly debated case of Monte dei Paschi di Siena ("**MPS**"), resolution was entirely bypassed through precautionary recapitalization.[931] This section delves into the Italian banks' cases and the respective decisions made by the SRB and Italian resolution authorities.

6.4.1 Background

The Italian financial sector managed relatively well during the initial phase of the 2008 financial crisis, resulting in limited reliance on government support by Italian banks.[932] However, the extension of financial turmoil to European sovereign debt considerably impacted Italian banks. Their average non-performing loans ratio surged from 5.5% in 2007 to approximately 14% by 2012.[933] Consequently, Italian banks were compelled to enhance their solvency ratios under challenging conditions, as mandated by the European Banking

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929 Single Resolution Board, 'The SRB Will Not Take Resolution Action In Relation to Banca Popolare di Vicenza and Veneto Banca' (srb.europa.eu, 12 December 2017) < https://www.srb.europa.eu/en/node/341> accessed 2 November 2024.

930 Graeme Wearden, 'Italy to Wind Up Two Failing Banks at Potential Cost of €17billion' (the guardian.com, 25 June 2017) available at: < Italy to wind up two failing banks at potential cost of €17bn | Banking | The Guardian> accessed 17 November 2024.

931 Precautionary recapitalisation was granted based on Article 18.5(d)(iii) of the SRM Regulation.

932 That was probably to two main reasons. First, thanks to low exposures to complex financial products; secondly, because there was no major real estate bubble, see IMF, 'Italy: 2010 Art IV Consultation' (2010) Country Report No 10/157102, 102.

933 IMF, 'Italy: Financial System Stability Assessment' (2013) Country Report No 13/300, 9.

Authority and the Bank of Italy.[934] This required banks to heavily involve retail savers, continuing a practice from previous years.[935] From 2006 to 2009, Italian banks issued over 12,200 bonds worth around €350 billion to retail customers and over 600 bonds amounting approximately to €130 billion to professional investors.[936] Following the 2011 sovereign debt crisis, Italian banks' bond issuances surged further. By 2012, the total amount reached €960 billion, constituting over 50% of families' investment portfolios and nearly 11% of their total financial assets.[937]

By 2015, ongoing challenges highlighted the fragility of the banking sector and its vulnerability to economic weaknesses. During 2016-2017, Italy faced a near-systemic crisis threatening the entire financial sector and a significant number of banks, both large and small.

6.4.2 The recapitalisation of MPS

The first major banking casualty in Italy following the financial crisis was MPS, the nation's fourth-largest bank and subject to SSM oversight.[938] The October 2016 Italian referendum, which aimed to reform the country's constitution by reducing the powers of the Senate and streamlining the legislative process, further complicated the already tense political environment.[939] As the referendum approached, the handling of the MPS crisis became even more critical.

Despite the EU resolution framework being in place, this crisis was managed through precautionary recapitalization by the Italian government. MPS had struggled since the aftermath of the financial crisis and had received public aid since 2009.[940] Nevertheless, the 2016 comprehensive stress tests highlighted severe weaknesses under adverse conditions, exacerbating MPS's difficulties.[941] In July 2016, MPS's board approved a series of measures

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[934] Ferrarini and Piantelli (n 864), 491.

[935] ibid.

[936] ibid.

[937] ibid.

[938] ibid, 493.

[939] Jill Treanor, 'Monte dei Paschi Shares Fall After Italian Referendum Result' (the guardian.com, 5 December 2016) available at: <https://www.theguardian.com/business/2016/dec/05/monte-dei-paschi-shares-fall-italian-referendum-result> accessed 2 November 2024.

[940] State Aid n°SA. 36175 (2013/N)—Italy, §§23 .

[941] European Parliament, 'The Precautionary Recapitalisation of Monte Dei Paschi di Siena' (europarl.europa.eu, 4 June 2017) available at: <The precautionary recapitalisation of Monte dei Paschi di Siena> accessed 2 November 2024.

to offload bad loans and reinforce the bank's capital.[942] However, by December 2016, the capital increase efforts had failed, necessitating the initiation of further actions.[943]

On 23 December 2016, MPS announced its intention to seek a precautionary recapitalization after failing to fully raise capital from private investors. Initially, MPS obtained a State guarantee for its liabilities, issuing a total of €110 billion between January and March 2017.[944] Subsequently, in June 2017, the bank received additional public support in the form of a €5.4 billion precautionary recapitalization.[945] After extended negotiations with the Italian government, the European Commission approved this recapitalization, stipulating that burden-sharing be imposed on shareholders and subordinated debt holders. Consequently, the Italian Ministry of Economy and Finance was authorized to subscribe to €3.9 billion in newly issued shares and allocate €1.5 billion to compensate for the mis-selling of junior bonds to retail clients affected by the burden-sharing.[946] Another essential component of the plan involved transferring the €26.1 billion non-performing loan portfolio to a privately funded special vehicle, partially financed by the Atlante II fund.[947] MPS also sold the lower-risk senior notes of the vehicle to private investors, facilitating the sale by applying for State guarantees on market terms for the senior tranche under an Italian state guarantee scheme.[948]

The ECB determined that MPS was neither failing nor likely to fail, thus avoiding the bank's resolution and a creditor bail-in. Hence, once again, a banking crisis was financed through taxpayer money, this time in the form of a precautionary recapitalization as permitted under EU law.

6.4.3 The Liquidation of the Venetian Banks

In 2017, Veneto Banca and Banca Popolare di Vicenza, two former co-operative banks from the Veneto region in Northern Italy, went through Compulsory Administrative

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942 ibid, 2.

943 ibid.

944 State guarantees were provided pursuant to Law Decree No 237/2016, art 7, which was approved by the Council of Ministers on 23 December 2016.

945 Ferrarini and Piantelli (n 864), 493.

946 ibid.

947 European Parliament (n 941).

948 ibid.

Liquidation.[949] Veneto Banca ("**VB**") was founded in 1877 and embarked on an aggressive growth strategy since 1997, aiming to become a major player in the Italian banking sector. By 2012, VB had expanded its presence in Italy and Eastern Europe, with total assets of €33.5 billion, 586 branches and 6,241 employees, ranking among the top ten banking groups in Italy.[950]

Banca Popolare di Vicenza ("**BPVi**") was the oldest cooperative bank in the Venetian area, established in 1866.[951] It also experienced significant expansion in the 1990s, especially in the early 2000s, when it opened prestigious offices in São Paulo, Shanghai, Hong Kong, New Delhi and Moscow.[952] By 2014, BPVi had total assets of €46.5 billion, 654 branches and 5,295 employees, also among the top ten banking groups in Italy.[953]

The troubles for VB started in 2013, when a Bank of Italy inspection detected signs of financial deterioration. VB had not correctly calculated the capital raised through new share issuance, which was financed by granting large or special loans, known as 'kissed loans', to investors.[954] The Bank of Italy's report required adjustments to the loan portfolio value, which significantly affected VB's balance sheet and demanded strengthening its asset base.[955] This was the beginning of a turbulent period for VB, which faced further inspections from the Bank of Italy, CONSOB and the ECB as part of the SSM.[956] These reports revealed a series of violations and misconducts regarding corporate governance and client relations. By 2015, the market for VB shares reflected these ongoing issues, with the share price falling from €39.5 to €30.5 after the annual general meeting.[957]

In December 2015, shareholders approved the 'Serenissima project,' which included: (i) transforming VB from a public cooperative company (*società cooperativa per azioni*) into a joint-stock company (*società per azioni*), (ii) a capital increase up to €1 billion and (iii)

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[949] For an overview of the cases of Venetian banks, see Paolo Giudici, 'The Venetian Banks' Collapse" in Danny Busch, Guido Ferrarini and Gerard van Solinge (eds), *Governance of Financial Institutions* (Oxford, OUP 2019).

[950] Ferrarini and Piantelli (n 864), 494.

[951] ibid.

[952] ibid.

[953] ibid.

[954] ibid.

[955] Bank of Italy, 'Technical Note Transmitted by the Bank of Italy to the Committee of Enquiry of the Regional Council of Veneto' (2016) available at: <Bank of Italy - Technical note transmitted by the Bank of Italy to the Committee of Enquiry of the Regional Council of Veneto> accessed 2 November 2024.

[956] Ferrarini and Piantelli (n 864), 495.

[957] ibid.

listing the bank's ordinary shares on the main market of the Italian Stock Exchange.[958] The ECB viewed the 'Serenissima project' as crucial to avoid severe repercussions. However, the IPO failed, as 98.86% of the public offer of the bank's shares remained unsubscribed, preventing VB's shares from being listed. The Atlante fund stepped in, subscribing for shares worth approximately €988.6 million and obtaining 97.64% of VB's share capital by June 2016. By the end of the year, Atlante injected an additional €628 million into VB.[959]

Efforts to rescue VB escalated in 2017. In January, VB launched a settlement initiative to mitigate legal risks for small shareholders who had seen most of their investments in VB's shares disappear.[960] In February and June, VB issued State-guaranteed bonds amounting to a total of €4.9 billion and in March, it applied for 'precautionary recapitalization' from the Italian Government.[961] Moreover, VB explored a merger with Banca Popolare di Vicenza. Despite these efforts, VB was not admitted to precautionary recapitalization.

BPVi experienced a similar series of events. In 2014, the Bank of Italy identified unauthorized trading in the bank's own shares during an assessment. Prior supervisory critiques of BPVi's behavior escalated. Joint inspections by the Bank of Italy, the ECB, and CONSOB in 2015 uncovered extensive irregularities, including the 'kissed loans' phenomenon, regulatory breaches, and inadequacies in the share valuation process.[962] By mid-2015, BPVi's CET1 ratio and Total Capital Ratio were below the ECB's targets.[963] The share price fell from €62.5 to €48 after the shareholders' meeting in April 2015.[964] As a result, BPVi proposed a recapitalization plan to bring its CET1 and Total Capital back above the minimum targets.[965] This plan included converting into a joint-stock company, raising up to €1.5 billion in capital, and listing the shares on the main market by spring 2016.[966]

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[958] ibid.

[959] European Central Bank, ''Failing or Likely to Fail' Assessment of Veneto Banca Societa per Azioni' (bankingsupervision.europa.eu, 2017) available at: < https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.2017_FOLTF_ITVEN.en.pdf> accessed 2 November 2024, para 4.

[960] ibid., para 7.

[961] Ferrarini and Piantelli (n 864), 495.

[962] ibid, 496.

[963] ibid.

[964] ibid.

[965] ibid.

[966] ibid.

The Extraordinary Shareholders' Meeting approved this plan in March 2016 following an ECB recommendation.[967]

Post-IPO, BPVi's share price was set between €0.10 and €3.00 per share, yet only 7.66% of the global offering was subscribed, preventing the shares from being listed.[968] The Atlante fund then subscribed to BPVi shares amounting to €1.5 billion, securing a 99.33% shareholding by December.[969] Atlante committed an additional €310 million to BPVi.[970] In early 2017, BPVi initiated a settlement with shareholders, while issuing State-guaranteed bonds worth €5.2 billion in February and June.[971] In March, BPVi applied for 'precautionary recapitalization' from the Italian Government and began working on a merger with VB.[972] However, like VB, BPVi was not admitted to precautionary recapitalization.[973]

After prolonged struggles, on 23 June 2017, the ECB declared that VB and BPVi were 'failing or likely to fail', citing repeated breaches of supervisory capital requirements and the inability of the banks to present credible capital plans.[974] The ECB promptly informed the SRB.[975] Nonetheless, the SRB decided against taking resolution action, determining that the resolution of VB and BPVi was 'not necessary in the public interest', based on various reasons applicable to both banks.[976]

More specifically, the SRB determined that the banks' functions, such as deposit-taking, lending activities and payment services, were considered non-critical because they were provided to a limited number of third parties and could be replaced in a satisfactory manner

967 ibid.

968 ibid.

969 ibid.

970 ibid.

971 ibid.

972 ibid.

973 ibid.

974 European Central Bank, 'ECB Deemed Veneto Banca and Banca Popolare di Vicenza Failing or Likely to Fail' (bankingsupervision.europa.eu, 23 June 2017) available at: < https://www.bankingsupervision.europa.eu/press/pr/date/2017/html/ssm.pr170623.en.html> accessed 2 November 2024.

975 ibid.

976 Single Resolution Board (n 929).

within a reasonable timeframe.[977] The SRB concluded that the failure of these banks was unlikely to cause significant adverse effects on financial stability, mainly because of their low financial and operational interconnections with other financial institutions.[978]

Normal Italian insolvency proceedings were deemed capable of achieving resolution objectives to the same extent as formal resolution, providing comparable protection for depositors, investors, other customers and client funds and assets.[979] As a result, both VB and BPVi were wound up under the Italian law of Compulsory Administrative Liquidation, as mandated by Law Decree No. 99/2017. Their businesses, branches and the majority of assets and liabilities were transferred to Intesa Sanpaolo ("**ISP**") through an open, competitive and non-discriminatory process, for €1. ISP acquired €45.9 billion in assets and €51.3 billion in liabilities, while retaining a claim for the imbalance against the two banks.[980] The Italian Government guaranteed risks from VB and BPVi's warranties in the share-purchase agreement and other legal risks up to a maximum of €1.991 billion.[981] Additionally, it provided €3.5 billion to ISP to cover capital needs and an extra €1.285 billion for corporate restructuring as required by the State Aid regime.[982] Non-performing loans not transferred to ISP were moved to SGA SpA, a public bad bank.[983] Untransferred equity participations valued at €1.7 billion and non-transferred liabilities remained with the

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977 Single Resolution Board, 'Notice Summarising the Effects of the Decision Taken in Respect of Banca Popolare di Vicenza S.p.A.' (srb.europa.eu, 2017) available at: < https://www.srb.europa.eu/system/files/media/document/23.6.2017_summary_notice_banca_popolare_di_vicenza_s.p.a._20.00.pdf> accessed 2 November 2024; Single Resolution Board, 'Notice Summarising the Effects of the Decision Taken in Respect of Veneto Banca' (srb.europa.eu, 2017) available at: < https://www.srb.europa.eu/system/files/media/document/23.6.2017_summary_notice_veneto_banca_s.p.a_20.00.pdf> accessed 2 November 2024

978 ibid; see also Single Resolution Board, 'Decision of the Single Resolution Board in its Execution Session of 23 June 2017 Concerning the Assessment of the Conditions for Resolution in Respect of Banca Popolare di Vicenza S.p.A. with the Legal Entity Identifier V3AFM0G2D3A6E0QWDG59, addressed to Banca d'Italia in its capacity as National Resolution Authority (SRB/EES/2017/12) (srb.europa.eu, 23 June 2017) available at: < https://www.srb.europa.eu/system/files/media/document/srb-ees-2017-12_non-confidential.pdf> accessed 2 November 2024; Single Resolution Board, 'Decision of the Single Resolution Board in its Executive Session of 23 June 2017 concerning the assessment of the conditions for resolution in respect of Veneto Banca S.p.A with the Legal Entity Identifier 549300W9STRUCJ2DLU64, addressed to Banca d'Italia in its capacity as National Resolution Authority (SRB/EES/2017/11), accessed 5 November 2024.

979 ibid.

980 Ferrarini and Piantelli (n 864), 498.

981 ibid.

982 ibid.

983 ibid.

banks under liquidation.[984] Small retail investors were reimbursed, under certain conditions, by the inter-banking solidarity fund for 80% of their claim value and by ISP.[985]

The Bank of Italy justified the government's actions in a report to the House of Representatives, stating that the costs of the crises fell primarily on shareholders and subordinated bondholders, adhering to the EU law principle that burdens should first fall on owners and investors to combat moral hazard.[986] As resolution procedures were not activated, there was no need to utilize the bail-in tool, ensuring full protection for liabilities not covered by the Interbank Deposit Protection Fund, such as deposits over €100,000 and ordinary bonds, mostly held by households and SMEs.[987] The Italian Government opted for liquidation aid along the liquidation procedure to identify a buyer and maintain operational continuity for the two banks, which would have ceased in a standard liquidation.[988] Without the precautionary recapitalization, certain retail investors and SMEs would have to incur the losses, negatively impacting the local economy. [989]

On 25 June 2017, the European Commission approved the Italian Government's measures to facilitate the compulsory liquidation of BPVi and VB and their sale to ISP.[990] The SRB had determined that resolution action was not necessary in the public interest for either BPVi or VB, so the Italian authorities had to liquidate the two banks under national insolvency procedures.[991] Italy recognized the significant regional economic impact of the wind-down and sought Commission approval for using national funds to mitigate these effects.[992] Under EU State Aid rules, especially the 2013 Banking Communication, shareholders and subordinated bondholders must fully share the cost, while senior bondholders remain unaffected and depositors are fully protected per EU regulations.[993] The Commission found that the measures complied with EU State Aid rules as existing shareholders and

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984 ibid.

985 ibid.

986 ibid.

987 ibid.

988 ibid.

989 ibid.

990 European Commission, 'State Aid: Commission Approves Aid for Market Exit of Banca Popolare di Vicenza and Veneto Banca under Italian Insolvency Law, Involving Sale of Some Parts to Intesa Sanpaolo' (ec.europa.eu, 25 June 2017) available at: <Commission approves aid for market exit of BPVI and Veneto Banca under Italian insolvency law, involving sale of some parts to Intesa> accessed 2 November 2024.

991 Single Resolution Board (n 977); Single Resolution Board (n 978).

992 European Commission (n 990).

993 Donnelly and Asimakopoulos (n 349), 864.

subordinated debt holders fully contributed, reducing intervention costs for the Italian State.[994] BPVi and VB would be wound up orderly and exit the market, with Intesa restructuring and downsizing the transferred activities.[995] Intesa's deep integration would eventually restore viability to the sold parts. The Commission also confirmed that the measures did not constitute aid to Intesa, as it had been selected through an open, fair and transparent sales process, ensuring the activities were sold at the best available offer.[996]

The Commission further noted that Banca Popolare di Vicenza and Veneto Banca were small Italian commercial banks, primarily operating in Northern Italy.[997] As of December 31, 2016, BPVi had around 500 branches, a market share of about 1% in deposits and around 1.5% in loans, with total assets just below €35 billion.[998] Similarly, Veneto Banca had approximately 400 branches, a market share of about 1% in both deposits and loans and total assets of €28 billion.[999]

6.5 ANALYSIS OF THE RECAPITALISATION OF MPS AND LIQUIDATION OF THE VENETIAN BANKS IN LIGHT OF THE POWER FRAMEWORK

The Italian cases illustrate how core EU member states respond when domestic interests are at risk under EU-level decisions concerning failing banks. In such scenarios, member states often exploit the discretionary authority afforded by the EBU regulations to influence outcomes. In critical situations, core member states will exercise their power to bypass established resolution regimes, advocating for increased flexibility in addressing bank failures. Italy's experience demonstrates how significant political and economic stakes drive countries to navigate or circumvent EU mandates, highlighting the broader tension between centralized directives and individual state interests.

6.5.1 Analysis of the recapitalisation of MPS in light of the power framework

The experience of the precautionary recapitalization of MPS demonstrates the significant discretionary room available to core member states to exercise their power *ex post* to protect domestic interests. Precautionary recapitalization can be employed to "remedy a serious

994 European Commission (n 990).
995 ibid.
996 ibid.
997 ibid.
998 ibid.
999 ibid.

disturbance in the economy of a member state and preserve financial stability."[1000] However, the assessment of what constitutes a serious disturbance under the EU state aid law leaves considerable room for interpretation.[1001] As analysed in section 3.4.2 (*Reasons for the Incompleteness of the EBU Framework*) of chapter 3, the Commission states that "the global financial crisis can create a serious disturbance in the economy of a Member State and that measures supporting banks are apt to remedy that disturbance."[1002] Nonetheless, the Commission's reasoning incorporates the recipient's past economic difficulties without making an explicit connection to the severity or specific implications of the current disturbance.[1003] Furthermore, even smaller banks outside the scope of the SRM have received State aid, thus heightening legal uncertainty in the banking sector.[1004] Therefore, in the absence of a clear legal precedent, member states have considerable latitude to organize precautionary recapitalizations, effectively circumventing the resolution process.[1005]

The Italian state's initiative to retain control over the resolution process and manage the recapitalisation of MPS began with a pointed critique of the EU framework for handling failing banks. Deputy Governor Salvatore Rossi of the Bank of Italy, in his speech delivered on 7 April 2016 criticised the EU bank resolution framework, highlighting its perceived limitations and risks when applied to the specific context of Italy's banking system.[1006] His primary concerns were the *prioritization of objectives* within the EU resolution framework, arguing for flexible application of the bail-in tool and the need for a public backstop.[1007]

More specifically, Rossi sought to exploit the ambiguity in the *hierarchy of objectives* within the EU resolution framework to *frame the mandate* in the way that aligned with his

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[1000] BRRD, Art. 32(4)(d).

[1001] See section 3.4.1(ii)(a) of Chapter 3 above.

[1002] European Commission, 'Decision 2015/455 of 23 July 2014 on the State aid SA.34826 (2012/C), SA.36005 (2013/NN) implemented by Greece for Piraeus Bank Group relating to the recapitalisation and restructuring of Piraeus Bank SA [2015] OJ L 76/30, recital 182.

[1003] European Commission, 'State aid SA.46558 (2016/N) – Greece – Liquidity support to Attica Bank' (ec.europa.eu, 2016) available at: <https://ec.europa.eu/competition/state_aid/cases/266301/266301_1846436_93_2.pdf> accessed 2 November 2024, para 33.

[1004] European Commission, 'State aid: Commission approves restructuring plan for Vestjysk Bank A/S' (ec.europa.eu, 2017) available at: < https://ec.europa.eu/commission/presscorner/detail/en/ip_17_2073>.

[1005] Donnelly and Asimakopoulos (n 349).

[1006] Salvatore Rossi, 'The Banking Union in the European Integration Process' (2016) (bis.org, 7 April 2016) available at: <https://www.bis.org/review/r160413d.pdf> accessed 2 November 2024.

[1007] ibid.

agenda.[1008] He emphasized that while *the objective of protecting taxpayers* is crucial, its mechanical application without room for national discretion could destabilize the financial system.[1009] He argued that the EU framework's homogenous treatment of all banks neglected the unique role banks play in maintaining public confidence and systemic stability, unlike other businesses such as supermarkets or advertising agencies.[1010] In addition, Rossi underscored the necessity of promoting *the objective of financial stability* in Italy.[1011] He asserted that the initial application of the EU resolution regime in countries like Portugal and Italy revealed significant limitations and risks.[1012] The rigid imposition of certain regulations, Rossi argued, can threaten the confidence of savers and thereby destabilize the broader financial system and economy.[1013]

Another point of contention for Rossi was the centralised *exercise of formal authority* in Brussels.[1014] He argued that although some rules within the BRRD allow for discretion to balance multiple resolution objectives (protection of taxpayers, systemic stability, depositors' protection, continuity of financial services), the framework's overarching rigidity leaves little room for pragmatic solutions tailored to national contexts.[1015] Rossi reiterated that, during the negotiations on the BRRD, Italian authorities suggested that the bail-in tool should apply only to newly issued bonds that explicitly included terms authorizing write-downs or conversions under resolution conditions.[1016] They also advocated for delaying the implementation of the new rules until 2018, allowing investors time to adapt and banks to accumulate sufficient bail-in-able liabilities.[1017] However, these recommendations were overridden by political pressures from Northern European countries.[1018]

[1008] Refer to section 4.4.4 (*Control of decision-making processes*) of Chapter 4 for information on how objectives and framing issues serve as sources of power.

[1009] Rossi (n 1006).

[1010] ibid.

[1011] ibid.

[1012] ibid.

[1013] ibid.

[1014] In respect of formal authority as source of power, see section 4.4.4 (*Control of decision-making processes*) of Chapter 4.

[1015] Rossi (n 1006).

[1016] ibid.

[1017] ibid.

[1018] ibid.

Rossi also argued for establishing a temporary public backstop to address scenarios where the bail-in tool might exacerbate systemic risks rather than mitigate them.[1019] According to Rossi, the absence of a public backstop reflected many European countries' reluctance to shoulder even a temporary burden arising from another country's banking crisis.[1020] This highlighted the ongoing tension between EU-wide supervision and national sovereignty.[1021] Furthermore, Rossi criticized the European Deposit Insurance Scheme for lacking a public backstop function for struggling banks and for its protracted transition period.[1022] He pointed out the Northern countries' preference for regulatory harmonization before implementing mutual guarantee schemes, a stance he found inadequate for addressing immediate systemic risks.[1023]

By emphasizing the need for national discretion, Rossi attempted to shift the *decision-making venue* from the EU level back to national law.[1024] He aimed to reposition power, enabling Italy to implement resolution measures that better fit its specific economic and financial environment. This effort to change the venue of authority highlights how powerful actors can frame debates to *shift decision-making to venues* more favourable to their arguments, thereby challenging the centralized *formal authority* exerted by Brussels. In essence, Rossi was seeking to regain a *level of formal authority* for Italy in financial regulation that he felt was overly constrained by the centralized EU resolution framework.

By criticising the existing European regulations, Rossi effectively laid the groundwork for the launch of the Atlante Fund, a private alternative investment fund into which various institutional investors contributed. The primary objectives of the fund were twofold: first, to act as a backstop facility for capital increases by Italian banks by acquiring shares of the affected banks and second, to facilitate the purchase of non-performing loans and property assets from Italian banks.[1025] This move can be seen as a deliberate reaction to the EU new

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[1019] ibid.

[1020] ibid.

[1021] ibid.

[1022] ibid.

[1023] ibid.

[1024] In respect of "control of counter-organisations" as source of power, see section 4.4.4(vii) (*Control of counter-organisations*) of Chapter 4.

[1025] Thomas Hale, Martin Arnold, Rachel Sanderson, 'Italy's Atlante Bank Fund Shoulders Big Burden' (FT.com, 20 April 2016) available at: <https://www.ft.com/content/97508874-0664-11e6-9b51-0fb5e65703ce> accessed 2 November 2024.

regulatory framework. The Atlante Fund served as a mechanism to protect the national banking system, offering a backstop facility as envisaged by Rossi.

The creation of the Atlante Fund can be viewed as a strategic *mobilization of financial resources* to address the banking crisis in Italy.[1026] By securing financial resources internally, Italy significantly bolstered its ability to advance its national agenda at the EU level. This internal financial autonomy allowed Italy to mitigate the constraints imposed by the reluctance of other EU member states to protect bondholders exposed to the failing Italian banks. Unlike other nations that might rely on EU funds for bank recapitalization, Italy's independence in this matter provided it with a unique leverage point. *The ability to control financial flows* internally not only reinforced Italy's negotiating position but also enabled it to promote its preferred policy outcomes without being overly constrained by external pressures. Furthermore, Italy's strategic control over financial resources considerably enhanced its capacity *to deal with uncertainty*.[1027] The establishment of the Atlante Fund demonstrated Italy's proactive approach in safeguarding its banking system, thereby reducing reliance on external financial aid and enabling Italy to promote its national interests even in the face of resistance from EU bodies.

Following the establishment of the Atlante Fund, the Bank of Italy continued to exercise its *instrumental power* to criticize the European resolution framework. On 26th April 2016, the Bank of Italy's governor, Ignazio Visco, criticized European regulations before the Finance and Treasury standing committee of the Italian Senate in Rome.[1028] He argued that the EU regulations limited the interbank deposit protection fund's scope to merely reimbursing deposits, categorizing any other intervention as state aid, despite the fund being privately funded and independently managed.[1029] In light of the power framework, the Bank of Italy leveraged its *expertise in financial regulatory issues* to argue that the EU regulations hindered effective crisis resolution.[1030] By mobilizing its expertise in financial regulatory

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[1026] In respect of mobilisation of financial resources as a source of power, see section 4.4.3 (*Control of Scarce Resources*) of Chapter 4.

[1027] In respect of an actor's ability to deal with uncertainty as a source of power, see section 4.5 (*Structural Power*) of Chapter 4.

[1028] Ignazio Visco, 'Fact-finding Inquiry on the Italian Banking and Financial System and the Protection of Savings, Also Regarding Supervision, Crisis Resolution and European Deposit Insurance' (bis.org, April 2016) available at: <https://www.bis.org/review/r160428a.pdf> accessed 2 November 2024.

[1029] ibid.

[1030] In respect of expertise as a source of power, see section 4.3 (*Instrumental Power*) of Chapter 4 above.

issues, the Bank of Italy aimed to influence public debate and regulatory decisions, positioning itself as an authoritative voice on the matter.

The following day, Stefano De Polis of the Bank of Italy's national resolution authority supported Visco's view. De Polis argued that the conflicting regulations on state aid and the new European legal framework for resolution essentially prevented proactive fund interventions needed to address banking crises effectively.[1031] This statement underscores an *hierarchy of objectives* struggle, indicating that European rules and regulations were constraining Italy's ability to manage financial crises, thereby critiquing the institutional framework that prioritized *the objective of promoting competition over financial stability*. Visco reiterated his stance on 5 May 2016, emphasizing that Italy should not entirely dismiss state aid.[1032] He argued for state intervention to secure banks' investors, including subordinated debt holders, in the event of a systemic crisis *and prioritize financial stability over other objectives*.

Both Visco's and De Polis's statements reflect a high level of reluctance by the Bank of Italy to fully implement the EBU resolution framework. Their critique of the application of the bail-in tool to wind down subordinated debtholders highlights an institutional struggle over *formal authority*. They argued that the current procedures and rules excessively limited the Bank of Italy's options in managing crises, calling for a revision of these rules to allow for more effective and equitable crisis management strategies. By doing so, they aimed to influence the broader regulatory framework at the EU level, advocating for changes that would enhance Italy's capacity to address financial instability.

On 4 July 2016, the ECB increased the capital requirements for MPS to address the high level of non-performing loans and outline a recapitalization plan.[1033] In response, the Italian government expressed significant concerns and criticized the ECB for its lack of prior communication.[1034] The Italian finance minister specifically condemned the ECB for failing

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[1031] Stefano De Polis, 'Protection of Bank Deposits within the Framework of the European Banking Union' (Presentation, Director of the Resolution and Crisis Management Unit, Bank of Italy) available at: <https://www.bancaditalia.it/pubblicazioni/interventi-vari/int-var-2016/depolis-270416.pdf> accessed 2 November 2024.

[1032] Ignazio Visco, 'Workshop On Stability of the Banking System' (bancaitalia,it,5 May 2016) (Keynote Speech by Ignazio Visco, Governor of the Bank of Italy) available at: <https://www.bancaditalia.it/pubblicazioni/interventi-governatore/integov2016/visco-050516.pdf?language_id=1> accessed 2 November 2024.

[1033] European Parliament (n 941), 2.

[1034] ibid; Silvia Aloisi and Balazs Koranyi, 'Italy Criticises ECB Over Monte Paschi Capital Decision' (reuters.com, 2016) available at: <Italy criticises ECB over Monte Paschi capital decision | Reuters> accessed 2 November 2024.

to provide adequate explanations regarding the decision to raise the capital requirements for the bank, highlighting a lack of transparency and communication in the decision-making process.[1035] The Italian government's criticism of the ECB's decision reflects a strategic use of *instrumental power, particularly through lobbying and advocacy*.[1036] By publicly raising concerns and condemning the ECB's lack of communication, the Italian finance minister sought to exert pressure on the ECB and influence its decision-making processes.

During the same period, the Italian government began to face mounting pressure from local politicians to bail out investors. On 11th July 2016, Enrico Rossi, the President of the Tuscany region, asserted that if state intervention became necessary for MPS, the responsible managers should be held accountable and replaced by individuals with lower salaries.[1037] Rossi also emphasized the political necessity of protecting pensioners.[1038] The following day, Antonio Patuelli, President of the Italian Banking Association (ABI), argued that the BRRD needed to be balanced against the Italian Constitution, which states that the Republic "encourages and protects" saving.[1039]

The Italian government's actions illustrate the use of *formal authority*, where figures like Enrico Rossi leveraged their official positions to push for specific responses to the banking crisis. Rossi's statements called for the replacement of MPS managers, emphasizing accountability and protection for pensioners, thereby using his *formal authority* to influence public opinion and guide the government's response. Similarly, Patuelli's invocation of Article 47 of the Italian Constitution represents an appeal to *formal legal structures and norms*.[1040] By emphasizing the constitutional mandate to protect savings, Patuelli strengthened the argument for balancing BRRD with national financial stability policies. This appeal to constitutional authority underscores the formal power embedded in Italy's legal and political institutions, reinforcing the legitimacy of their stance against the EU regulations.

[1035] ibid.

[1036] In respect of expertise as a source of power, see section 4.3 (*Instrumental Power*) of Chapter 4 above

[1037] Jan A. Timmerman, 'Italy and the Banking Union' (utwente.nl, 10 July 2019) available at: <https://essay.utwente.nl/79155/1/Timmermann_BA_BMS.pdf> accessed 2 November 2024.

[1038] ibid.

[1039] Silvia Merler, 'Italy's Bail-in Headache' (bruegel.org, 19 July 2016) available at: <https://www.bruegel.org/blog-post/italys-bail-headache> accessed 2 November 2024.

[1040] ibid.

The *control of counter-organizations* is illustrated by how the Italian government and the Bank of Italy aligned their positions and effectively represented the interests of the Italian banking industry. Although the ABI (Italian Banking Association) maintained a relatively quiet public presence on the issue, its interests were strongly advocated for by government officials and the Bank of Italy. Patuelli's public statement invoking constitutional protections further amplified this alignment. This tactic denotes a strategic *control of counter-organizations*, where the government and the Bank of Italy became the primary voices for the banking sector, thus centralizing the advocacy effort and presenting a united front in negotiations with European authorities. The support from the Italian Banking Association underscored that the banking industry's strategic interests were already being addressed through official government channels, negating the need for a more overt public stance by the ABI.

On 29 July 2016, the EBA released the results of its stress tests, identifying MPS as the weakest bank in the EU.[1041] In response, MPS proposed a strategy to raise €5 billion from private investors to avoid implementing a bail-in for subordinated debt holders and equity investors.[1042] The strategy included using the Atlas fund to address the bank's bad loans.[1043] Meanwhile, Italian public officials, the Italian Banking Association and the Italian central bank strongly advocated against the bail-in of subordinated debt holders, ensuring that the plan excluded any recapitalization measures for subordinated debt.[1044]

On 8 August 2016, the Italian government, in partnership with the Bank of Italy, supported the launch of the Atlante II Fund.[1045] This initiative aimed to address the significant issue of non-performing loans ("**NPLs"**) plaguing the Italian banking system. Unlike its predecessor, which had a broader mandate, Atlante II was specifically designed to focus exclusively on acquiring and managing NPLs.[1046] These non-performing loans had been a substantial burden on bank balance sheets, affecting liquidity and overall financial stability.

[1041] Christos Hadjiemmanouil, 'Monte dei Paschi: A Test for the European Policy Against Bank Bailouts' (blogs.law.ox.ac.uk, 2 May 2017) available at: <https://blogs.law.ox.ac.uk/business-law-blog/blog/2017/05/monte-dei-paschi-test-european-policy-against-bank-bailouts> accessed 2 November 2024.

[1042] Andrea Miglionico, 'The Restructuring of Monte Dei Paschi di Siena: A Controversial Case in the EU Bank Resolution Regime' (2019) 30(3) European Business Law Review 469, 477.

[1043] ibid.

[1044] ibid, 483.

[1045] Valentina Za and Andrea Mandala, 'Italian Bank Rescue Fund Atlante to Buy More Bad Loans' (reuters.com, 22 November 2016) available at: < https://www.reuters.com/article/business/italian-bank-rescue-fund-atlante-to-buy-more-bad-loans-idUSKBN13H0TU/> accessed 2 November 2024.

[1046] ibid.

By pooling resources from both public and private investors, including major banks and insurance companies, Atlante II sought to purchase these distressed assets at discounted rates and manage their recovery over time. Quaestio Capital Management SGR was appointed to oversee the fund, leveraging its expertise to identify worthwhile investment opportunities and develop strategies for asset recovery and liquidation.

Despite these efforts, MPS was unable to secure private investors, leading to a further deterioration in its financial position. On 9 December 2016, MPS requested an extension from the ECB until 20 January 2017 to raise additional capital. However, the ECB denied this extension request.[1047] On 19 December 2016, MPS made a final appeal to institutional investors to purchase shares to meet recapitalization requirements.[1048] Yet, these efforts failed to generate sufficient capital.[1049] The bank missed the projected deadline of 22 December 2016 and no private sector involvement materialized. Due to the absence of an anchor investor and lack of private sector engagement, the Atlante fund withdrew its support, attributing increased risk perception by private investor Quaestio Capital Management SGR.[1050]

The absence of private sector involvement and the subsequent withdrawal of support by the Atlante Fund underscore a fundamental structural constraint faced by the Italian government. MPS had limited *structural power* within Italy's banking network, leading to a lack of strong incentives for private investors to participate in its recapitalization. The marginal position of MPS within the broader financial landscape meant that other financial entities had limited exposure to its potential failure, reducing their motivation to intervene. This situation reflected a broader preference within the banking industry for a government-led recapitalization, which aligned more closely with their interests. Private investors, concerned about the heightened risk associated with MPS, were unwilling to commit capital without a more secure anchor, leading to their withdrawal. Consequently, the Italian

[1047] Harry Yorke, 'ECB Rejects Bailout Extension for Monte dei Paschi as shares plummet' (telegraph.co.uk, 9 December 2016) available at: <https://www.telegraph.co.uk/business/2016/12/09/european-markets-remain-buoyant-investors-digest-yesterdays/> accessed 2 November 2024.

[1048] Ben Martin, 'Monte Dei Paschi Rescue Thrown into Turmoil' (telegraph.co.uk, 19 December 2016) available at: < https://www.telegraph.co.uk/business/2016/12/19/monte-dei-pasci-rescue-thrown-turmoil/> accessed 2 November 2024.

[1049] ibid.

[1050] Timmerman (n 1037), 29.

government was left with no choice but to step in, highlighting the industry's strategic push for a resolution that shifted the financial burden onto the state.

The withdrawal of support from the Atlante fund was a significant loss for both the central bank and the government. Initiated by these institutions, the fund was envisioned as an alternative to the deposit guarantee scheme, aimed at providing capital to distressed banks. However, the fund could not match the structure of the Italian Deposit Guarantee scheme, which was previously under the direct supervision of the Bank of Italy.[1051] The newly established private structure of Atlante did not permit the government or the Bank of Italy to leverage the fund's capacities.[1052] Moreover, the banking industry showed reluctance to rescue MPS at their expense, preferring instead a government-led recapitalization.[1053] The structural dynamics at play reveal the broader implications of network positioning within the financial sector. Banks and financial institutions with greater centrality and interconnectedness wield more influence and have more robust safety nets, both from private peers and public institutions.

On 23 December 2016, MPS requested a precautionary recapitalization from the Italian government.[1054]As part of the process, the ECB confirmed to the Italian Ministry of Economy and Finance, as well as the European Commission, that MPS had a capital shortfall amounting to €8.8 billion under the adverse scenario of the 2016 stress test. This confirmation was based on Q3 2016 data, which were the latest available at that time.[1055] Additionally, the ECB provided a solvency statement and affirmed MPS's liquidity status.[1056]

On the following day, the Italian government enacted Law Decree No. 237/2016, later converted into Law No. 15/2017, which set forth a €20 billion bailout package aimed at assisting troubled banks.[1057] This decree outlines public financial support intended to

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[1051] Quaglia and Howarth (n 403).

[1052] Timmerman (n 1037), 29.

[1053] ibid.

[1054] State guarantees were provided pursuant to Law Decree No 237/2016, art 7, which was approved by the Council of Ministers on 23 December 2016.

[1055] Internationally Monetary Fund, 'Euro Area Policies – Financial Sector Assessment Program: Technical Note – Bank Resolution and Crisis Management' (img.org, July 2018) IMF Country Report No. 18/232 available at: <Euro Area Policies: Financial Sector Assessment Program-Technical Note-Bank Resolution and Crisis Management> accessed 2 November 2024, 12.

[1056] ibid.

[1057] Single Resolution Board (n 978), Recital 26.

manage banking crises through both liquidity support and public recapitalization measures. The liquidity support provisions include state-backed guarantees on liabilities issued subsequent to the decree's implementation. Concerning public recapitalization, the Italian government is enabled to inject capital into banks as a precautionary measure. Although the Italian bailout decree introduces burden-sharing elements, it is designed to largely exclude certain creditor groups from bail-in proceedings.[1058] As stipulated by the Law Decree, only shareholders and holders of hybrid and subordinated bank bonds are subjected to the burden-sharing arrangement. Additionally, the decree instituted a compensation mechanism to safeguard retail investors, ensuring they receive new financial instruments as part of the burden-sharing process.[1059]

As noted in section 4.4.1 (*Rule-making power)* of chapter 4, the structure of any legal order directly influences the power dynamics within an organizational field and rulemaking serves as a strategic tool with which powerful actors can shape desired outcomes. By establishing the bail-out fund, Italy *exercised its rulemaking power* to create an alternative mechanism to address the country's specific economic and financial needs. This move allowed Italy to specify acceptable behaviours and actions within its banking system, effectively carving out a regulatory niche that better suited its national interests while challenging European centralization. This highlights Italy's ability to leverage r*ulemaking power* to impose its interpretation and priorities, thereby establishing new rules under which national objectives could still be met, demonstrating an alternative approach within the bounds of existing EU regulations.

On 21 June 2017 the ECB issued another solvency statement for MPS, this time based on Q1 2017 figures.[1060] Subsequently, on 26 June 2017, the Atlante II fund agreed to acquire bad loans from MPS.[1061] These steps facilitated the approval of a precautionary recapitalization by the European Commission on 4 July 2017, amounting to up to €5.4

[1058] Article 22(1) of Law Decree No. 237/2016 stipulates the framework for loss allocation among creditors, specifying that "the Minister of Economy and Finance shall subscribe to the Issuer's shares under Article 18 only following the burden-sharing process as outlined in this article, with the objective of minimizing the use of public funds.

[1059] The Ministry of Finance may step in to purchase shares, providing investors with ordinary bonds from the bank, issued at par either by the bank itself or an affiliate within the same group, equal in value to the amount spent by the Ministry on acquiring the shares. Access to the compensation scheme is restricted to specific conditions: (1) it is available solely to retail investors, excluding qualified or professional investors and (2) the Ministry of Finance may facilitate a settlement agreement between a bank and these investors to prevent or resolve disputes related to the sale of converted instruments.

[1060] International Monetary Fund (n 1055), 12.

[1061] ibid.

billion.[1062] The approval included a mandate for a five-year restructuring plan to pivot MPS's focus towards retail banking and to offload €26 billion worth of bad loans, as valued at the end of 2016.[1063]

Several commentators have expressed concerns about the ECB's decision that deemed MPS as not failing, especially given the lingering doubts regarding the bank's viability had persisted for months.[1064] An important thing to note about the decision-making process for approving precautionary recapitalization is its highly private nature, relying on information that is not publicly available.[1065] This confidentiality is purportedly maintained to protect financial stability, but it also allows national authorities and EU bodies to control the *flow of important information*. By limiting public disclosure, these authorities can navigate the decision-making process without external scrutiny, thus retaining significant power. This *control over information* is a significant source of power, enabling core states to manage the narrative and influence outcomes to align with their national priorities.[1066] By *framing issues* and selectively releasing information, the Italian authorities could shape the agenda to suit their interests, effectively guiding the EU bodies.[1067]

The end result of the MPS crisis was largely driven by Italy's vested interest in protecting domestic taxpayers and responding to strong calls from various policy officials to avoid a bail-in, especially in the sensitive context of the October 2016 Italian referendum. The political costs associated with imposing a bail-in, which would have directly affected retail investors, coupled with the upcoming referendum, heightened the urgency for a government-led solution. This domestic imperative influenced decision-making at the EU level, as Italian authorities leveraged their instrumental and institutional power to assert significant pressure on EU bodies. Ultimately, these domestic dynamics, including political considerations and the need to maintain public confidence, played a critical role in guiding

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[1062] ibid.

[1063] ibid.

[1064] Martin G. Gotz, Jan Pieter Krahnen and Tobias Troger, 'Taking Bail-in Seriously – The Looming Risks for Banking Policy in the Rescue of Monte Paschi di Siena' (elischolar.library.yale.edu, 2017) SAFE Policy Letter No. 54 available at: <https://elischolar.library.yale.edu/ypfs-documents2/2796/> accessed 2 November 2024.

[1065] ibid.

[1066] In respect of control of information as a source of power, see section 4.5 (*Structural Power*) of chapter 4.

[1067] Refer to Section 4.4.4(viii) (*Control of Counter-organisations*) for an in-depth discussion on how framing issues can serve as a powerful tool.

the European Commission's approval process, allowing Italy to secure a precautionary recapitalization that aligned with its national priorities.

This section analyzed how the Italian government and the Bank of Italy actively leveraged their *instrumental power* through lobbying and public criticisms to influence policy discussions at both the national and EU levels, aiming to secure favorable treatment for MPS. Political representatives, officials from the Bank of Italy and Italian resolution authorities utilized their *formal authority* to advocate for changes in the EU resolution framework, invoking constitutional mandates *to shift decision-making processes from the EU to more favorable national venues*. The alignment between the Italian government, the Bank of Italy and the Italian Banking Association illustrated strategic *control over counter-organizations* in relation to the EU bodies. By presenting a unified front in advocating for the domestic banking sector's interests, Italian authorities ensured that these positions were effectively represented and integrated into broader national policy strategies. Through the establishment of the Atlante Funds and the government bail-out fund used for the recapitalisation of MPS, Italy used its *rule-making powers* to mobilize *internal financial resources*, significantly strengthening its negotiating position within the EU. This *control over financial resources* reduced the country's reliance on external financial aid and allowed for greater control over the resolution process. The hesitation of the Atlante Fund to engage in the recapitalization of MPS highlighted *the importance of structural power* and illustrated that failing institutions at the center of the financial network might have more access to funds. Finally, the decision-making processes of EU bodies concerning the precautionary recapitalization of MPS, conducted behind closed doors, facilitated *the control of information flows*. This confidentiality enabled Italian authorities to guide narratives and influence outcomes without external scrutiny, ensuring that policy decisions aligned with national priorities.

Timeline of the MPS recapitalisation

Date	**Event**
7 April 2016	Salvatore Rossi, deputy governor of the Bank of Italy, criticises the European regulations on bank resolution and calls for more flexibility and pragmatism
11 April 2016	The Italian government announces the launch of the Atlante fund, a private alternative

	investment fund to support capital increases and non-performing loans of Italian banks
26 April 2016	Ignazio Visco, governor of the Bank of Italy, criticises the European restrictions on the interbank deposit protection fund and argues for the possibility of state aid in case of systemic crisis
27 April 2016	Stefano De Polis, member of the Bank of Italy's national resolution authority, supports Visco's criticism and claims that the EU rules on state aid and resolution limit the effective crisis management and the protection of creditors' rights
5 May 2016	Visco reiterates his opposition to the bail-in tool and suggests that the state should intervene and protect subordinated bondholders in case of bank failure
4 July 2016	The ECB raises its capital requirements for MPS and asks the bank to reduce its non-performing loans and develop a plan of recapitalisation. The Italian government and the Bank of Italy express their concerns and dissatisfaction with the ECB's decision
11 July 2016	Enrico Rossi, president of the Tuscany region, calls for the protection of pensioners who invested in MPS and the accountability of the bank's managers
12 July 2016	Antonio Patuelli, president of the Italian Banking Association (ABI), states that the BRRD needs to be balanced against the Italian Constitution, which protects saving
29 July 2016	The EBA publishes the results of the stress tests, showing that MPS is the weakest performer in the EU. The bank presents a plan to raise 5 billion euros of capital from private investors and to offload its bad loans to the Atlante fund, in order to avoid the bail-in of subordinated bondholders
8 August 2016	The Italian government and the Bank of Italy launch Atlante II, a fund focused solely on non-performing loans in the banking system
9 December 2016	MPS asks the ECB to extend until 20 January 2017 the deadline to raise more capital, but the ECB rejects the request

19 December 2016	MPS makes a final call to institutional investors to invest in shares and asks its subordinated bondholders to swap their bonds to equity, but the bank fails to raise sufficient capital
22 December 2016	MPS formally requests state aid for a precautionary recapitalisation
23 December 2016	The Italian cabinet announces that the bank will be rescued with a 20 billion euro fund that has been established for the banking sector and approved by the parliament earlier in the week
4 July 2017	The European Commission approves the precautionary recapitalisation of MPS

6.5.2 Analysis of the liquidation of the Venetian Banks in light of the power framework

As noted in section 4.4.4(v) (*Objectives*) of Chapter 4, following the ECB's determination that a credit institution is failing or likely to fail, the SRB must assess whether resolution is in the public interest. A resolution is deemed to be in the public interest if it is necessary for the achievement of the resolution objectives which include (i) ensuring the continuity of the failing credit institution's critical functions, (ii) avoiding significant adverse effects on financial stability, (iii) protecting public funds by minimizing reliance on extraordinary public financial support and (iv) protecting deposits or client assets. If these conditions are not met, the failing bank must be liquidated under domestic law.[1068]

The Italian government used its *instrumental power* to lobby for a solution that excluded the bail-in of senior bondholders and deposit holders. Italy's finance minister Pier Carlo Padoan entered into close talks with EU authorities behind closed doors to achieve a result to this effect.[1069] The Italian treasury repeatedly stated that "the minister reiterates that the solution does not foresee any form of bail-in and senior bondholders and deposit holders will in any case be completely guaranteed".[1070] These statements are in contradiction with

[1068] BRRD, Article 32.

[1069] Rachel Sanderson, 'Italian Finance Ministers Assures Rescue for Struggling Banks is Near' (FT.com, 13 June 2017) available at: < https://www.ft.com/content/8fcd2616-bf0f-3a74-b65a-69a55435d213> accessed 2 November 2024.

[1070] ibid.

the EU bail-in legislation which explicitly provides for the bail-in of senior creditors of failing credit institutions. [1071]

The SRB has broad discretion in its *ad hoc* assessment of whether a resolution aligns with the public interest. This discretion can lead to varied interpretations and potentially controversial decisions. In the cases of VB and BPVi, institutional views diverged: the SRB found no public interest in resolution, whereas the Commission identified sufficient public interest to justify state aid for the Veneto banks' national liquidation. The SRB stated that the resolution was not in the public interest as: (i) the banking functions performed by the banks were not critical, as they were provided to a limited number of third parties and were capable of being replaced in an acceptable and timely manner, (ii) a potential failure would be unlikely to cause significant adverse effects on financial stability due to low interconnectedness and (iii) normal Italian insolvency proceedings would achieve the objectives of resolution just as well as the resolution itself.[1072] On the contrary, the Commission determined that the state aid was necessary to prevent a serious disturbance in the Italian economy, particularly to the potential system-wide contagion effects of the bank's liquidity crisis.[1073] The Commission found the measure appropriate, necessary and proportionate given that it was limited to EUR 3.5 billion with a guarantee only on new issuances of senior debt and maturities between three months to three years and the Veneto banks' commitment to several behavioural safeguards such as suspending dividend payments, banning acquisitions and restricting advertisements related to State support.[1074]

Two days after the SRB's decision, the Italian government adopted an Italian Decree, according to which extraordinary and urgent measures could be taken on the treatment of bank failures, subject to the approval by the Commission under the state aid rules. The provisions of this decree provided for the forced transfer by the insolvency administrator of the bank's businesses to the higher bidder excluding subordinated debt outstanding litigation claims, combined with the provision of public support by the Italian government

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[1071] SRM Regulation, Article 27.

[1072] Single Resolution Board (n 978).

[1073] European Commission, 'State Aid SA.47150 (2016/N) – Italy – Liquidity support to Veneto Banca' (ec.europa.eu, 18 January 2017) C (2017) 328 Final available at: < https://ec.europa.eu/competition/state_aid/cases/267518/267518_1978814_104_2.pdf> accessed 3 November 2024, para 40.

[1074] ibid, paras. 43-44.

to the higher bidder in the form of €4.785bn direct cash payment, as well as ancillary guarantees up to €11.2 billion.[1075] The excluded liabilities and the NPLs were transferred to a risk management company.[1076] The subordinated bonds issued by Veneto banks were not transferred to Intesa, which however, paid €60 million restitution to the retail depositors that held such bonds, with another €140 million being paid, if needed, by the banking sector.[1077]

The Italian government adeptly navigated the flexibility provided by the public interest clause, exploiting the absence of a *clear hierarchy in the EU's resolution objectives* to push for bank liquidation under national law. The lack of explicit guidance on the prioritization of these objectives at the EU level allowed Italy to argue that initiating resolution proceedings at the EU level was unnecessary. By framing the banks' size and interconnectedness as insufficient to justify an EU-level intervention, the Italian authorities contended that liquidation under national law would yield similar results.[1078] This strategic approach enabled Italy *to shift the decision-making process* to national fora, thereby allowing the Italian public officials to reframe the agenda to better serve domestic interests. In essence, the ambiguity in the EU's resolution *objectives* provided core states like Italy with the latitude to tailor the resolution process to their specific needs, bypassing more stringent EU-level measures.

Under the SRM, the European Commission has the authority to object to the resolution schemes proposed by the SRB on public interest grounds. However, it is notable that the Commission chose not to publicly express any concerns over the SRB's decisions relating to the Veneto banks, even though it later deemed there was public interest justifying state aid by the Italian authorities. The initial cases reveal that the legal framework is designed more to mitigate legitimacy concerns rather than pose a substantial obstacle.[1079] As highlighted in Section 4.4.4 (*Decision-making process*), the *sequence of decision-making* is

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[1075] Rachel Sanderson, 'Intesa Sanpaolo Forecasts €675m a Year in Savings from Veneto Bank Layoffs' (FT.com, 21 December 2017) available at: < https://www.ft.com/content/899fe3ab-178f-3dc1-b78d-58cfbab352b4> accessed 3 November 2024.

[1076] Donnelly and Asimakopoulos (n 349), 866.

[1077] ibid.

[1078] Lucrezia Reichlin, 'The European Banking Union Falls Short in Italy – Veneto Brings a Lesson on How to Deal with Failing Banks' (FT.com, 27 June 2017) available at: <https://www.ft.com/content/3b8bc570-5a7e-11e7-b553-e2df1b0c3220> accessed 3 November 2024.

[1079] Merijin Chamon, 'The Empoweremnt of Agencies under the Meroni Doctrine and Article 114 TFEU: Comment on United Kindgom v. Parliament and Council (*Short-selling*) and the Proposed Single Resolution Mechanism' 2014 3 European Law Review 380.

important. Although the Commission can object to resolution schemes based on public interest, the ultimate decision rests with the Council. This involvement of the Council injects a political dimension into the process, as politicians may prioritize short-term electoral gains over long-term financial stability. In this instance, many Italian retail investors were exposed to the Veneto banks, the Italian finance minister was reluctant to approve a bail-in for these investors and likely sought to influence the SRB's decision accordingly. The SRM Regulation appears designed to allow politicians from core EU countries to control the decision-making process, enabling intervention if the SRB adopts a resolution scheme opposed by influential political figures. In this context, it appears the Commission opted not to object, fully aware of the preferences of the Italian finance minister.

The *timing of decisions* within the SRM influences power dynamics, often allocating greater power to core member states. The stringent time limits imposed on the Commission for making crucial decisions relating to bank resolutions are a notable factor. For instance, in the Banco Popular case analysed above, the entire process from the SRB's proposal to the Commission's endorsement transpired within just 77 minutes.[1080] This brief timeframe suggests that the Commission is either unable to conduct a comprehensive assessment of each resolution decision within such a constrained period or that the SRB, the Commission and the Council pre-agree on the proposed actions long before the official decisions, likely through negotiations behind closed doors.[1081] The reliance on expedited, behind-the-scenes negotiations inherently benefits those core member states *well-integrated into informal policy networks*, granting them early access to information and enabling them to shape the decision-making agenda to their advantage.

The lack of a clear hierarchy of objectives, the discretionary nature of the public interest concept and the sequence of the decision-making process enabled the Italian authorities to *redirect the decision process from EU bodies to national entities, a venue more favorable to their local interests*. Leveraging its *rule-making powers*, Italy enacted a decree permitting the provision of state aid to the Venetian banks. By doing so, Italy effectively ensured that the resolution would be handled in a manner aligned with national interests rather than

[1080] Richard Crump, 'Banco Popular Investors Say EU Officials Doomed Bank' (law360.co.uk, 17 August 2017) available at: <https://www.law360.co.uk/articles/955209/banco-popular-investors-say-eu-officials-doomed-bank> accessed 3 November 2024.

[1081] Donnelly and Asimakopoulos (n 349), 865.

broader EU-imposed criteria. This *level of control over rule-making* allowed the Italian government to craft a more favorable outcome for local stakeholders, thereby minimizing political fallout.

Moreover, Italy's ability to *mobilize substantial financial resources internally*, without relying on EU funds, played a pivotal role in its approach to recapitalizing the Veneto banks in accordance with domestic preferences. The decree adopted by the Italian government enabled the compulsory transfer of the bank's business to the highest bidder by the insolvency administrator. Intesa Sanpaolo acquired the viable assets of the two Veneto banks with government support, including a €4.785 billion direct cash payment to protect its capital ratios and €11.2 billion in state guarantees.[1082] By providing significant financial backing independently without recourse to EU funds, Italy could tailor the resolution process to its own preferences avoiding potential opposition from other member states. For Intesa Sanpaolo, this deal was highly beneficial as it allowed the bank to acquire valuable assets at a favorable price, bolstered by substantial financial support from the Italian government. The transaction significantly enhanced Intesa's market position, enabling it to compete more effectively on the EU level against other major banks.[1083]

The handling of the Italian banking crisis faced significant criticism, with commentators arguing that the approach undermined the EBU resolution regime intended to prevent the use of public funds for bank rescues.[1084] Some commentators contended that the liquidation of Italian banks was "a slap in the face of Italian taxpayers... a dagger in the heart of the banking union."[1085] Critics believed that earlier intervention by the ECB could have resulted in smaller losses for taxpayers.[1086] The issue of non-performing loans had been known to investors long before the crisis escalated and it was felt that these banks should have been

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[1082] Sanderson (n 1075).

[1083] In addition to the cash payments and guarantees provided by the Italian state, Intesa Sanpaolo also retained the regional banks' tax credits amounting to €1.9 billion, see FT Opinion, 'Italian bailout: too small to fail' (FT.com, 26 June 2017) available at: < https://www.ft.com/content/53c99c18-5a63-11e7-9bc8-8055f264aa8b> accessed 3 November 2024.

[1084] Claire Jones and Caroline Binhan, 'ECB Supervisor Defends Role in Italian Banking Crisis' (FT.com, 4 July 2017) available at: <https://www.ft.com/content/c813eb7e-5fdf-11e7-91a7-502f7ee26895> accessed 3 November 2024.

[1085] Martin Sandbu, 'Italy Cheats Itself- Bank Bailout Is a Recoverable Setback For the Banking Union' (FT.com, 28 June 2018) available at: < https://www.ft.com/content/84b8bd46-5b3e-11e7-b553-e2df1b0c3220> accessed 3 November 2024. .

[1086] Opinion, 'Italy Shows EU Banking Union Still Has Far to Go: Two Imperfect Liquidations Need Not Stop Financial Integration' (FT.com, 26 June 2017) available at: <https://www.ft.com/content/f01db25e-5a70-11e7-9bc8-8055f264aa8b> accessed 3 November 2024.

dissolved years prior.[1087] The ECB was criticized for its delay in action, not intervening before declaring the banks "failing or likely to fail."[1088] The perceived lack of decisive measures from both Italian authorities and the ECB ultimately worsened the outcome, failing to respect the spirit of the European resolution framework.[1089]

In response to these comments, Ms. Lautenschlager, a member of the ECB's executive board, clarified that it is not within the remit of the SSM to decide “whether the taxpayer is affected” and, if so, to what extent.[1090] She highlighted the challenge supervisors face in balancing their decisions on when to intervene, noting that shareholders and debtors also have rights that need to be respected.[1091] Ms. Lautenschlager is correct in asserting that insolvency is not a binary state and bank's difficulties can manifest in various degrees and forms. Thus, caution is paramount when determining whether a bank is failing. However, her comments on taxpayer money signal an important acknowledgment: when it comes to fiscal costs, the decision-making process extends beyond the remit of supervisory authorities like the ECB and the SRB and falls into the hands of member states. This essentially makes such decisions political. In addition, it is important to note that the Italian banks were experiencing significant struggles well beyond minor difficulties and had been in this precarious situation for months.[1092] Any hesitation in declaring that a bank is failing due to concerns over financial stability was mitigated by the fact that the size of these banks was not considered systemically significant, either at the EU or national level. In addition, if ECB officials are hesitant to declare a bank as failing due to potential litigation issues, one must consider how these concerns will be amplified in the case of systemic banks. Such institutions, typically headquartered in core jurisdictions, involve multiple stakeholders, thereby increasing the uncertainty related to both financial stability and stakeholder impacts.

The handling of the crisis by the Venetian banks caused significant discontent among German politicians, who felt it contravened the regulatory framework established after the financial crisis designed to prevent the use of taxpayer money in banking rescues. Markus

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[1087] ibid,

[1088] ibid.

[1089] ibid.

[1090] Jones and Binhan (n 1084).

[1091] ibid

[1092] Marcus Ashworth, ‘A Curious Calm in Italy’s Drama’ (Bloomberg.com, 5 May 2017) available at: <https://www.bloomberg.com/gadfly/articles/2017-05-05/a-curious-calm-in-italy-s-drama> accessed 3 November 2024.

Ferber, a close ally of Chancellor Angela Merkel and vice-chair of the EU Parliament's Economics Committee, articulated that the plans indicate "the promise that the taxpayer will not stand in to rescue failing banks any more is broken for good."[1093] Carsten Schneider, a Social Democrat Bundestag whip and budget policy expert, warned that such decisions discredit the efforts to complete the banking union and push the creation of a common deposit-guarantee scheme further into the future.[1094] Schneider emphasised that the Italian government's decision was a "grave mistake."[1095]

Despite these strong criticisms, Germany had no direct stake in the resolution of the Veneto banks. There were no German creditors tied to these banks and their collapse did not threaten Eurozone financial stability as they were not systemically important. Furthermore, Italy did not seek financial assistance from EU public funds. The primary concern for Germany was the implication that state aid to Italian banks might suggest an implicit guarantee by the Italian government to senior bond investors, undermining the EU's resolution mechanism. Additionally, Germany was worried that any precedence of using EU common funds to bail out banks would have significant fiscal implications for Germany, affecting its financial responsibilities within the EU.

As core member states within the EU, Germany and Italy operate on balanced terms, with no incentives for Germany to prevent the liquidation of these banks or interfere further. The nature of negotiations between such core states respects this equilibrium, preventing undue influence over one another's domestic policies. In this context, Germany's criticism of the Italian resolution authority's approach can be interpreted as a strategic move to discourage support for an EU-wide deposit insurance scheme, aligning with its broader economic priorities of maintaining fiscal discipline. While voicing disapproval, Germany refrained from deeper involvement, acknowledging *the equal power dynamics* and lack of direct interests affected.

[1093] Jim Brunsden, 'Berlin Leads Backlash Against Italian Bank Rescue – Germany Wants to Close EU Loophole That Allows Senior Debtholders to Escape Losses' (FT.com, 26 June 2017) available at: <https://www.ft.com/content/71ece778-5a53-11e7-9bc8-8055f264aa8b> accessed 3 November 2024.

[1094] ibid.

[1095] ibid.

6.6 CONCLUSION

The case studies examined in this chapter illustrate that the EBU resolution regime is not an impartial and rigid framework but rather a flexible and highly politicized system. The policy outcomes within this regime are significantly influenced by the political preferences and economic interests of the Eurozone core countries, which shape the application and enforcement of the EBU rules in practice. The resolution of banking crises across different member states reveals a nuanced landscape of power dynamics, where the interests of core states often take precedence, leading to divergent approaches to resolution.

The resolution of the Cypriot banking crisis, occurring before the establishment of the EBU, remains a critical example highlighting that core EU states can substantially dictate the terms and conditions imposed on periphery states. Guided by a precedent-setting approach, this crisis showcased how stringent measures, including the controversial bail-in of large depositors, were employed to stabilize the broader Eurozone financial system, underscoring the power asymmetry within the EU. The reliance of Cyprus on financial assistance from core EU states and institutions exposed the disparities and challenges periphery states face, setting the stage for understanding the political nature of subsequent EBU resolutions.

The resolution of Banco Popular in Spain under the EBU resolution framework reveals that when the political costs for core states are minimal, the EBU rules can be stringently applied. The successful resolution, characterized by the bail-in of international investors and the acquisition by Banco Santander, underscored that adherence to EBU regulations is feasible when local political repercussions in core member states are negligible. This case illustrates that when the domestic interests of core states are not directly threatened, the regime's enforcement is rigorous, aligning with broader EU objectives while potentially disregarding the local consequences in periphery economies.

Conversely, the Italian banking crises, involving Monte dei Paschi di Siena, Banca Popolare di Vicenza and Veneto Banca, highlight the challenges that emerge when significant local political stakes are at play. Italy's handling of its banking sector's troubles underscores the discretionary power exercised by core states to protect domestic interests. Utilizing precautionary recapitalization and leveraging national liquidation processes, Italy effectively circumvented the stringent EBU bail-in rules, showcasing the influence of national political pressures and the need to mitigate local fallout. The Italian approach

demonstrates a protective stance towards domestic constituencies, underscoring the flexible and political nature of the EBU regime.

These case studies collectively reveal that the EBU resolution framework is not a uniform and impartial system. Instead, it embodies a political dimension where the power and interests of core Eurozone countries play a pivotal role in shaping resolution outcomes. The differing approaches to bank resolutions in Spain and Italy and the pre-EBU example of Cyprus, illustrate that the enforcement and flexibility of EU rules vary based on the national political and economic stakes involved. The evolution of the EBU regime continues to reflect the balance of local interests versus broader EU mandates, emphasizing the enduring influence of core member states in navigating the complexities of banking crises within the Eurozone.

7 THE LIMITS OF ADMINISTRATIVE AND JUDICIAL REVIEW IN THE EBU FRAMEWORK

7.1 INTRODUCTION

The previous chapters have demonstrated how the EBU framework is significantly influenced by the power dynamics among member states, particularly between core and periphery countries. Core Eurozone member states can leverage their power to protect their domestic interests and impose their policy preferences on the broader Eurozone. This influence manifests in various ways, from shaping regulations to impacting the practical application of EBU rules. The provided case studies reveal that the resolution outcomes of distressed banks are often dictated not solely by the objective application of EU rules but also by the political and economic interests of core states. These states exert considerable pressure on EBU authorities and other member states to secure favourable outcomes, often at the expense of periphery states.

Two potential avenues for such protection are administrative review and judicial review. Administrative review involves the assessment and potential reversal of decisions by higher administrative authorities within the EBU framework, providing an internal mechanism for accountability.[1096] Judicial review, on the other hand, permits the legal challenge of EBU decisions before the CJEU.[1097] This chapter will critically examine both the administrative and judicial review processes of decisions made by the ECB and the SRB, evaluating their effectiveness in providing checks and balances on the exercise of power within the EBU framework.

In terms of administrative review, the Administrative Board of Review ("**ABoR**") evaluates decisions made by the ECB, while the Appeal Panel reviews those made by the SRB. However, the effectiveness of these review mechanisms is significantly undermined by several critical issues. One major concern is the fear of retaliation from powerful regulatory bodies, which may discourage many entities, particularly those in periphery EU states, from seeking reviews. Moreover, the composition and appointment procedures of these regulatory bodies are significantly influenced by the authorities they are meant to oversee, raising issues of potential bias. Furthermore, these reviews are confined to assessing

[1096] SSM Regulation, Article 24; SRM Regulation, Article 85.

[1097] SSM Regulation, Article 24(11); SRM Regulation, Article 86.

procedural and substantive legality, without considering the merits of the decisions involved. Ultimately, within the framework of the SSM, the advisory nature of ABOR's opinions limits the influence of administrative reviews since the ECB holds the final power to make revised decisions. Concerning the SRB's Appeal Panel, while its rulings are legally binding, it can merely endorse or return the case to the SRB, which retains the authority to issue an amended decision.

Judicial review conducted by the CJEU under Article 263 of the TFEU also faces notable limitations. Strenuous standing requirements hinder access to judicial review, presenting considerable obstacles for many affected parties. Additionally, the CJEU's scope of review is narrowly restricted to procedural correctness and manifest errors, thereby avoiding an in-depth examination of the substantive merits of decisions. This narrow focus allows many potentially problematic decisions to go unchallenged. As a retrospective mechanism, judicial review often arrives too late to prevent the immediate adverse effects of regulatory decisions, failing to provide real-time protection. Additionally, political and economic power structures within the EU add complexity, subtly influencing judicial processes that are more likely to legitimise rather than challenge the existing state of affairs.

7.2 ADMINISTRATIVE AND JUDICIAL REVIEW UNDER THE SSM AND SRM

The EBU relies on two main mechanisms for the review of the decisions taken by the ECB and the SRB under the SSM and the SRM, respectively. The first mechanism is the internal administrative review, which allows the affected parties to challenge the legality of the decisions before the same authority that adopted them. The second mechanism is the external judicial review, which enables the affected parties to appeal the decisions before the CJEU.

The internal administrative review is governed by different rules depending on whether the decisions are taken by the ECB or the SRB. For the ECB, the internal review is conducted by an independent ABoR, which can either confirm, remit or propose amendments to the contested decision.[1098] The ABoR's opinion is not binding, but the ECB must state the

[1098] SSM Regulation, Article 24(7).

reasons for deviating from it.[1099] For the SRB, the internal review is performed by an Appeal Panel, which can annul, confirm or amend the contested decision.[1100] The Appeal Panel's decision is binding, unless the SRB decides to refer the matter to the CJEU within two months.[1101]

The external judicial review is based on Article 263 TFEU, which grants the CJEU the power to review the legality of the acts of the EU institutions, bodies, offices or agencies.[1102] The CJEU can annul the decisions of the ECB or the SRB if they are contrary to the EU law, including the principles of proportionality, subsidiarity, legal certainty and fundamental rights.[1103]

7.2.1 Administrative Review

(i) The SSM

The ABoR is an internal administrative body within the ECB, responsible for reviewing decisions taken by the ECB in the exercise of its powers under the SSM.[1104] It consists of five highly reputable individuals from Member States with extensive knowledge and professional experience in banking and financial services. These members must not be current staff of the ECB, nor staff of any competent authorities or Union institutions involved in the ECB's supervisory tasks.[1105] Members and two alternates are appointed by the ECB for a five-year term, renewable once.[1106]

The administrative review process conducted by the ABoR begins when the affected party submits a request.[1107] The ABoR's role is to review decisions made by the ECB, including those implementing national laws that transpose EU directives.[1108] The decisions must be

[1099] Decision of the European Central Bank of 14 April 2014 concerning the establishment of an Administrative Board of Review and its Operating Rules (ECB/2014/16) (2014/360/EU) (the "**ABoR Decision**"), Article 16(5).

[1100] SRM Regulation, Article 85(8).

[1101] ibid.

[1102] TFEU, Article 263.

[1103] ibid, Article 263 para. 2.

[1104] SSM Regulation, Article 24(1).

[1105] ibid, Article 24(2).

[1106] ibid.

[1107] The affected party can be either a natural or legal person, see Article 24(5) of the SSM Regulation.

[1108] Article 24(1) of the SSM Regulation. The ECB has the power to directly implement EU law, and when EU law includes directives, the ECB can also implement national laws implementing these directives, Article 4(3) of the SSM Regulation.

directly addressed to or be of direct and individual concern to the affected party.[1109] These criteria align with those for the judicial review of ECB decisions by the CJEU and it is expected that the ABoR will rely on CJEU case law to determine the admissibility of specific requests.[1110]

To initiate a review, the request must be submitted in writing and include a statement of grounds, within one month of the ECB decision being notified to the requesting party.[1111] If there is no notification, the time limit starts from the day the appellant becomes aware of the ECB decision.[1112]

The scope of the internal administrative review is limited to assessing whether the substance and procedures of the ECB's actions conform with the SSM Regulation.[1113] Once the request's admissibility is confirmed, the ABoR must express an opinion within a timeframe appropriate to the urgency of the matter, but no later than two months from the receipt of the request. The ABoR's opinion will address only the grounds raised by the applicant in their notice of review.[1114] This opinion is then submitted to the ECB's Supervisory Board, which is responsible for preparing a new draft decision.[1115] The Supervisory Board must forward this draft decision to the Governing Council, incorporating the ABoR's opinion.[1116] The Governing Council will then decide the draft decision's fate. If the Governing Council does not oppose the draft decision within ten working days of submission, it is considered adopted.[1117] The draft decision can annul, confirm, or replace the original decision. Both the opinion and the draft decision must be reasoned and communicated to the parties involved.[1118]

[1109] SSM Regulation, Article 24(5).

[1110] For an analysis of the admissibility criteria under the CJEU case law, see section 7.2.2 (*Judicial Review*) below. As a result, a *"contested decision is of direct concern to an applicant if that decision directly affects the legal situation of the applicant or influences his or her material situation or has a foreseeable impact on his or her legal position",* whereas *"a legal act of an EU institution or agency is of individual concern when it affects specific natural or legal persons by reason of certain attributes peculiar to them, or by reason of a factual situation that differentiates them from all other persons and distinguishes them individually in the same way as the addressee".*

[1111] SSM Regulation, Art. 24(6).

[1112] ibid, Art. 24(1)

[1113] ibid.

[1114] ABoR Decision, Article 10(2).

[1115] SSM Regulation, Article 24(7).

[1116] ibid.

[1117] ibid; ABoR Decision, Article 10(2).

[1118] SSM Regulation, Article 24(9).

It is important to note that submitting a review request does not have a suspensory effect.[1119] However, the Governing Council, upon the ABoR's recommendation and after having heard the Supervisory Board, may suspend the application of the contested decision if the circumstances require such action.[1120] The Governing Council may suspend the effects of a supervisory decision if the request for review is admissible, not obviously unfounded and if the immediate application of the contested decision may cause irreparable damage.[1121] In this regard, these conditions are similar to those required for obtaining a suspension order from judicial bodies, such as having a valid initial case and the potential for significant damage if a delay is not granted.

Appealing to the ABoR is not a mandatory step before approaching the CJEU.[1122] However, it is often beneficial for applicants to seek an administrative review first, as this can save both time and costs.[1123]

(ii) The SRM

Similar to the ABoR under the SSM, the Appeal Panel established under the SRM is an internal administrative body of the SRB. It is responsible for reviewing specific decisions taken by SRB in the exercise of certain functions under the SRM.[1124] The Appeal Panel comprises five highly reputable individuals from Member States with extensive knowledge and professional experience in banking and financial services.[1125] These members must not be current staff of the SRB, nor staff of any competent authorities or Union institutions involved in the SRB's resolution tasks.[1126] Members and two alternates are appointed by the SRB for a five-year term, renewable once.[1127]

[1119] ibid., Article 24(8).

[1120] ibid.

[1121] ABoR Decision, Article 9.

[1122] SSM Regulation, Article 24(1)

[1123] Concetta Brescia Morra, Rene Smits and Andrea Magliari, 'The Administrative Board of Review of the European Central Bank: Experience after 2 Years' (2017) European Business Organisation Law Review 567, 581.

[1124] SRM Regulation, Articles 85(1) and 85(3).

[1125] ibid, Article 85(2).

[1126] ibid.

[1127] ibid.

In contrast with the ABoR under the SSM, the Appeal Panel does not have general appellate jurisdiction. Instead, it is authorised to review only specific decisions outlined in the SRM Regulation.[1128] These decisions include:

- measures to address or remove substantive impediments to resolvability;
- simplified obligations for certain institutions;
- determinations regarding the minimum requirements for own funds and eligible liabilities subject to write-down and conversion powers;
- impositions of penalties for non-compliance or lack of cooperation with the SRB;
- decisions on the determination and collection of contributions to the SRB's administrative expenses; and
- decisions on *ex post* contributions to the SRF.

Consequently, the jurisdiction of the Appeal Panel is primarily focused on the preventive aspects of the SRM and the credit institutions' contributions to the SRF and the SRB's administrative expenses. In contrast, executive decisions relating to the resolution of failing banks made by the SRB, including the adoption of resolution schemes, are excluded from the Appeal Panel's review. These decisions fall under the direct review of the CJEU.[1129]

The process commences when the affected party submits a written appeal, including the statement of grounds, to the Appeal Panel within six weeks of the notification date of the SRB decision, or, if no notification was given, from the day the decision came to the party's attention.[1130]

Filing the appeal does not automatically suspend the application of the contested decision.[1131] However, the Appeal Panel has the discretion to suspend the decision if circumstances warrant such action.[1132] Unlike the ABoR and the Governing Council under the SSM, the Appeal Panel seems to have broader discretion in assessing relevant

[1128] ibid, Article 85(3).
[1129] ibid, Articles 85(1), 85(3) and 86.
[1130] ibid, Article 85(3).
[1131] ibid, Article 85(6).
[1132] ibid.

circumstances, as they are not restricted by specific legal criteria. It is plausible that the requirements outlined in Articles 278 and 279 of the TFEU would apply.[1133] These requirements include that the applicant's arguments must not be manifestly lacking in foundation, that interim protection is urgent and necessary to prevent serious and irreparable damage to the applicant and that a balancing of interests must show the applicant's need for protection outweighs the public interest in the continued operation of Union law acts.[1134]

The Appeal Panel will first decide whether the appeal is admissible.[1135] In terms of standing requirements, any national or legal person, including the national resolution authorities, may appeal the above decisions if they are addressed to that person, or are of direct and individual concern.[1136] Similar to the ABoR under the SSM, these standing criteria are consistent with those for the judicial review of EU bodies' decisions by the CJEU. It is expected that the Appeal Panel will rely on CJEU case law to determine the admissibility of specific requests.[1137]

If the appeal is deemed admissible, the Appeal Panel will then assess whether the SRB's decision is "well-founded".[1138] While the SSM Regulation explicitly states that the ABoR's review pertains to the procedural and substantive conformity of ECB decisions with the applicable framework, the SRM Regulation does not clearly specify whether the Appeal Panel's review is limited to the legality of the contested decisions or extends to their merits and the discretionary choices made by the SRB. Notably, the Appeal Panel cannot substitute its own decision for that of the SRB.[1139] It can only confirm the SRB's decision or remit the case back to the SRB.[1140] In the latter scenario, the SRB is bound by the Appeal Panel's decision and is required to adopt an amended decision.[1141] Therefore, unlike the ABoR's

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[1133] TFEU, Article 278 and 279.

[1134] For the relevant CJEU case law, see Caroline Naômé, 'The Effects of Appeals' in Caroline Naômé, *Appeals Before the Court of Justice of the European Union* (Oxford, OUP 2018).

[1135] SRM Regulation, Article 85(7).

[1136] ibid., Article 85(3).

[1137] For an analysis of the admissibility criteria under the CJEU case law, see section 7.2.2 (*Judicial Review*) below. As a result, a *"contested decision is of direct concern to an applicant if that decision directly affects the legal situation of the applicant or influences his or her material situation or has a foreseeable impact on his or her legal position",* whereas *"a legal act of an EU institution or agency is of individual concern when it affects specific natural or legal persons by reason of certain attributes peculiar to them, or by reason of a factual situation that differentiates them from all other persons and distinguishes them individually in the same way as the addressee".*

[1138] SRM Regulation, Article 85(7).

[1139] ibid, Article 85(8).

[1140] ibid.

[1141] ibid.

advisory and non-binding opinions, the decisions of the Appeal Panel are binding on the SRB.

(iii) Analysis of the administrative review framework in light of the power framework

As discussed in the previous chapters of this thesis, the power framework suggests that core member states have a greater influence on the policy-making and governance of the EBU, which may result in policy outcomes that favour their interests. Therefore, it is important to analyse whether the ABoR and the Appeal Panel can effectively check and balance the exercise of power by the ECB and the SRB and safeguard the rights and interests of the periphery member states and other affected parties. In this section, I will examine the main features and challenges of the administrative review processes in light of the power framework and assess their implications for the protection of periphery states from the exercise of power by core states.

(a) The deterrent effect of power dynamics on the right of review

According to Rene Smits, a member of the ABoR, challenging a supervisor through formal proceedings is a major and frequently tough decision, mainly because of possible consequences.[1142] The supervisor retains authority over the challenger's business and might respond with increased scrutiny.[1143] Maintaining a positive relationship with the supervisor post-dispute may discourage banks from seeking administrative or judicial review of decisions they contest. It is not surprising, therefore, that when compared to the total number of supervisory decisions, the rate of administrative reviews under the EBU framework is quite low. According to the ECB Annual Report 2016, there were 1,835 prudential decisions out of a total of 2,686 authorisation procedures, in addition to thousands of fee decisions each year.[1144] The review rate can be calculated by dividing the number of review requests (8) by the total number of supervisory decisions (1,835 + 3,099 = 4,934), resulting in a rate of 0.16%, or one in every 617 decisions being subject to ABoR review.[1145] In 2017, the

[1142] Rene Smits, 'Interplay of Administrative Review and Judicial Protection in European Prudential Supervision – Some Issues and Concerns' (ssrn.com, 2018) available at: < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3092805> accessed 3 November 2024, 2.

[1143] ibid.

[1144] ibid.

[1145] iibd.

number of cases reviewed by ABoR dropped by 50%, with only 4 cases submitted.[1146] In addition, as shown in table 7 below, the ABoR's yearly reviews fluctuate but never display a high volume, ranging from only 1 to 6 finalized opinions. The SRB's Appeal Panel similarly handles a modest number of cases, consistently resolving between 4 to 6 appeals annually in recent years.[1147] Furthermore, the nature of the ABoR's opinions shows that many reviews result in minimal changes to the contested decisions, such as replacing the decision with one of identical content. The sporadic withdrawal of requests within the ABoR review process over the years further highlights that entities prefer to back down or settle informally rather than proceed with contentious formal processes.

Table 7: This table shows the number of reviews performed by the ABoR from 2014 to 2023

	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
ABoR opinions finalised	3	2	1	2	5*	4	4	6	6	3
ABoR opinions proposing to replace the contested decision with a decision of identical content	3**	-	-	1	1	3	4	1	2	2
ABoR opinions proposing to replace the contested decision with an amended decision or with improved reasoning	-	1	-	-	1	1	-	2	4	1
ABoR Opinions proposing to abrogate the contested decision and to replace it with a new decision	-	-	-	-	1	-	-	-	-	-
ABoR opinions proposing to abrogate the contested decision	-	-	1	-	-	-	-	-	-	-
ABoR opinions finding a request inadmissible	-	1	-	1	2	-	-	3	-	-
Request withdrawn	1	1	-	-	-	1	-	1	2	1
ABoR proporsal for suspension	-	-	-	1	-	-	-	-	-	-

Source: ECB[1148]
**One opinion covered two ECB decisions.*
***In one of the three opinions, the ABoR proposed that the Supervisory Board should replace the contested decision with a decision which establishes the same supervisory measures.*

[1146] ibid.

[1147] Single Resolution Board, 'Annual Report 2023' (srb.europa.eu, 2023) available at: <https://www.srb.europa.eu/system/files/media/document/2024-06-28_Annual-Report-2023.pdf> accessed 3 November 2024, 53; Single Resolution Board, 'Annual Report 2022' (srb.europa.eu, 2022) available at: <https://www.srb.europa.eu/system/files/media/document/2023-07-20_SRB-Annual-Report_2022.pdf> accessed 3 November 2024, 56; Single Resolution Board, 'Annual Report 2021' (srb.europa.eu, 2021) available at: https://www.srb.europa.eu/system/files/media/document/2023-02-03_Annual-Report-2021.pdf accessed 3 November 2024, 64.

[1148] European Central Bank, 'ECB Annual Report on Supervisory Activities 2023' (bankingsupervision.eu, March 2024) available at: <https://www.bankingsupervision.europa.eu/press/publications/annual-report/pdf/ssm.ar2023~2def923d71.en.pdf> accessed 3 November 2024, 71.

No safeguards currently exist to protect credit institutions that wish to lodge complaints from retaliation. This can be contrasted with the Federal Reserve's procedures for appealing material supervisory decisions, where policies are in place to prevent retaliation against supervised credit institutions lodging appeals. These policies prohibit any retaliatory actions against supervised credit institutions that choose to file such appeals.[1149] Key features of these measures include allowing the Ombudsman to attend hearings or deliberations as an observer when requested by the institution or Federal Reserve staff.[1150] The Ombudsman is also tasked with tracking complaints from regulated institutions to identify patterns and recurrent issues.[1151] Furthermore, the Ombudsman is empowered to mediate retaliation complaints initially, investigate unresolved complaints to determine their validity and report findings to the relevant Board Committee, Division Director and the head of Supervision at the Reserve Bank.[1152] The Ombudsman must also proactively follow up with institutions six months after their appeals have been resolved to inquire if they believe they have experienced any form of retaliation.[1153]

In conclusion, having a right to administrative review does not automatically mean that those impacted will contest the decisions of the ECB or the SRB. Several factors might contribute to the fewer reviews compared to supervisory decisions. These could include a perceived low chance of success, the potential costs and resources required for an appeal or a preference for informal negotiation and dialogue. Nonetheless, the desire to avoid additional scrutiny or disputes with the regulator will also play a role in this decision. There are currently no procedures in place to protect credit institution filing appeals from retaliatory actions by the ECB or SRB.

(b) Composition of the ABoR and Appeal Panel

A right of appeal is only valuable if the appellate body operates independently, ensuring an impartial and unbiased assessment of contested decisions. These appeal panels must

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[1149] Board of Governors of Federal Reserve System, 'Internal Appeals Process for Material Supervisory Determinations and Policy Statement Regarding the Ombudsman for the Federal Reserve System' (federalreserve.gov, 2024) available at: <https://www.federalreserve.gov/supervisionreg/srletters/SR2028a1.pdf> accessed 3 November 2024, see Section E (*Safeguards Against Retaliation*).

[1150] ibid.

[1151] ibid.

[1152] ibid.

[1153] ibid.

function without undue influence from the institutions whose decisions they are scrutinizing, thereby promoting objectivity in the review process. In line with this, the relevant framework requires ABoR members and the Appeal Panel to "act independently and in the public interest," without being influenced by any external directives.[1154] In addition, members must submit a public declaration of commitments and interests, highlighting any direct or indirect interests that might be considered prejudicial to their independence or confirming the absence of such interests.[1155] Furthermore, the SSM Regulation imposes an incompatibility regime for ABoR members, prohibiting them from concurrently serving as staff of the ECB or as staff of any national or Union institutions involved in ECB-related tasks within the SSM.[1156] Additionally, if a member faces a conflict of interest that could influence or appear to influence their impartiality, they must be replaced by an alternate member.[1157]

Despite the above measures to ensure independence, it is important to highlight that both the SSM and SRM appeal bodies are an extension of the authority that they oversee.[1158] As Jean-Paul Redouin, the Chair of the ABoR of the ECB, has written: "we are not an advisor to the Governing Council. But we are not a judge either".[1159] The members of the appeal panels are appointed by the governing bodies of these respective authorities. The *appointment process* involves a public call for expressions of interest published in the Official Journal of the EU.[1160] In terms of the SSM, the Executive Board of the ECB, after hearing the Supervisory Board, submits the nominations to the Governing Council which *formally appoints* the members of the ABoR. In terms of the SRM, the SRB appoints the members of the Appeal Panel.

Even though a public call for expressions of interest is part of the *appointment process*, the final approval still lies with the Governing Council, raising concerns about potential bias

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[1154] SSM Regulation, Article 24(4); SRM Regulation, Article 85(5).

[1155] ibid.

[1156] ibid, Article 24(2),

[1157] As stipulated in Article 3(3) of the ABoR Decision, the two alternates will temporarily replace members of the Administrative Board in instances of temporary incapacity, death, resignation, or removal from office. Additionally, alternates will step in if there are justified concerns regarding a conflict of interest in relation to a specific review request.

[1158] Sabino Cassese, 'A European Administrative Justice' (bancaitalia.it, June 2018) in Banca D' Italia, 'Judicial Review In the Banking Union and in the EU Financial Architecture Conference Jointly Organized by Banca d'Italia and the European Banking Institute' available at: <https://www.bancaditalia.it/pubblicazioni/quaderni-giuridici/2018-0084/qrg-84.pdf> accessed 3 November 2024, 14.

[1159] ibid, 13.

[1160] For an overview of the appointment process see section 2.3 (*The European Banking Union*) of Chapter 2.

and the perceived independence of the review boards. Since the same bodies responsible for making supervisory and resolution decisions hold the ultimate *formal authority* to appoint members of the review boards, this *sequence of decision making* provides the Governing Council with significant leverage in the appointment process.[1161] This is problematic as it undermines the impartiality of the review process, potentially compromising the fairness and objectivity of appeals by prioritizing candidates who may align with the interests of the bodies they are supposed to review. Furthermore, appointments to specific positions often depend not solely on the formal process but on negotiations within the institution's *informal networks*. It is expected that the Supervisory Board and the Governing Council of the ECB will negotiate behind closed doors regarding their preferred candidates even before the call for nominations is issued. This means that the most probable applicants will be those who have connections or affiliations with members of the ECB or the SRB, or those who share their views and interests. In other words, as noted in section 4.4.4(ii) (*Representation*) of Chapter 4 (*Power Framework*), by participating in the appointment process of the members of the Appeal Panels, the ECB and SRB influence the extent to which competing interests are represented within the organization. This means that the members of the Appeal Panels, who are responsible for reviewing the decisions of the ECB and the SRB, may adhere to and promote the values and objectives favoured by these supervisory authorities.

Therefore, it is simply inaccurate to claim that the ABoR operates independently of the Supervisory Board, considering that the majority of its current members have ties to the ECB or EBA. For example, Pentti Hakkarainen transitioned from his role as a member of the SSM Supervisory Board to join the ABoR.[1162] Similarly, Christiane Campill, before her appointment to the ABoR, served as an alternate member of the SSM Supervisory Board and participated in the ECB Financial Stability Committee.[1163] Additionally, Eduard Fernandez-Bollow was a former management board member of the EBA, while Ilias Plaskovitis joined the ABoR after serving on the SSM Supervisory Board.[1164] Damir Odak,

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[1161] For an overview of the concepts of 'representation', 'formal authority' and 'sequence of decision making' as sources of power, see section 4.4.4 (*Control of Decision-Making Processes*) of Chapter 4.

[1162] In respect of the current composition of the ABoR, see European Central Bank, 'Administrative Board of Review' (bankingsupervision.europa.eu, 2024) available at: < https://www.bankingsupervision.europa.eu/organisation/whoiswho/administrativeboardofreview/html/index.en.html> accessed 3 November 2024.

[1163] ibid.

[1164] ibid.

another current member, also previously served at the EBA.[1165] This pattern of appointments suggests that the ABoR is predominantly comprised of individuals with significant previous affiliations to the ECB or other European regulatory bodies. Such a composition may foster "club-behaviour" thinking, where decision-making could be influenced by the shared institutional backgrounds of its members.

(c) Evaluating Bias Risks in ECB and SRM Appeal Procedures

Regarding the independence of the appeal bodies in carrying out their tasks, the secretaries of both the ABoR and the Appeal Panel are supported by the staff of the same authorities they oversee.[1166] The ABoR Secretariat handles tasks such as preparing reviews, organizing pre-hearings and hearings, drafting proceedings, maintaining a review register and providing necessary assistance.[1167] In addition, the ECB supports the ABoR with legal expertise for evaluating ECB's decisions and can provide legal opinions upon request.[1168] Similarly, within the SRM, the Secretariat manages appeals by assigning case numbers, maintaining an appeals register, circulating documents, organizing Appeal Panel meetings and hearings and providing other essential support.[1169]

As noted in section 4.4.2 (*Boundary Management*) of Chapter 4, these secretariats control important *information boundaries*.[1170] Utilizing the same Secretariat for supervisory decisions and appeals means that the Secretariat staff could have pre-existing biases or loyalties, possibly influencing the neutrality of the review process. There is a risk that *information flow* can be controlled or filtered in a way that favors the supervisory board's decisions, thus undermining the appeal's objectivity. Frequent interactions between the Secretariat and the supervisory boards also create opportunities for informal influence and information exchanges. Even without explicit intent, these interactions can lead to a

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[1165] ibid.

[1166] Concetta Brescia Morra, 'The Administrative and Judicial Review of Decisions of the ECB in the Supervisory Field' (ssrn.com, 2016) Quaderni di Ricerca Giuridica, Banca d'Italia, No 81 available at: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2851819> accessed 3 November 2024, 14.

[1167] ABoR Decision, Article 6.

[1168] Morra (n 1166), 14.

[1169] Single Resolution Board, 'Appeal Panel of the Single Resolution Board - Rules of Procedure' available at: <https://www.srb.europa.eu/system/files/media/document/2024-02-20_SRB-Appeal-Panel_Rules-of-Procedure_EN.pdf> accessed 3 November 2024 (the "**SRB Appeal Panel Rules of Procedure**").

[1170] For an overview of 'boundary management' as source of power, see section 4.4.2 (*Boundary Management*) of Chapter 4.

convergence of perspectives that might compromise the perceived independence of the appeal process.

More importantly, with regard to the ABoR under the SSM, relying on the ECB for legal expertise can create a conflict of interest. The ECB is the entity whose decisions are being reviewed and its legal opinions may not be entirely neutral. Legal issues are rarely black and white and often involve interpreting complex regulations, balancing competing interests and applying nuanced judgments to specific facts. Because of this, different legal experts can legitimately arrive at divergent conclusions about the same issue. When the ABoR relies on the ECB for legal opinions, it effectively narrows the range of legal interpretations to those endorsed or supported by the very institution whose actions are under scrutiny. This dependency can lead to a form of confirmation bias, where the review process becomes predisposed to findings that align with the ECB's existing perspectives and rationalizations.

(d) *Locus standi* and admissibility criteria

The ABoR is authorized to review decisions made by the ECB under the powers granted by the SSM Regulation. These decisions include any actions that definitively establish the ECB's position at the end of an administrative process and are intended to have binding legal consequences that can affect the appellants' interests, regardless of their legal form.[1171] As a result, internal documents and preliminary acts, such as intermediate steps within a multi-stage procedure, cannot be directly challenged before the ABoR.

NCAs within the SSM are not authorized to request a review of decisions made by the ECB through the ABoR. This restriction may raise concerns about the potential marginalization of national interests and the limited avenues for NCAs to express their viewpoints. The only entities permitted to appeal ECB decisions to the ABoR are credit institutions and various stakeholders in the banking sector, contingent upon meeting specific admissibility criteria. These criteria, rooted in the case law developed by the CJEU, include standing requirements stipulating that the decision must be addressed to the affected party or be of direct and

[1171] Decisions should not be interpreted in a formalistic sense, implying that only the legal acts specified in Article 132(1) TFEU are subject to review. Instead, as clarified by European Court of Justice (CJEU) case law, a broader understanding is required—one that encompasses any measures intended to produce binding legal effects that can affect the interests of the appellants.

individual concern to them.[1172] Additionally, applicants must demonstrate a present and vested interest in the proceedings, implying that they would benefit from the annulment of the contested decision.[1173] As noted in section 7.2.2(i) in respect of the judicial review below, the strict application of these standing requirements by the CJEU has faced criticism for potentially limiting access to justice and undermining the rule of law within the EU.[1174]

Regarding the Appeal Panel under the SRM, all natural and legal persons, including national resolution authorities, have access to this forum. Similar to the ABoR under the SSM, given the clear alignment between the wording of this provision and that of the TFEU, it follows that the case law of the CJEU regarding standing requirements is essentially applicable.[1175] However, appeals can only be made against specific types of SRB decisions. As noted in section 7.2.1(ii) (*the SRM*) of this chapter, the decisions eligible for appeal are primarily focused on the preventive aspects of the resolution mechanism and matters related to credit institutions' contributions to the SRF and the SRB's administrative expenses. In contrast, executive decisions made by the SRB concerning the resolution of failing banks, such as the adoption of resolution schemes, are excluded from the Appeal Panel's review. These executive decisions, which can significantly impact credit institutions, essentially involve determinations on the continuation or winding down of failing banks. Such resolutions critically affect the rights and interests of the banks and their stakeholders. The inability to challenge these crucial executive decisions means that the advantages of swift justice associated with the administrative review process are unavailable for decisions that most profoundly affect credit institutions.

(e) Scope and intensity of administrative review

The ABoR's review involves assessing whether the decision in question complies both procedurally and substantively *with the SSM Regulation*.[1176] Based on the wording of the

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[1172] For an overview of the admissibility criteria as developed by the CJEU, see section 7.2.2 (*Judicial Review*) below.

[1173] Morra et al. (n 1123), 576.

[1174] Andreas Witte, 'Standing and Judicial Review in the New EU Financial Markets Architecture' (2015) Journal of Financial Regulation 226, 231.

[1175] As a result, a "contested decision is of *direct* concern to an applicant if that decision directly affects the legal situation of the applicant or influences his or her material situation or has a foreseeable impact on his or her legal position", whereas "a legal act of an EU institution or agency is of *individual concern* when it affects specific natural or legal persons by reason of certain attributes peculiar to them, or by reason of a factual situation that differentiates them from all other persons and distinguishes them individually in the same way as the addressee. For an analysis of the Plaumann test see section 7.2.2 (*Judicial Review*) below.

[1176] SSM Regulation, Article 24(1).

provision, it is debatable whether the scope of this review is confined strictly to the conformity of the decision with the SSM Regulation (*stricto sensu*) or whether it extends to all applicable substantive and procedural law. Given the ECB's authority to enforce all relevant EU legal provisions, including those transposed into national legislation via EU directives, the scope of the ABoR's review should be interpreted as encompassing a broader spectrum of applicable law.[1177] This includes ensuring compliance with not only the SSM Regulation but also all pertinent EU legislation and the national laws that implement these directives.[1178]

The SSM Regulation explicitly states that the administrative review performed by the ABoR shall "respect the margin of discretion left to the ECB to decide on the opportunity to take those decisions".[1179] In other words, the internal administrative review by the ABoR is confined to examining the legality of the contested decision and does not extend to questioning its merits. Moreover, as detailed in section 7.2.2(ii) (*Scope*) in respect of judicial review below, when an ECB decision involves a broad margin of discretion or "complex economic assessment," the ABoR's review will adhere to a "limited standard of review" similar to that of the CJEU in comparable situations.[1180] This means the review by the ABoR will focus on whether the due process requirements were met. In particular, it will review the observance of procedural rules, assess the adequacy of the statement of reasons, confirm the material accuracy of the facts and ensure there are no errors in law, manifest errors of assessment or misuse of powers.[1181]

In addition, the review performed by the ABoR is limited to examining the grounds set forth in the notice of review filed by the applicant.[1182] The ABoR cannot independently introduce

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[1177] SSM Regulation, Article 4(3); Morra et al. (n 1123), 576-577.

[1178] This is consistent with the principles of judicial review and established case law of the Court of Justice of the European Union (CJEU). The CJEU ensures that EU institutions and agencies, including the ECB and SRB, adhere to the entirety of EU law, see section 7.2.2(ii) (*Scope of review*) of below.

[1179] Recital 64 of the SSM Regulation.

[1180] In the case of *Telefónica and Telefónica de España v Commission*, C-295/12 P, at paragraph 54, the Court of Justice affirmed that while the Commission enjoys a certain level of discretion regarding economic matters, particularly in areas requiring complex economic assessments, this does not exempt it from judicial scrutiny. It was emphasized that the EU judiciary must not only verify the factual accuracy, reliability, and consistency of the evidence presented but must also ensure that such evidence includes all pertinent data necessary for a comprehensive evaluation of complex situations, supporting the resulting conclusions. This principle is reaffirmed in several judgments, including *Commission v. Tetra Laval*, C-12/03 P, EU:C:2005:87, paragraph 39; *Chalkor v. Commission*, C-386/10 P, EU:C:2011:815, paragraph 54; and *Otis and Others*, C-199/11, EU:C:2012:684, paragraph 59.

[1181] Andrea Magliari, 'Intensity of Judicial Review of the European Central Bank's Supervisory Decisions' (2019) 17 Central European Public Administration Review 73.

[1182] ABoR Decision, Articles 10 and 17(1).

new grounds for review or supplement the applicant's submissions.[1183] In addition, the ABoR conducts its review based on the circumstances at the time the ECB initially acted, i.e., later developments are considered irrelevant.[1184] Interestingly, however, once the ABoR has completed its review, the Supervisory Board may consider additional elements when preparing the proposal for a new draft decision, allowing it to pursue the broader objectives entrusted to it by the SSM Regulation.[1185]

While the SSM Regulation stipulates that the scope of review for the ABoR is to assess both procedural and substantive conformity of the ECB decisions with the relevant legal framework, the SRM regulations concerning the Appeal Panel do not clearly define whether its review is limited to the legality of the contested decision or extends to its merits.[1186] In the context of resolution measures, the SRB enjoys broad discretion and deals with complex subject matters. Although not explicitly stated, both the scope and the intensity of the review carried out by the Appeal Panel are shaped along the lines of the CJEU review of legality both in terms of standing requirements and admissibility criteria as well as the scope and intensity of the review. Similar to the ABoR under the SSM, the Appeal Panel's administrative review cannot substitute the discretion exercised by the SRB when such discretion lies within the administrative domain. Consequently, the Appeal Panel will adopt a "limited standard of review," similar to the one used by the ABoR.[1187] The Appeal Panel will not adjudicate on the precedence of one interest over another but will focus on identifying any incorrect exercise of the SRB's discretion starting with an examination of the stated reasons.[1188] Furthermore, like the ABoR within the SSM framework, the Appeal Panel appears to be confined to the terms of the decision it is set to review, thereby precluding it from conducting further investigations or collecting new evidence on its own.[1189]

This scope of review stands in sharp contrast to the broader and more protective provisions adopted by the Federal Reserve Board. The process for reviewing appeals against material

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[1183] ibid.

[1184] Morra et al. (n 1123), 576.

[1185] ibid.

[1186] Morra (n 1166), 25.

[1187] ibid, 31.

[1188] SRM Regulation, Article 85(7); SRB Appeal Panel Rules of Procedure, Article 9.

[1189] ibid.

supervisory determinations by the Federal Reserve Board is significantly more comprehensive and offers greater safeguards for appellants than the limited standard applied by the ABoR.[1190] The Federal Reserve's documentation outlines a two-tiered review process that ensures comprehensive oversight. In the first level of review, the initial review panel conducts its decision-making as if no prior determination has been made.[1191] Importantly, the panel is not permitted to defer to the judgment of the Reserve Bank that issued the original decision.[1192] However, it may consider examination workpapers from the Federal Reserve and materials submitted by the institution, but only if the panel finds it reasonable to do so.[1193] Moreover, the panel must determine whether the material supervisory determination complies with the Board's policies, applicable laws and regulations and ensure that it is substantiated by the record.[1194] The final level of review, conducted by a different panel, is characterized by a more restrictive scope.[1195] This panel's review is limited to the record upon which the initial review panel based its decision.[1196] The final review panel adopts a deferential standard, assessing only whether the decision of the initial review panel was reasonable.[1197] Like the initial review panel, the final review panel may hold an informal meeting, but is restricted from introducing any facts not already present in the record.

The administrative review conducted by appeal bodies under the EBU framework limits the protection for credit institutions in periphery states, as it focuses solely on examining the legality of decisions based on the grounds explicitly stated by the applicant. This restriction means the review does not include an assessment of broader policy implications or the suitability of decisions for periphery states. However, decisions made by the ECB or SRB may be legally compliant but could still be influenced by the interests of core member states. While these decisions adhere to the parameters set by EU institutions and do not violate

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[1190] For an overview of the Federal Reserve's administrative review process, see Sullivan and Cromwell LLP, 'Federal Reserve Board Proposes Revised Process for Appeal of Material Supervisory Determinations' (sullcrom.com, 2 March 2018) available at: <SC_Publication_Federal_Reserve_Board_Proposes_Revised_Process_for_Appeal_of_Material_Supervisory_Determinations.pdf> accessed 3 November 2024.

[1191] Board of Governors of Federal Reserve System (n. 1199), section B (*General Procedures for Appealing a Material Supervisory Determination*), para. 7.

[1192] ibid.

[1193] ibid.

[1194] ibid, para 16.

[1195] ibid, para. 15.

[1196] ibid.

[1197] ibid, para 16.

legal or due process requirements, they often involve policy choices that, although lawful, may not be adequately tailored to the needs and circumstances of periphery states. In essence, these decisions can represent a misuse of power where discretion, while not exercised illegally, fails to serve the interests of all EU member states. The appeal bodies' scope of review, confined to examining the legality rather than the suitability of ECB and SRB decisions for all member states, does not address this issue. Consequently, even if decisions fail to address the specific needs of periphery states, as long as they adhere to legal and procedural requirements, they will pass the scrutiny of the ABoR.

(f) Legal effects of the Appeal Bodies' Decisions

Following the review of the admissibility and substance of the appeal, the ABoR is limited to recommending that the Supervisory Board either approves a new draft decision that revokes the initial decision, replaces it with one of identical content or amends it.[1198] The ABoR lacks the authority to resolve the issue or declare the decision legally void. The Supervisory Board must consider the ABoR's opinion before submitting a revised draft decision to the Governing Council.[1199] The opinions of the ABoR are consultative and non-binding for both Supervisory Board and the Governing Council.[1200] The purpose of this limitation to remittance is presumably to safeguard the competent body's discretionary powers. Additionally, it is rooted in the constraints imposed by EU treaties, as the ECB, being an EU institution, cannot have its decisions bound by the opinions of an administrative body.[1201] While the ABoR's opinion cannot be appealed to the ECB,[1202] appeals against ECB decisions are permissible without first exhausting administrative remedies.

Upon receiving the ABoR's opinion, the Supervisory Board should propose a new decision to the Governing Council, taking into account the ABoR's views, but not limited to the applicant's grounds for review. The Supervisory Board "may consider additional factors in

[1198] SSM Regulation, Article 24(7).

[1199] ibid.

[1200] ibid.

[1201] Consequently, the non-binding nature of the ABoR's opinions is justified by the necessity to uphold primary law, which mandates that only the Governing Council and the Executive Board serve as the decision-making bodies of the ECB.

[1202] Article 263(5) TFEU, which provides that 'acts setting up bodies, offices and agencies of the Union may lay down specific conditions and arrangements concerning actions brought by natural or legal persons against acts of these bodies, offices or agencies intended to produce legal effects in relation to them', only applies to the SRB Appeal Panel, but not the ABoR, as an internal body of an EU institution, see Morra (n 1123).

its proposal for a new draft decision."[1203] These new factors could be particularly relevant if the bank's circumstances have changed since the original ECB decision, or if previously unknown information or information considered to be less relevant has come to light.[1204]

Unlike the ABoR under the SSM, decisions made by the Appeal Panel are legally binding on the SRB. The Appeal Panel established under the SRM may confirm the decision taken by the SRB or remit the case to the latter.[1205] The SRB shall be bound by the decision of the Appeal Panel and it shall adopt an amended decision.[1206]

Therefore, the appeal bodies do not hold the ultimate *authority* to amend the decisions taken by the ECB or SRB. Within the SSM, the ultimate decision-making power lies with the Supervisory Board and the Governing Council, who have the discretion to disregard the opinion of the ABoR. Their capacity to introduce and rely on new grounds that were not considered during the ABoR's review makes it even easier for them to justify disregarding the ABoR's recommendations. When decisions can be justified on previously unconsidered grounds, the ABoR's role as a check on the Supervisory Board and the Governing Council's decisions is significantly weakened. Appellants are left at a disadvantage because they cannot effectively challenge or prepare for these new grounds, ultimately rendering the appeal process less meaningful.

In the case of the SRB, although the opinion of the Appeal Panel is legally binding, the SRB must take an amended decision, as the Appeal Panel can only confirm or remit the case. By remitting a decision, the panel can mandate the SRB to reconsider its decision, highlighting procedural or legal deficiencies, but it cannot impose a specific resolution or outcome. This limitation means that while the SRB is obligated to amend its decision in light of the Appeal Panel's findings and recommendations, it retains significant control over the final outcome. The SRB has the authority to interpret and implement the Appeal Panel's recommendations based on its own judgment and expertise. This procedural structure allows the SRB to adapt the final resolution according to its specialized understanding and strategic objectives, even after an appeal.

[1203] ABoR Decision, Article 17(1).

[1204] Rene Smits (n 1142), 3.

[1205] SRM Regulation, Article 85(7).

[1206] ibid.

7.2.2 Judicial Review

The previous section demonstrated that administrative review often fails to provide a sufficient degree of independence and impartiality, revealing its limitations in safeguarding periphery states from the exercise of power by core states. As previously mentioned, appellants have the right to contest decisions made by the ECB and SRB before the CJEU, which acts as an additional safeguard for protecting their rights.

The necessity of pursuing administrative review is not a prerequisite for decisions made by the ECB under the SSM.[1207] When it comes to submitting a request for an ECB decision review to the ABoR, this action is entirely optional.[1208] The aggrieved party has the right to either seek an internal review by the ABoR before escalating to the CJEU or to directly file for annulment with the CJEU. Should the party choose the ABoR pathway, they can later challenge the ECB's decision, whether it was confirmed or newly adopted post-ABoR review, in the General Court. However, the ABoR's opinion itself is not subject to challenge as it does not qualify as a justiciable legal act.[1209]

In contrast, under SRM, decisions made by the SRB require the exhaustion of administrative remedies as a condition of admissibility.[1210] When the option to appeal to the Appeal Panel is available, the affected party must first exhaust this administrative avenue before filing an action for annulment with the General Court. If the Appeal Panel upholds the contested decision, the party can then directly pursue judicial proceedings against the decision of the Appeal Panel.[1211] However, if the Appeal Panel refers the case back to the relevant authority, any new decision made by that authority can only be challenged before the CJEU. In both scenarios, the action can address both legal and factual issues.[1212]

This section delves into the primary features and challenges of the judicial review of ECB and SRB decisions, considering relevant case law from both the CJEU and the General

[1207] SSM Regulation, Article 24(11).

[1208] ibid.

[1209] Morra et al (n 1123), 573.

[1210] Article 86(1) of the SRM Regulation provide that judicial proceedings may be brought before the Court of Justice contesting a decision taken either by the appeal body or, in cases where there is no such right of appeal by the Authority.

[1211] Morra et al (n 1123), 572.

[1212] ibid.

Court. It will be argued that judicial review within the framework of the EBU has significant limitations in its ability to protect periphery states from the exercise of power by core states.

(i) Standing Requirements

The SSM Regulation grants a right of judicial review to the persons affected by the acts of the ECB or the NCAs.[1213] The decisions of the ECB that are subject to review are those that directly affect the individual credit institutions or those that contain binding instructions to the NCAs regarding an individual credit institution.

The judicial review of the ECB decisions is based on Article 263 of the TFEU, which empowers the CJEU to review the legality of the acts of the EU institutions, bodies, offices or agencies that are intended to produce legal effects vis-à-vis third parties.[1214] The CJEU has jurisdiction to hear actions brought by a Member State, the European Parliament, the Council, the Commission or the parties addressed by a decision.[1215] In addition, any natural or legal person may institute proceedings against (i) an act addressed to that person[1216] or (ii) which is of direct and individual concern to them, or (iii) against a regulatory act which is of direct concern to them and does not entail implementing measures.[1217]

One of the main challenges for natural or legal persons seeking to challenge the acts of the ECB or the NCAs under Article 263 of the TFEU is to meet the standing requirements of direct and individual concern.[1218] The CJEU has interpreted these requirements in a strict and narrow manner, often excluding many applicants from accessing judicial review. The criterion of direct concern is satisfied if the contested act affects the legal situation of the applicant directly, without leaving any discretion to the addressees of the act regarding its implementation.[1219] There is case law suggesting that direct concern could still be established even if the act requires some form of implementation, provided that the impact on the applicable is foreseeable and there is no discretion for the implementing body.[1220]

[1213] SSM Regulation, Article 4(3).

[1214] TFEU, Article 263.

[1215] TFEU, Article 263(1).

[1216] It's crucial to remember that, in this context, the term "addresses" doesn't refer to everyone impacted by the act but solely to those explicitly specified as its intended recipients.

[1217] Article 263(4) of the TFEU.

[1218] For an analysis of the CJEU standing requirements, see Witte (n 1174).

[1219] ibid, 231.

[1220] *Firma Plaumann & Co v Commission*, C-25/62, EU:C:1963:17.

The criterion of individual concern is more demanding, as it requires the applicant to show that they are affected by the act by reason of certain attributes or circumstances that distinguish them from all other persons.[1221] This is known as *the Plaumann test*, which states that a person is individually concerned by a decision if they are in a situation similar to that of the addressee.[1222] The CJEU has applied this test in a rigid and consistent manner, dismissing many actions for annulment for failing to meet the individual concern requirement, without examining the direct concern requirement.[1223] This approach has been criticised for limiting the access to justice for individuals and undermining the rule of law in the EU.[1224]

For "regulatory acts" that do not entail implementing measures, individual concern is not required and only direct concern is necessary.[1225] This adjustment has led to interpretations suggesting that the threshold for "direct concern" in the absence of implementing measures is somewhat more lenient compared to the *Plaumann test*.[1226] By reducing the burden of proof on applicants in such cases, this amendment intends to enhance access to judicial review and strengthen the rule of law within the EU, making it slightly easier for individuals and businesses to challenge regulatory acts that affect them directly.[1227]

To bring proceedings before the CJEU, the applicant must not only meet standing requirements but also demonstrate a legal interest, meaning the annulment of the contested act must have the potential to produce legal consequences or benefit the applicant.[1228] The CJEU has ruled that the repeal of an act does not bar its judicial review, as repeal does not imply acknowledging its unlawfulness.[1229] Moreover, the CJEU has clarified that it should not appraise the likelihood of an action's success in national courts under national law, as doing so would effectively overstep its jurisdiction. Thus, the CJEU's responsibility is to verify that the applicant has a legal interest in the act's annulment at the EU level.

[1221] ibid.

[1222] ibid.

[1223] Witte (n 1174).

[1224] ibid.

[1225] TFEU, Article 263(4).

[1226] Witte (n 1174), 253.

[1227] ibid.

[1228] Morra et al (n 1123), 576.

[1229] Crédit Mutuel Arkéa v ECB [2017] (Case T-712/15), paras 40–2. The appeal against the Tribunal's ruling was rejected by the ECJ on 2 October 2019. Crédit Mutuel Arkéa v ECB [2019] (Cases C-152/18 P and C-153/18 P).

The ECB wields specific supervisory powers enabling it to impose obligations or limitations directly on significant banks.[1230] This authority permits the ECB to take direct actions and issue decisions to individual credit institutions without any intermediaries.[1231] These decisions are made under EU law, based on the direct applicability of the SSM Regulation, thereby removing the need for national law involvement and streamlining supervisory actions directly under EU instruments. Banks, as the direct recipients of these decisions, have clear standing to contest them under the TFEU, as they are directly addressed by the ECB's actions.

Furthermore, the ECB can issue binding instructions to NCAs to implement supervisory measures, which NCAs must then enforce within their national legal frameworks.[1232] The ECB can legally mandate the NCAs to exercise their national supervisory powers.[1233] Some experts argue that a party is considered directly impacted by an ECB instructions and thus eligible to appeal before the CJEU only when the NCA exercises no autonomous discretionary decision-making power, simply executing the decision issued by the ECB.[1234] Conversely, if the national authorities retain any discretionary power, the affected party must pursue an appeal in the national courts.[1235] In such instances, the national courts are responsible for referring the question of the ECB instruction's annulment to the CJEU through preliminary reference proceedings.[1236] To successfully annul or suspend the national decision, the party must first initiate an appeal within the national judicial system.[1237]

[1230] SSM Regulation, Article 9.

[1231] ibid.

[1232] Article 9(1) sub-paragraph 3 and Article 7(1) sub-paragraph 1 of the SSM Regulation. Article 9(1) states that "to the extent necessary to carry out the tasks conferred on it by this Regulation, the ECB may require, by way of instructions, those national authorities to make use of their powers, under and in accordance with the conditions set out in national law, where this Regulation does not confer such powers on the ECB. Those national authorities shall fully inform the ECB about the exercise of those powers". In addition, Article 18(5) concerning administrative penalties, affirms that "… where necessary for the purpose of carrying out the task conferred on it by this Regulation, the ECB may require national competent authorities to open proceedings with a view to taking action in order to ensure that appropriate penalties are imposed in accordance with the acts referred to in the first subparagraph of Article 4(3) and any relevant national legislation which confers specific powers which are currently not required by Union law". In the latter case, penalties are applied by the NCAs.

[1233] ibid.

[1234] Tomas Arons, 'Judicial Protection of Supervised Credit Institutions in the European Banking Union' in Danny Busch and Guido Ferrarini, *European Banking Union* (Oxford, OUP 2020).

[1235] ibid.

[1236] ibid.

[1237] ibid.

In the *Trasta* case, shareholders challenged two decisions by the ECB: the initial decision to withdraw the authorization of Trasta Komercbanka AS ("**TKB**") and a subsequent decision after the ABoR proceedings.[1238] The General Court initially ruled that the ECB's withdrawal of TKB's banking license directly affected the shareholders' legal situation by preventing the bank from pursuing its economic objectives, thus altering their rights to dividends and voting. However, upon appeal, the CJEU annulled the General Court's decision, stating that the withdrawal did not directly affect the shareholders' legal position but merely had an economic effect.[1239] The CJEU highlighted that the shareholders still retained their rights at the general meeting, even though the bank's liquidation was carried out by a national court under national law, making the case inadmissible.

In the *Carige* case, Mrs. Corneli, a minority shareholder, contested the ECB's decision to place Banca Carige under temporary administration, arguing that it directly impacted her rights as a shareholder.[1240] The court recognized that although she was a minority shareholder, her right to vote and partake in the management and supervisory bodies was significantly altered by the ECB's decision.[1241] These changes included the suspension of rights to convene shareholder meetings and set agendas, directly affecting her legal situation without the need for intermediary measures.[1242] The General Court dismissed the ECB and the Commission's argument that, given the large number of shareholders, the case did not meet the *Plaumann test* for individual concern, affirming that the closed group of identifiable shareholders met the criteria, distinguishing it from the *Trasta* case.[1243]

Under the BRRD, member states must ensure that all persons affected by crisis prevention measures, decisions to place a credit institution under resolution or any subsequent resolution power decisions by a national resolution authority have the right to seek judicial review of those decisions.[1244] In the euro area, national resolution authorities operate under the directives of the SRB as stipulated by the SRM Regulation. These authorities must make

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[1238] *Trasta Komercbanka AS and Others v European Central Bank (ECB)* (Case T-698/16) Judgment of 30 November 2022 [2022].

[1239] ibid.

[1240] *Francesca Corneli v ECB* Case T-502/19 [2022] EU:T:2022:263.

[1241] For an analysis of the case, see Filippo Annunziata and Thomaz de Arruda, 'The *Corneli* Case and the Application of National Law by the European Central Bank' (ssrn.com, June 2023) Bocconi Legal Studies Research Paper Series available at: < CORNELI BOCCONI LP> accessed 3 November 2024.

[1242] *Francesca Corneli v ECB* (n 1290), para. 34.

[1243] ibid, paragraphs 69-70.

[1244] BRRD, Article 85.

decisions pursuant to national laws and regulations, impacting individual credit institutions and their stakeholders. Similar to the SSM Regulation, the SRM Regulation allows parties affected by SRB decisions to seek recourse to the CJEU.[1245]

A pivotal issue is whether the initial SRB decision to adopt a resolution scheme determining that: (1) the credit institution is failing or likely to fail; (2) no viable private sector solution exists to prevent failure; and (3) a resolution action is necessary for the public interest is subject to judicial review by the CJEU.[1246] As indicated earlier, the CJEU will utilize the *Plaumann* test to determine whether the resolution scheme directly and individually concerns the affected party. The decision to resolve a credit institution and determine applicable resolution tools leaves no room for discretionary action by NRAs. The implementation is automatic, stemming solely from EU law. Consequently, these initial SRB decisions are, in principle, subject to review by the CJEU at the request of parties who are directly and individually affected, such as the credit institution's stakeholders, including its shareholders and bondholders. The exact scope of parties considered "individually concerned" by the CJEU remains uncertain, as national practices vary with regard to standing for these stakeholders in resolution scenarios.[1247]

The SRB can implement its resolution scheme indirectly through NRAs using BRRD resolution powers, necessitating NCA compliance with SRB directives.[1248] Standing requirements necessitate that the SRB instructions directly concern the credit institution under resolution as addressed by NCA decisions. If SRB instructions leave no room for NCA material discretion, the original SRB decision may be contestable at the CJEU.[1249] Nevertheless, resolution implementation often demands autonomous NCA decision-making due to complex national private law implications, such as bailing-in financial instruments, selling business segments, asset separation, or transfers to bridge institutions.[1250] Given the applicability of national private law, NCAs are best positioned to execute SRB decisions

[1245] SRM Regulation, Article 86.

[1246] ibid, Article 18; Arons (n 1234), 125.

[1247] ibid.

[1248] SRM Regulation, Articles 18(9), subpara 1 and 29.

[1249] Arons (n 1234), 128.

[1250] ibid., 127-128.

autonomously, reflecting a two-tiered decision-making and judicial review process under the SRM.[1251]

In conclusion, SRB decisions to place a credit institution under resolution and determine the application of specific resolution tools are subject to CJEU review. Due to the inherent autonomous decision-making required by NCAs in implementing SRB decisions, challenges to NCA decisions addressed to the credit institution under resolution should be brought before national administrative courts.

(ii) Scope of Review

The applicant who has fulfilled the standing requirements must allege and prove the reasons for the CJEU to annul the decision of the ECB or the SRB. The grounds on which the CJEU's review will be based are lack of competence, infringement of an essential procedural requirement, infringement of the Treaties or of any rule of law relating to their application and misuse of powers.[1252]

As a foundational administrative principle, EU institutions and agencies must derive their authority from EU treaties. Article 114 of the TFEU, on which the SSM and SRM Regulations were based, has been upheld by the CJEU as a valid legal foundation.[1253] These regulations empower the ECB and SRB to make decisions and exercise powers over NCAs and credit institutions. While their material powers are derived from directly applicable EU financial regulations and national laws implementing EU financial directives, this can create complexities. The ECB and SRB must adhere to specific regulations of the supervised institution's home Member State, which leaves room for national legal particularities despite the comprehensive nature of EU directives.

In addressing the infringement of procedural requirements, the EU courts identified which procedural standards are essential under EU treaties.[1254] These critical requirements are derived from and shared by the common fundamental rights jurisprudence in the Member

[1251] ibid.

[1252] TFEU, Article 263(2).

[1253] Respectively, with regard to the European Union Agency for Network and Information Security (ENISA) and the ESMA, ECJ, judgment of 2 May 2006, *United Kingdom of Great Britain and Northern Ireland v European Parliament and Council of the European Union (ENISA case)*, C-217/04, ECLI:EU:C:2006:279; CJEU, 22 January 2014.

[1254] Arons (n 1234), 129-136.

States, as well as the European Court of Human Rights' case law.[1255] The ground of infringement of an essential procedural requirements encompasses five main aspects, namely the duty to consult, the right to be heard, the duty of confidentiality, compliance with internal procedural rules and the requirement to provide a statement of reasons.[1256] In the context of the SSM and the SRM, key among these rights are the right to be heard and the duty of EU administrative bodies to provide clear reasoning for their decisions.[1257] The SSM and SRM regulations explicitly outline these rights and duties within their provisions, imposing specific obligations on the ECB and the SRB. These regulations require the ECB to accompany its decisions with clear reasoning, detailing the material facts, legal grounds and supervisory considerations that underpin such decisions.[1258] Additionally, individuals or entities whose rights are affected by ECB and SRB decisions possess the right to comment on these decisions before they are finalized.[1259] They also have the right to access the supervisory file prior to the adoption of any decision that may adversely affect them.[1260]

The ground of review relating to the infringement of the EU Treaties or any rule of law relating to their application entails that the CJEU examines EU bodies' decisions for adherence to EU legislation including directives and regulations adopted on the basis of the EU Treaties.[1261] The EU Institutions and agencies, such as the ECB and SRB, are required to comply with the entire body of EU law, which includes the Treaties and secondary legislation. The CJEU interprets the phrase "any rule relating to its application" to include general principles of administrative law.[1262] The principle of proportionality is a key stone in EU law.[1263] This principle entails that actions taken by EU institutions must be suitable

[1255] ibid.

[1256] ibid.

[1257] Koen Lenaerts, Ignace Maselis and Kathleen Gutman, *EU Procedural Law* (OUP 2014), para 7.172.

[1258] SSM Regulation, Article 22(2), subpara 2.

[1259] ibid, Article 44.

[1260] ibid, Article 22.

[1261] Arons (n 1234), 129-136.

[1262] These principles include the principle of proportionality, the principle of protection of legitimate expectations, the principle of equal treatment and the principle of reasonable time in administrative procedures. Some of these principles have subsequently been codified in the EU Charter of Fundamental Rights. This Charter encapsulates all the rights recognized in the case law of the CJEU, the rights and freedoms enshrined in the European Convention on Human Rights, as well as other rights and principles emanating from the common constitutional traditions of EU Member States and various international instruments. The Charter applies to EU institutions, bodies, and agencies, as well as NCAs when they implement or apply EU law. For an in-depth analysis of the potential rights or principles that may be impacted by decisions of the ECB and SRB, and reviewed by the European Court of Justice, refer to Marco Lamandini, David Ramos, and Javier Solana's work, 'The European Central Bank (ECB) Powers as a Catalyst for Change in EU Law: Part 2: SSM, SRM and Fundamental Rights' (2017) 23(2) Columbia Law Review 199.

[1263] Consolidated Version of the Treaty on European Union [2012] OJ C326/13, Article 5(4).

for accomplishing the legitimate goals pursued by the legislation in question and must not exceed what is necessary to achieve those goals. When multiple suitable measures are available, the least burdensome option must be chosen and any disadvantages caused must not be disproportionate to the aims being pursued.[1264]

The CJEU has stipulated that misuse of power is established when an institution pursues objectives other than those for which the authority was conferred by the EU Treaties. As the CJEU has recognized, a Union act is invalidated by misuse of power only if it is evident, based on objective, relevant and consistent evidence, that the act was undertaken with the exclusive or primary purpose of achieving an end different from the one stated, or to evade a procedure specifically prescribed by the EU Treaties.[1265] The ECB and SRB are prohibited from making decisions or utilizing procedures with the exclusive or primary aim of achieving an objective other than what is explicitly stated. It is an exceptional occurrence for Union courts to declare a Union act void on grounds of misuse of power.[1266]

(iii) Intensity of Judicial Review

As discussed in chapter 3 (*The Heated Negotiations Over the EBU*), both the ECB and SRB operate with a certain degree of discretion under the EBU framework. The CJEU generally exercises judicial restraint when reviewing the ECB's policy decisions, acknowledging the institution's specialized expertise and independent status.[1267] In the *Gauweiler* case, the Court affirmed that the ECB has broad discretion in defining and implementing monetary policy.[1268] The Court ruled that the ECB is authorized to make decisions like the Outright Monetary Transactions programme if deemed necessary to achieve the objectives of the European System of Central Banks.[1269] The CJEU emphasized that the ECB's economic judgments should be respected unless they are manifestly erroneous.[1270] The Court highlighted that judicial review of the ECB's actions must avoid overstepping into the highly

[1264] See e.g. Case T-177/12, Spraylat v. ECHA, T-177/12, EU:T:2014:849, at paras. 33–36; Case T-293/11, Holcim (Deutschland) and Holcim v. Commission, EU:T:2014:127, at para 83; Case T-340/04, France Télécom v. Commission, EU:T:2007:81, at para 143.

[1265] Arons (n 1234), 135.

[1266] ibid.

[1267] Alicia Hinarejos, 'Gauweiler and the Outright Monetary Transactions Programme: The Mandate of the European Central Bank and the Changing Nature of Economic and Monetary Union' (2015) EuConst. 563, 575.

[1268] C-62/14 *Gauweiler* (n 572).

[1269] ibid, para 75.

[1270] ibid, paras 71-80.

technical domain that the Treaties allocate exclusively to the ECB.[1271] Therefore, the scope of judicial review of the ECB's activities, though obligatory, must be exercised with considerable caution. In the *Weiss* case, the Court reaffirmed the principles from *Gauweiler*, affirming the ECB's broad discretion in designing and implementing monetary policy measures, as long as these measures do not clearly exceed what is necessary to achieve their objectives.[1272] In this context, some analysts advocate for restrained judicial intervention in the ECB's policy decisions, citing its expert authority and the considerable autonomy provided by the Treaties.[1273]

However, this concept of "discretion" is multifaceted, as the extent of decision-making freedom granted to administrative bodies can vary based on the nature of the decisions they must make. Furthermore, the degree of discretion may also be influenced by the legal framework governing the administrative body, which can impose varying levels of constraints and guidance.[1274] As such, understanding the scope and limits of administrative discretion requires careful consideration of both the specific regulatory environment and the particular circumstances surrounding each decision.[1275] In some cases, this discretionary power is justified by the need for administrative authorities to make value judgments and prioritize certain interests depending on the context of the case at hand. In other cases, it is warranted by the intellectual complexity involved in reaching certain supervisory and resolution decisions.[1276]

As explained by Advocate General Léger, in the case of *Rica Foods v. Commission*, there are two types of discretion granted to EU bodies: "political" and "technical".[1277] Discretion of a political nature exists when institutions act in their capacity as 'political' authorities, particularly when they legislate in a given field or lay down guidelines for an EU policy.[1278] Recognition of such discretion is justified as the institutions must generally reconcile divergent interests and select options within the context of policy choices under their

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[1271] ibid, para 68.

[1272] Case C-493/17 (Grand Chamber) Proceedings brought by Heinrich Weiss and Others ECLI:EU:C:2018:1000, para 78.

[1273] Hinarejos (n 1267), 575.

[1274] For instance, discretion may be conferred to administrative authorities by specific legislation or the EU Treaties. Additionally, in certain situations, the European Court of Justice (CJEU) abstains from exercising judicial review due to the complexity of the issues involved, see Prek and Lefevre (n 289).

[1275] ibid.

[1276] ibid.

[1277] Opinion of A.G. Léger in Case C-40/03 P, Rica Foods v. Commission, EU:C:2005:93, at para 45.

[1278] ibid.

responsibility.[1279] This "political" discretion aligns with the political responsibilities conferred upon an institution by a Union provision.[1280] Conversely, technical discretion applies to EU institutions when they function as administrative authorities, justified by the complexity of the technical and economic scenarios they must assess and the evaluations they must perform. [1281]

In a similar vein, the case of *United Kingdom v. Parliament and Council (Case C-270/12)*, which involved the European Securities and Markets Authority (ESMA), also distinguishes between these two types of discretion.[1282] To conclude that the powers conferred upon ESMA did not breach the rules relating to the delegation of powers, the CJEU emphasized that such powers were exercised in relation to "factual technical assessments" and were "precisely delineated and amenable to judicial review in light of the objectives established by the delegating authority."[1283] For the CJEU, these powers did not involve a "very large measure of discretion" that "would be incompatible with the TFEU Treaty."[1284] This language resonates with academic distinctions between "technical discretion" and "discretion proper."[1285] Essentially, "discretion proper" refers to scenarios where the administration is granted the option to choose between different lawful courses of action by the Treaty or legislature.[1286] On the other hand, "technical discretion" arises when the judiciary acknowledges the complexity of the administration's assessments.[1287]

The assessment of whether the ECB or SRB have been granted "political" or “technical” discretion involves examining both the precise wording of the provision and the genuine intent of the rule-maker in conferring decision-making authority.[1288] For example, Article 10(1) of the CRR states that “competent authorities *may,* in accordance with national law partially or fully waive the application of the requirements set out in Parts Two to Eight to one more credit institutions situated in the same Member State and which are permanently affiliated to a central body which supervises them and which is established in the same

[1279] ibid.

[1280] ibid.

[1281] ibid, para 46.

[1282] *United Kingdom v Parliament and Council* (Case C-270/12) [2014] ECLI:EU:C:2014:18.

[1283] ibid, paras 52-54.

[1284] ibid.

[1285] Prek and Lefevre (n 289), 345.

[1286] ibid.

[1287] ibid.

[1288] ibid.

Member State, if the following conditions are met…".[1289] The General Court emphasized that the application of this provision is not automatic but is instead a discretionary power vested in the competent authority. Consequently, the ECB has the right to deny the requested waiver even if the conditions outlined in Article 10(1) of the CRR are fulfilled.[1290]

However, the wording of the provision is not the most important factor determining whether "political discretion" is granted to the ECB or SRB.[1291] The intention of the legislature can be inferred not only from the text but also through various other indications. When interpreting a provision of EU law, it is imperative to consider its language, the context in which it operates and the objectives it seeks to achieve.[1292] The aims of the specific provision may support the recognition of political discretion if they reveal the rule-maker's intention to allow the administration to "choose among policy options" or to "reconcile conflicting interests" before making a decision, thus determining the relative importance of these interests.[1293]

For example, the SRB's discretion to determine whether the resolution of a failing bank serves the "public interest" necessitates consideration of a variety of potentially conflicting objectives. These include: (i) ensuring the continuity of the bank's critical functions, (ii) avoiding significant adverse effects on financial stability, (iii) protecting public funds by minimizing reliance on extraordinary public financial support and (iv) safeguarding deposits and client assets.[1294] The SRB has the autonomy to weigh these factors and prioritize the objectives as it deems appropriate in each specific case, without judicial intervention. In addition, the Commission's discretion in deciding whether to approve state aid via precautionary recapitalization intended to remedy a serious disturbance in the economy of a Member State, is justified not solely by the permissive wording but is also tied to the "assessments of an economic and social nature" referenced in case law.[1295] This suggests that the Commission must weigh and balance competing interests, specifically harmonizing

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[1289] CRR, Article 10(1).

[1290] *Credit Mutuel Arkéa v ECB* (Case T-712/15) [2017] ECLI:EU:T:2017:900, paras 68-69.

[1291] Prek and Lefevre (n 289), 350.

[1292] *VEMW and Others* (Case C-17/03) [2005] EU:C:2005:362, para 41

[1293] Léger (n 1277), at para 45.

[1294] BRRD, Article 32.

[1295] *Germany v Commission* (Case T-143/12) [2016] EU:T:2016:406, para 152; *Italy v Commission* (Case C-372/97) [2004] EU:C:2004:234, para 83; *Deufil v Commission* (Case 310/85) [1987] EU:C:1987:96, para 18; *Banco Privado Português and Massa Insolvente do Banco Privado Português (*Case C-667/13) [2015] EU:C:2015:151, para 67.

free competition objectives with situations that justify exceptions, when assessing the alignment of precautionary recapitalization with the internal market.[1296]

The exercise of "technical" discretion includes decisions involving "complex economic assessments", which require specialised expertise and understanding of intricate economic concepts.[1297] The term "complex" itself can be misleading, as it might imply a level of intellectual challenge that is beyond the judiciary's ability to comprehend.[1298] However, it is not about the intellectual capacity of judges but rather the specialized nature of the information and the extensive discretion granted to financial authorities in these domains. For instance, when evaluating whether an institution is failing or likely to fail, the ECB or SRB must rely on sophisticated financial models, market predictions, risk evaluations and other intricate economic analyses that require specialized expertise that are integral to their professional assessment. EU Courts have recognized a variety of evaluations under the "complex economic assessment" label, illustrating the broad and sometimes arbitrary nature of what is considered complex. These evaluations are performed within the specific context of the questions at hand, meaning the court's assessment will depend heavily on the particular circumstances and the nature of the economic questions involved.[1299]

When EU administrative authorities are endowed with either "political" or "technical" discretion, the CJEU typically undertakes a "limited" rather than a "comprehensive" review of their decisions.[1300] This approach recognizes the constitutional separation of powers, as well as the specialized expertise and judgment EU authorities possess in their respective fields.[1301] However, the depth of judicial review tends to be even more constrained when scrutinizing an institution's exercise of "political" discretion compared to "technical" discretion.[1302] Regarding technical discretion, CJEU case law demonstrates the Court's commitment to maintaining a limited review standard while still employing judicial techniques to ensure thorough scrutiny of the ECB's technical assessments.

[1296] Prek and Lefevre (n 289), 351.

[1297] Andriani Kalintiri, 'What's In a Name? The Marginal Standard of Review of "Complex Economic Evaluations" in EU Competition Enforcement' (2016) 53(5) Common Market Law Review 1282.

[1298] ibid.

[1299] ibid.

[1300] Prek and Lefevre (n 289), 361-362.

[1301] ibid.

[1302] Léger (n 1277).

More specifically, in the context of "limited" review, EU judicial oversight of the actions of EU authorities is restricted to examining their legality. This entails verifying compliance with procedural rules, the obligation to state reasons, the material accuracy of facts and ensuring the absence of legal errors, manifest errors in assessment, or misuse of powers.[1303] As the drafters of the Treaties and secondary legislation intended certain decisions to be made by administrative authorities, EU courts must honour the distribution of powers established by the legislature and avoid substituting their own judgments. This does not relate to the scope of judicial review,[1304] but the intensity or depth of the review conducted by the EU Courts, which will not delve into the merits of a decision made by the EU authorities.[1305] Such "alternative review"[1306] or "process-oriented review"[12] has been described as a compromise between enhanced judicial scrutiny and the preservation of the administration's discretion.

When the CJEU applies a "limited review" standard, applicants can succeed in their pleas concerning infringements of the Treaty or its application rules only if there is a "manifest error of assessment." This threshold implies that the legal provisions must have been breached so evidently that the error in evaluation becomes obvious.[1307] Moreover, when the ECB or SRB exercise their discretionary powers, they must adhere to specific procedural guarantees.[1308] These include conducting comprehensive and impartial examinations of all relevant factors, as well as providing clear and adequate reasons for their decisions. Well-established case law holds that decisions from Community authorities must clearly disclose the reasoning behind the adopted measures.[1309] This disclosure is vital to enable the concerned parties to defend their rights and to allow the EU courts to exercise their judicial

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[1303] Prek and Lefevre (n 289), 362.

[1304] This remains the same, namely lack of competence, infringement of an essential procedural requirement, infringement of the Treaties or any rule of law relating to their application, and misuse of powers, as analyzed in section 7.2.2(ii) (*Scope of Review*) of this chapter. See e.g. in relation to the review of the ECB's decision relating to the prudential supervision of credit institutions: *Credit Mutuel Arkéa v ECB* (Case T-712/15) [2017] EU:T:2017:900, para 177

[1305] On this question see Léger (n 1277), at para 48

[1306] Jukka Tiili and Joannes Vanhamme, 'The "power of appraisal" (pouvoir d'appréciation) of the Commission of the European Communities vis-à-vis the powers of judicial review of the Communities' Court of Justice and Court of First Instance' (1998) 22 Fordham International Law Journal 885, 891–896.

[1307] *RJB Mining v Commission (*Case T-156/98) [2001] EU:T:2001:29

[1308] In the CJEU case *Technische Universität München v Hauptzollamt München-Mitte* (Case C-269/90) [1991] ECR I-5469, it was noted that "where the Community institutions have such a power of appraisal, respect for the rights guaranteed by the Community legal order in administrative procedures is of fundamental importance. Those guarantees include, in particular the duty of the competent institution to examine carefully and impartially all the relevant aspects of the individual case and the right of the person concerned to make his views known and to have an adequately reasoned decision. Only in this way can the Court verify whether the fa ctual and legal elements upon which the exercise of the power depends were present".

[1309] ibid, at para 14.

review. A lack of clear reasoning can lead to the annulment of the decision. The principle of providing adequate reasoning is distinct from the "assessment of manifest error."[1310] The Courts, when doubting the decision-making process of the EU institutions, may choose to annul a decision due to a deficient statement of reasons rather than assess the merits comprehensively or marginally.[1311] This is because reasoning is a purely procedural requirement.[1312] The obligation for careful and impartial examination, known as the "obligation of investigation," is a separate standard of review grounded in the principle of sound administration.[1313] This duty, alongside the requirement to state reasons, focuses solely on the presence of diligent and transparent investigation and reasoning, without delving into whether the Commission's assessments themselves were correct.[1314]

The rarity of annulments based on manifest errors of assessment highlights the high threshold for the General Court's intervention and reflects the judiciary's caution in substituting its judgment for that of the administration, except in exceptional cases.[1315] Rather than concentrating on the substance of the decision, the General Court generally adopts a "process-oriented review," emphasizing how discretion was exercised.[1316] This approach often leads to annulments due to inadequate reasoning or failure to thoroughly examine the case's specifics.[1317] Even when annulments are based on manifest errors of assessment, they rarely stand alone and are typically accompanied by findings that the administration failed to sufficiently consider the particular circumstances of the case.[1318]

The distinction between "comprehensive" and "limited" review is highly significant in practice.[1319] It prevents the EU Courts from interfering with pure policy questions or common interest evaluations, regardless of whether these assessments are based on scientific examinations.[1320] As long as the decisions of the ECB or SRB hinge on genuine policy choices and common interest appraisals, they can only be overturned by the Courts

[1310] Tilli and Vanhamme (n 1306).
[1311] ibid, 891.
[1312] ibid.
[1313] ibid, 900.
[1314] ibid.
[1315] Prek and Lefevre (n 289), 367.
[1316] ibid.
[1317] ibid.
[1318] ibid.
[1319] Tilli and Vanhamme (n 1306), 890.
[1320] ibid.

if they are evidently inappropriate to the extent that they constitute a "manifest error of appraisal."[1321] On the other hand, all other administrative applications of the law should be thoroughly reviewed by the EU Courts. In these instances, the concept of manifest errors of appraisal is unnecessary, affirming the need for "comprehensive" judicial oversight.[1322]

The recent CJEU cases concerning the exercise of powers by the ECB illustrate the CJEU's stance that a "limited" review standard will be applied in matters of "technical" and "political" discretion. In the *Crédit mutuel Arkéa v ECB* case, the General Court examined the ECB's decision to mandate additional capital requirements for a French credit institution under the Supervisory Review and Evaluation Process.[1323] This decision was grounded in an assessment of prudential risks, notably due to the institution's potential departure from the Crédit Mutuel group arising from internal conflicts. While applying a "limited review" standard, the Court went beyond merely verifying procedural legality. The Court evaluated the factual accuracy, reliability and consistency of the evidence used by the ECB. It also assessed whether the evidence included all relevant factors and whether it could substantiate the conclusions reached by the ECB. However, the Court refrained from substituting its own judgment for that of the ECB regarding the institution's risk profile. Instead, it focused on procedural guarantees and determined that a potential split from the group was not so improbable as to constitute a manifest error of assessment by the ECB.

In a case involving six French banks against the ECB[1324], the General Court reviewed the ECB's decision to deny exemptions under Article 429(14) CRR for certain exposures from the leverage ratio[1325] calculation, relevant to French savings accounts ("**Livret A accounts**"). The waiver would have allowed banks to exclude these low-risk exposures, which, according to French law, must be partially transferred to Caisse des Dépôts et Consignations ("**CDC**"), a public financial institution. These relationships are intended to

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[1321] ibid.

[1322] ibid.

[1323] *Credit Mutuel Arkéa v ECB* (n 1354).

[1324] Judgments in *Banque Postale v ECB* (Case T-733/16) [2018] ECLI:EU:T:2018:476; *BPCE v ECB* (Case T-745/16) [2018] ECLI:EU:T:2018:477; *Confédération nationale du Crédit mutuel v ECB* (Case T-751/16) [2018] ECLI:EU:T:2018:475; *Société générale v ECB* (Case T-757/16) [2018] ECLI:EU:T:2018:478; *Crédit agricole v ECB* (Case T-758/16) [2018] ECLI:EU:T:2018:479; *BNP Paribas v ECB* (Case T-768/16) [2018] ECLI:EU:T:2018:480.

[1325] The leverage ratio is intended to make sure banks hold enough capital compared to their total assets, thus limiting how much they can borrow against their equity. This helps strengthen banks' resilience to financial stress and lowers the risk of insolvency in economic downturns. Art. 429(2) CRR provides that "the leverage ratio shall be calculated as an institution's capital measure divided by the institution's total exposure". Paragraph 14 of Art.429 CRR allows competent authorities to authorise credit institutions to exclude certain exposures from their ratio calculation under certain circumstances.

facilitate governmental funding for social housing and public projects, leveraging the secure and low-risk profile of Livret A savings accounts.

The French banks argued that the ECB had failed to properly interpret the legislation and had committed both an error of law and a manifest error of assessment in its application of its power of waiver.[1326] They contended that since Livret A accounts are mandated by French law to be partially transferred to the CDC, the exposures are low-risk and should not be included in the leverage ratio, thereby presenting a more accurate risk profile. The ECB opposed this by arguing that although the exposures to Livret A accounts met the conditions mentioned in Article 429(14) CRR, it retained a margin of discretion to refuse exemptions if it deemed them necessary to ensure the safe and sound management of the supervised institutions.[1327] The ECB was particularly concerned about the transfers of assets by the CDC to the credit institutions, which, in its view, lacked sufficient prudential safeguards. The ECB raised issues about the operational risks linked to these savings, such as the obligations of the credit institutions to reimburse customers irrespective of the funds transferred to the CDC, which could affect their capital adequacy.

The Court first affirmed the ECB's discretionary authority by interpreting the regulatory provision as granting the ECB a margin of discretion to weigh different objectives: the necessity for a comprehensive overview of credit institutions' indebtedness versus the opportunity to consider low-risk exposures, like lending to public authorities, that do not stem from independent decisions by banks. Applying the "limited" standard of review, the Court made clear that its review could not substitute the assessment within the remit of the administration. The Court confined itself to verifying whether the contested decision was based on materially correct facts and free from legal error, manifest error of appraisal, or misuse of power.

The Court determined that the ECB's legal interpretation was indeed an error of law, as it rendered the waiver effectively inapplicable, a matter that falls within the Court's jurisdiction to review. The Court then rigorously scrutinized the appropriateness of the ECB's reasoning, particularly the ECB's concerns about the adjustment period. The term "adjustment period" refers to the time frame that credit institutions require to align their

[1326] Magliari (n 1181), 77.

[1327] ibid.

financial positions with public institutions after the asset transfers by the CDC. The ECB had argued that this period posed liquidity risks that could compel banks to sell assets to cover the interim deficit before receiving the funds from the CDC. However, the Court noted that the ECB's previous decisions regarding the applicants' liquidity ratios indicated that this period did not constitute a liquidity risk, given the existence of a government guarantee and the short duration between outflows and inflows. The Court found that the ECB had not thoroughly examined all relevant factors, such as the likelihood of a French State default or the actual liquidity risk posed by the adjustment period.

While the Court maintained a limited review approach, it did not follow a "light touch" approach as it might with political discretion. Instead, it refrained from substituting its findings for the ECB's, such as independently evaluating the improbability of a French State default or the risk of a bank run.[1328] In conclusion, the annulment was based on the ECB's incorrect interpretation of the relevant legal provisions and procedural inadequacies. The Court did not encroach upon the ECB's discretion by conducting an autonomous balancing of interests or reassessing complex economic appraisals underpinning the contested decisions.[1329] Thus, while upholding a limited review standard, the Court ensured comprehensive procedural scrutiny to maintain administrative accountability.[1330]

The preceding analysis shows that the intensity of judicial review by EU Courts in the context of the EBU regime depends on the nature and scope of the EU bodies' discretionary powers. The Court applies a limited review standard when assessing complex economic appraisals or policy choices made by EU bodies, but it does not shy away from scrutinizing the legal interpretation, procedural adequacy and rationality of the ECB's decisions. Supervisory measures that have a general scope, such as regulations, general instructions and guidelines, or involve discretionary weighing of diverse interests ("political" discretion) should be distinguished from decisions that merely apply legal provisions (circumscribed powers) or are based solely on technical assessments ("technical" discretion). In the latter two cases, the necessity to preserve the supervisory authority's margin of appraisal is less critical, while ensuring comprehensive judicial protection becomes paramount.

[1328] ibid, 81.
[1329] ibid.
[1330] ibid.

(iv) Analysis of judicial review in light of the power framework

As this section will demonstrate, the judicial review processes face significant limitations in protecting periphery member states from the exercise of power by core states. The CJEU's narrowly defined scope of review focuses primarily on procedural correctness rather than substantive merits. This limited review fails to effectively address the judicial bias inherent in the system, wherein political and economic influences shape decisions under the facade of neutrality. Furthermore, ex post judicial reviews, conducted after decisions have already caused potential harm, offer little real-time protection and often come too late to mitigate immediate adverse effects. Additionally, the review process struggles to address non-decisions or inactions—where key financial information held by NCAs in core states is withheld, preventing timely and informed regulatory measures.

(a) Scope of judicial review

The CJEU employs a "limited review" standard, focusing primarily on procedural correctness and the presence of manifest errors, without delving deeply into the substantive merits of decisions. However, many policy decisions that significantly impact Eurozone periphery states fall under the realm of "political" discretion, which the CJEU does not rigorously review. Consequently, policy choices driven by power dynamics that may be unsuitable for periphery states but beneficial for core states will be enforced without substantive judicial intervention.

A key example of such "political discretion" exercised by the SRB is the analysis of the Italian bank resolution cases in Chapter 6 (*Bank Resolution Cases in Practice Under the EBU*). The Italian government used *its instrumental and institutional* power to shift the decision-making process from EU fora to national fora, protecting domestic stakeholders from the politically costly bail-in exercise.[1331] The SRB decided there was no public interest in resolving the Venetian banks at the EU level.[1332] The high threshold for a "manifest error" associated with CJEU's judicial review means that if these SRB decisions were challenged at the CJEU, the judiciary would not be in a position to replace the SRB's assessment and decide that the Venetian banks should be resolved. Similarly, the CJEU would not challenge the ECB's determination that MPS is not failing or likely to fail, allowing the Italian

[1331] See sections 6.4 (*The Failure of the Venetian Banks*) and 6.5 (*Analysis of the Recapitalisation of MPS and Liquidation of the Venetian Banks in Light of the Power* Framework) of Chapter 6.

[1332] Single Resolution Board (n 978).

government to provide precautionary recapitalization. This maneuvering by the Italian government to avoid a politically damaging bail-in highlights a significant competitive imbalance, as periphery states may not have the same leverage or ability to circumvent rules even if, from a policy perspective, they should.

Furthermore, core countries have incentives to impose strict conditions on periphery states or credit institutions established in such jurisdictions struggling to comply with the EBU regime, often without considering their unique economic or nuanced local conditions. For instance, as analysed in Chapter 6 (*Bank Resolution Cases in Practice Under the EBU*), mandating banks to raise capital during a crisis, similar to the EBA's capital exercise to restore investor confidence during the Eurozone sovereign debt crisis, can devastate the local banking systems of periphery states.[1333] Similarly, bail-in measures affecting local stakeholders can severely impact the financial health of these economies. Without clear legal or procedural violations, the court defers to the EU institutions' discretion and expertise, leaving little room to challenge such decisions that adversely affect periphery states.

Therefore, the CJEU's limited review of the EU institutions' decisions leaves periphery states vulnerable to the "political" discretion of EU institutions that may be influenced by the power dynamics of core states.

(b) Judicial bias

The conventional view posits that judges are neutral and objective arbiters of justice.[1334] This perspective suggests that judicial decisions are based purely on legal principles and facts, free from external influences and personal biases.[1335] It assumes that the judiciary functions independently of political pressures and operates with the sole aim of upholding the rule of law. This idealized view portrays judges as impartial figures who act as guardians of justice, tasked with ensuring fairness and equality before the law.

However, this perspective often obscures the underlying biases and political influences that shape judicial decisions.[1336] This bias is systematically embedded in both the legal texts and institutions supporting EU administrative decision-making. For example, the ECB

[1333] See section 6.2.2 (*Analysis of the Resolution of the Cypriot Banks in Light of the Power Framework*) of Chapter 6.

[1334] Duncan Kennedy, *A Critique of Adjudication* (Harvard University Press, 1998), 32.

[1335] ibid, 29-32.

[1336] ibid.

influenced by core states' power dynamics, often prioritizes financial stability at the EU level.[1337] These decisions, presented under the guise of neutrality and objectivity, effectively obscure the political and ideological influences at play. As a result, this facade of impartiality masks the true impact on the Eurozone's periphery states, which frequently suffer most from these policies. These policies can exacerbate existing socio-economic inequalities and do not adequately address the unique challenges faced by periphery economies.[1338]

Far from challenging existing power structures, the EU adjudication process frequently operates within them, thereby legitimizing the prevailing distribution of power and resources. Judicial review mechanisms fail to challenge these deeper power structures and the economic ideologies they reinforce.[1339] Instead, they tend to legitimize and perpetuate them, offering only limited remedies that do not fundamentally address the socio-economic disadvantages faced by periphery states.[1340] In the *Pringle* decision, for example, the CJEU upheld the amendments establishing the ESM highlighting the primary objective of ensuring financial stability within the Eurozone.[1341] However, this decision did not fully consider the impact of these amendments on the power dynamics among member states, as it shifted decision-making outside the EU legal framework to negotiations between member states, accompanied by minimal procedural safeguards. For fear of triggering a financial meltdown, the CJEU tends to avoid delving deeply into the review of policy measures that may have a disproportionate effect on Eurozone periphery member states, thus prioritising financial stability over other potentially impacted rights and considerations.[1342]

In sum, judicial processes tend to be inherently conservative, prioritizing stability and the maintenance of established hierarchies over transformative justice. Judicial review, therefore, risks becoming a tool that upholds the *status quo* rather than an instrument of genuine corrective justice.

[1337] For a discussion how the ECB''s pursuit of its objective to promote financial stability can have an impact on fundamental rights, see Lamandini et al (n 1262).

[1338] ibid.

[1339] Evgeny Bronislavovich Pashukanis, *The General Theory of Law and Marxism* (New Brunswick and London, Transaction Publishers 2003).

[1340] ibid.

[1341] *Thomas Pringle v. Government of Ireland*, Case C-370/12, EU:C:2012:756.

[1342] Lamandini et al (n 1262).

(c) *Ex post* judicial review is too late to prevent harm

Ex post judicial review is an important tool for ensuring legality in decision-making processes, but it is limited in its effectiveness when it comes to protecting periphery states against the adverse effects of decisions by EBU institutions that are influenced by core states' power dynamics. By the time a decision reaches the stage of judicial review, any damage to the financial system of periphery states will already have occurred. This damage, whether it relates to market stability, investor confidence or broader economic implications, cannot be easily undone, even if the decision is subsequently annulled by the CJEU. Therefore, the retrospective nature of *ex post* judicial review means that it addresses issues after they have materialized, offering no real-time mitigation against immediate adverse effects.

The right to suspend decisions is not a panacea for periphery states. The announcement of a contested decision suffices to instil uncertainty and potential adverse consequences. The fact that the lodging of an appeal does not automatically suspend the effects of the challenged decision underscores that suspension is the exception, not the norm. Within the EBU framework, there is a rebuttable presumption that suspending the enforcement of a resolution would be against the public interest.[1343] This further emphasizes the limited protective capacity of an appeal. Additionally, to protect the interests of third parties acting in good faith who have acquired shares or other assets through resolution tools or powers, the annulment of a decision does not affect subsequent administrative acts or transactions based on that decision. In such cases, remedies are limited to compensation for the applicant's loss, rather than reversing the harmful impacts on the financial system.[1344]

(d) The limitations of judicial review in addressing information asymmetries

Judicial review, by its nature, is designed to evaluate the legality and appropriateness of decisions and actions taken by public authorities. However, it is inherently limited when it comes to reviewing decisions that have not been made. In the context of the EBU, NCAs in core states often hold crucial financial information that could affect periphery states.

[1343] BRRD, Article 85(4)

[1344] ibid.

Unfortunately, these NCAs have little incentive to share such information with the EU bodies, which hampers these bodies' ability to take informed and timely action.[1345]

The problem is compounded by the fact that judicial review cannot address inaction or non-decisions effectively. When NCAs choose not to share vital information, the EU bodies remain in the dark, unable to make decisions that could prevent emerging financial risks. By the time any judicial review process can address these non-decisions, systemic risks may have already crystallized into significant financial instability. This reactive nature of judicial review, which depends on the existence of a decision or action, makes it ill-suited to handle situations requiring pre-emptive regulatory measures.

(v) National Courts

As already explained, national courts will be involved in the judicial review process in terms of both the ECB and SRB when the NCAs exercise autonomous decision making when instructed to use powers conferred to them under national law by the ECB or SRB.[1346] As discussed, if the NCAs retain any level of discretion, the affected party must seek redress through national courts.[1347]

In such cases, it is the responsibility of the national courts to refer the matter of annulling the ECB's instruction to the CJEU via preliminary reference proceedings, as they cannot rule on the validity of EU law themselves.[1348] When national courts refer questions to the CJEU via the preliminary reference procedure, the rulings provided by the CJEU are binding on the referring courts as to EU law. This binding nature ensures the uniform interpretation and application of EU law across all member states.[1349] Moreover, CJEU judgments interpreting EU law hold an authority comparable to national supreme courts in civil law countries. National courts must consider these judgments when interpreting EU law or risk the unsuccessful party filing an action for damages based on the non-contractual liability of the relevant Member State.[1350]

[1345] Carletti et al (n 562).

[1346] Arons (n 1234).

[1347] ibid.

[1348] TFEU, Article 267.

[1349] *Foto-Frost v Hauptzollamt Lübeck-Ost* (Case 314/85) [1987] ECR 4199

[1350] *Köbler v Republic of Austria* (Case C-224/01) [2003] ECLI:EU:C:2003:513

More importantly, the scope of judicial review for SRB decisions is notably limited. The BRRD imposes certain constraints on the intensity of review, suggesting that national courts should base their decisions on the complex economic assessments made by resolution authorities rather than conducting a full re-evaluation.[1351] This implies that the detailed evaluation underlying the selection and application of resolution measures is generally beyond the purview of national courts. Instead, their review should be restricted to verifying whether the evidence used by the resolution authority is factually accurate, reliable and consistent, includes all relevant information necessary to assess the complex situation and is capable of substantiating the conclusions drawn.[1352]

Therefore, reliance on national courts for judicial review of ECB and SRB decisions may not adequately protect periphery states due to inherent limitations in the review process. The complex economic assessments underpinning ECB and SRB decisions might reflect the interests and economic priorities of the more influential core member states, thereby neglecting the unique economic conditions and constraints of periphery states. As national courts are bound to adhere to these complex assessments without full re-evaluation, periphery states might find that their judicial avenues are effectively curtailed. This is compounded by the fact that the CJEU judgments interpreting EU law hold authority similar to that of national supreme courts in civil law countries. National courts must take these judgments into account, further limiting their discretion.

7.3 ECB'S AND SRB'S LIABILITY IN THE PERFORMANCE OF THEIR TASKS

Where damage has already occurred and judicial review of the decisions made is insufficient protection, affected parties may seek compensation for losses incurred due to the actions of EU institutions during their duties.[1353] The SSM and SRM Regulations specifically establish this liability. According to these regulations, the ECB and SRB are obligated, in line with

[1351] BRRD, Recital 89.

[1352] ibid.

[1353] In its Opinion CON/2012/96, the ECB drew attention to this issue: European Central Bank, 'Opinion of the European Central Bank of 27 November 2012 on a Proposal for a Council Regulation Conferring Specific Tasks on the European Central Bank concerning Policies relating to the Prudential Supervision of Credit Institutions and a Proposal for a Regulation of the European Parliament and of the Council Amending Regulation (EU) No 1093/2010 Establishing a European Supervisory Authority (European Banking Authority) (CON/2012/96) [2013] OJ C30/5, paragraph 1.7. However, no limitation of liability was introduced in the SSM Regulation, see recital 61,

the general principles common to Member States' laws, to remedy any harm caused by them or their personnel while performing their duties.[1354]

In the wake of the global financial crisis, there is a growing expectation for national authorities to shield supervisory bodies from legal actions. Notably, the Basel Committee on Banking Supervision's Core Principles for Effective Banking Supervision highlight this.[1355] Specifically, one of these core principles recommends that national legal frameworks should incorporate legal protection for banking supervisors.[1356] This recommendation is further detailed in an essential criterion, which stipulates that laws should safeguard supervisors and their staff against lawsuits for actions taken or omissions made while executing their duties in good faith.[1357]

In the same vein, a report by the World Bank on legal protections for banking supervisors concluded that amidst political consensus, often triggered by banking crises, there is an opportunity to amend banking laws to grant greater authority to central banks and regulatory agencies.[1358] The report advised that these amendments should also incorporate legal protections for banking supervisors within the legislation.[1359] It emphasized that although various models for these protections exist, it is essential to ensure the broadest possible coverage for banking supervisors in the legal framework.[1360]

In response to the Core Principles for Effective Banking Supervision, the ECB articulated the importance of robust legal protections for supervisors to ensure effective oversight and safeguard the public interest.[1361] It asserted that the liability of the ECB, national competent authorities and their officials should be limited to cases of intentional misconduct or gross negligence.[1362] This stance reflects an emerging normative trend in both Member States and key global financial centers, which increasingly favour restrictions on the liability of

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[1354] Article 87(4) of the SRM. The SSM does not include articles providing for this kind of liability but the preamble reiterates the principle set out in the SRM, see recital 61.

[1355] Basel Committee on Banking Supervision, 'Core Principles for Effective Supervision' (bis.org, April 2024) available at: <https://www.bis.org/bcbs/publ/d573.pdf> accessed 3 November 2024

[1356] ibid, Core Principle 2.

[1357] ibid, Essential Criterion 9.

[1358] Donal Nolan, 'The Liability of Financial Supervisory Authorities' (2013) 4 Journal of European Tort Law 190, 197.

[1359] ibid.

[1360] ibid.

[1361] Opinion of the European Central Bank (n 1353), recital 61.

[1362] ibid.

banking supervisors.[1363] The ECB also highlighted that this approach aligns with the case-law of the CJEU, which imposes liability only in instances of qualified unlawfulness.[1364] The ECB further underscored the need to harmonize the Union's supervisory liability regime with the global consensus outlined in the Core Principles.[1365] These principles advocate for legal safeguards that protect supervisors and their staff from lawsuits for actions taken or omissions made in good faith, including the provision to cover defence costs.[1366] Such protections are deemed essential, given the complexity and urgency of supervisory tasks, especially during financial crises when quick decisions must be made under significant time pressure. Additionally, the ECB argued that a unified liability regime within the SSM is crucial for preserving its operational integrity. A fragmented and overly stringent liability framework could weaken the resolve of supervisory authorities to take necessary action. [1367]

The necessity for enhanced legal protection for financial supervisors must be viewed within the broader context of a long-term reassessment of the objectives of financial supervision. The EBU framework shifts the focus from mere depositor protection to ensuring the stability of the Eurozone financial system by emphasizing systemic risk.[1368] In this context, litigation by affected parties against supervisory authorities can destabilize the regulatory framework by distorting priorities and diverting the attention of supervisors from their primary role of maintaining financial system stability.[1369]

More broadly, the argument for special protection is driven by the need for authorities to perform their supervisory duties without the fear of liability, fostering independence and confidence in their decisions.[1370] Additionally, there are concerns about the diversion of resources to handle litigation and the risk that liability for discretionary regulatory decisions could inadvertently interfere with the overall direction of regulatory policy during individual case adjudications.

[1363] Robert J. Dijkstra, 'Liability of Financial Supervisory Authorities' (2012) 3 Journal of European Tort Law 346.

[1364] Opinion of the European Central Bank (n 1353).

[1365] ibid.

[1366] Basel Committee on Banking Supervision (n 1355).

[1367] Opinion of the European Central Bank (n 1353).

[1368] Phoebus Athanassiou, 'Financial Supervisors' Accountability – A European Perspective' Legal Working Paper Series No 12/August 2011, 35-37.

[1369] ibid.

[1370] ibid.

Following the Eurozone sovereign debt crisis, several European jurisdictions have increasingly adopted measures to shield financial authorities from liability. In numerous jurisdictions, banking supervisors are granted immunity for decisions made during the exercise of their supervisory functions, except in instances of "intentional misconduct," "fraud," "gross fault," "bad faith," or "gross negligence."[1371] Thus, it can be argued that the general legal principles common to the Member States—under which the ECB's or SRB's liability will be assessed—include restrictions or exclusions of liability for supervisors. It is likely that the CJEU will determine that the ECB's or SRB's liability for supervisory or resolution decisions cannot be unlimited, based on the same public policy considerations that have led to the implementation of such limitations in national legislation.[1372]

This regime has the potential to reinforce existing power imbalances. By shielding supervisory authorities from litigation, the current liability framework eliminates a crucial check on potentially biased decision-making. This limitation significantly restricts the ability of periphery states to seek redress and hold EU authorities accountable for their actions.

7.4 CONCLUSION

This chapter has critically assessed the effectiveness of administrative and judicial review mechanisms within the European Banking Union (EBU) EBU the rights and interests of Eurozone periphery states against the backdrop of dominant core state power dynamics.

The administrative review processes, managed by the ABOR for the ECB and the Appeal Panel for the SRB, provide only limited checks on the decisions of these powerful regulatory bodies. The fear of retaliation, potential bias in the composition and appointment procedures and the strictly procedural focus of these reviews undermine their effectiveness for the protection of periphery states. The non-binding nature of the ABoR's opinions and the SRB's capacity to amend decisions based on remittances further dilute the potential impact of administrative reviews.

[1371] Nolan (n 1358).

[1372] Chiara Zilioli, 'Justiciability of Central Banks' Decisions and the Imperative to Respect Fundamental Rights' (2017) ECB Legal Conference 91.

Judicial review, while offering a formal avenue to challenge decisions under the TFEU, faces its own critical constraints. Strenuous standing requirements, a narrow focus on procedural correctness and a high threshold for evidencing manifest errors limit access and effectiveness. The retrospective nature of judicial review often arrives too late, making it ineffective in preventing immediate and real-time adverse impacts on periphery states. An underlying issue is the inherent bias within the EBU framework, where policies shaped by core states prioritize European-wide financial stability, often at the expense of addressing the nuanced economic conditions of periphery states. The judiciary's cautious approach, aimed at avoiding systemic financial risks, further reinforces this bias, making substantial judicial interventions rare. This conservative judicial stance tends to maintain the prevailing distribution of power, thus legitimizing the status quo rather than offering avenues for corrective justice. Finally, the shield of liability provided to supervisory bodies like the ECB and SRB adds another layer of complexity. While it ensures that these institutions can perform their duties without the constant fear of litigation, it also significantly limits the ability of periphery states to seek redress or challenge potentially biased decision-making. This legal shield, aligned with global trends of limiting supervisor liability, exacerbates existing power imbalances and restricts judicial avenues for vulnerable states.

In sum, while the EBU framework has mechanisms in place for administrative and judicial reviews, these processes are constrained in ways that render them insufficient in addressing the deeply entrenched power imbalances between core and periphery Eurozone states.

8 MAKING THE EBU WORK FOR ALL MEMBER STATES

8.1 INTRODUCTION

The preceding chapters established that the EBU institutions grant EU policy officials significant discretion to make crucial *ex post* decisions with substantial distributional consequences for Member States. Given the indeterminate nature of EBU rules, the pivotal issue lies in who interprets and enforces these rules when member states advocate for their interests in differing ways. This thesis employed a power framework to argue that power dictates these decisions and demonstrated how power manifests itself in the drafting, supervision and enforcement of the EBU regulations.

In this regard, this thesis revealed that decisions made during bank failures are inherently political. The application of the EBU regime is biased, contrary to the assertions of some commentators. Instead, policy outcomes reflect the interests of the member states at stake. Consequently, seemingly similar cases of failing banks are handled differently, depending on whether the policy decisions receive support from core member states. Core member states, with their considerable influence, often shape outcomes to their advantage, while periphery states may find their interests sidelined, reinforcing existing inequalities within the Eurozone.

Despite the EBU framework incorporating administrative and judicial review mechanisms, these processes are not effective in addressing the profound power imbalances between core and periphery states. Judges predominantly review procedural correctness and manifest errors, rather than the substantive impacts of decisions. Additionally, *ex post* judicial review only addresses issues after harm has occurred, failing to provide real-time protection against adverse decisions influenced by core states' power dynamics. Judicial bias, influenced by these entrenched power dynamics and disguised as neutrality, exacerbates the socio-economic disparities faced by periphery states. Consequently, the judicial process falls short in offering meaningful redress and perpetuates the existing power structure.

In summary, the preceding chapters revealed how power is exercised within the EBU framework, laying the foundation for recommendations aimed at improving the institutional framework to ameliorate power imbalances. The present chapter will explore whether specific amendments to the EBU institutional design could recalibrate the incentives of those involved in the decision-making process, leading to better policy outcomes for

periphery states.[1373] The objective of this chapter is to identify mechanisms to curtail the influence of powerful member states, ensuring that the EBU institutions serve the interests of all Eurozone member states more equitably. Creating a more balanced institutional framework that is responsive to all member states is advantageous not just for periphery states, but also for core states. The rising popularity of Eurosceptic parties in major Eurozone economies poses a significant threat to the unity and mutual support critical to the Eurozone, potentially undermining its political foundation.[1374] Core member states, by prioritising their own interests within the EBU framework and subjecting EU institutions to national bodies, risk compromising European economic solidarity and, in turn, their own long-term stability in case Euro-sceptic parties come to power domestically.

This discussion will examine how targeted institutional reforms could limit the power of core states, foster more balanced decision-making and better protect the interests of periphery states. While proposing these recommendations, however, this chapter recognises the limited role of law in inter-state relations.[1375] Legal frameworks are often shaped and enforced by those very states with the most influence, thereby reflecting their interests and power structures.[1376] Powerful states are often both the architects and guardians of international legal norms, crafting rules that reinforce their own hegemonic positions. Regardless of the institutional framework adopted, elements of discretion will always allow powerful states to interpret and enforce rules in ways that benefit them. When significant interests are at stake, these states may even choose to violate rules to safeguard domestic concerns.[1377] In other words, legal tools are not sufficient on their own to completely dismantle the deeply rooted power structures that maintain the divide between core and periphery states in the Eurozone. However, these same legal tools can still play a role in mitigating harm. By implementing appropriate legal measures, we can at least curb the unchecked expansion of financial practices that disproportionately affect Eurozone periphery states.

[1373] Institutions have the capacity to establish appropriate incentives for the stakeholders involved in the decision-making process, ensuring that decisions are made in the best interests of all member states, see Timothy Besley, *Principled Agents*? *The Political Economy of Good Government* (Oxford, OUP 2006).

[1374] Henry Foy, 'How the EU Far Right Could Soon Have the Power to Bring Brussels to a Halt' (FT.com, 2 July 2024) available at: < https://www.ft.com/content/c8205483-c79c-4cea-afc1-db6a78d78ce9> accessed 3 November 2024.

[1375] Karl Marx, *Later Political Writings* (Terrell Carver ed, CUP, Cambridge 1996), 159–160.

[1376] Martti Koskenniemi, 'The Politics of International Law' (1990) 1(1) European Journal of International Law 4.

[1377] Stephen Krasner, *Sovereignty: Organised Hypocrisy* (Princeton, Princeton University Press 1999).

8.2 MAKING THE EBU FRAMEWORK WORK FOR ALL MEMBER STATES

The application of the power framework to the EBU institutions has revealed that, rather than ameliorating the power imbalances between core and periphery member states, the EBU rules often magnify them by imposing constraints on periphery states' ability to express their policy preferences in EU fora. This realisation underscores the need for amendments to the current framework to better balance power among member states. Key proposed amendments include (i) redefining the scope of credit institutions under the remit of the ECB and SRB, (ii) adjusting the composition of fora tasked with making significant supervisory and resolution decisions, (iii) revising the objectives framework of the EBU and (iv) changing control over financial and information flows in the EBU.

8.2.1 Scope

As noted in section 2.3.2 (*The SSM*) of Chapter 2 of this thesis, the ECB is responsible for supervising credit institutions that meet specific criteria. These criteria include institutions with total assets exceeding €30 billion, those with total assets above €5 billion where 20% or more of their total assets are cross-border assets or liabilities, the three most significant institutions in each participating member state, institutions that have requested or received financial assistance from the ESM and those deemed significant by NCAs for the domestic economy.[1378]

The EU's thresholds for transferring supervisory duties to the central level means that smaller credit institutions, including community and regional banks in the Eurozone's periphery, fall within the EBU framework. These smaller institutions frequently cannot manage the heavy regulatory burden, which involves compliance with complex rules requiring substantial investments in both personnel and technology.[1379] This financial strain can typically be borne only by large banks.[1380] These larger banks also benefit from the option to reduce their capital charges via the internal ratings-based approach, an option generally unavailable to smaller institutions, thus conferring another competitive advantage

[1378] SSM Regulation, Article 6(4).

[1379] Matthias Lehmann, 'Single Supervisory Mechanism Without Regulatory Harmonization? Introducing a European Banking Act and a "CRR Light" for Smaller Institutions' (2017) EBI Working Paper Series No. 3 available at: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2912166> accessed 20 October 2024.

[1380] Luca Amorelio, 'Europe Goes "Countercyclical": A Legal Assessment of the New Countercyclical Dimension on the CRR/CRD IV Package' (2016) 17 European Business Organization Law Review 137, 155.

on the larger entities.[1381] Moreover, large banks have the benefit of sophisticated operational models, which enable them to diversify their business strategies, optimise their balance sheets and enhance their return on investment, further exacerbating the differences between small and large banks.[1382]

As noted by Lehmann, it is crucial to avoid a 'one size fits all' regulatory approach, as applying the same standards to both small and large banks is impractical.[1383] This issue has been highlighted in discussions about Basel III, which has been criticized for its methodology, despite being intended only for 'internationally active banks,' generally large institutions.[1384] However, the EU chose to implement the Basel capital requirements for all its banks and investment firms. The rationale was that banks functioning in one Member State could potentially provide services throughout the entire EU single market, engaging in cross-border activities.[1385] Additionally, the EU pointed out the risks of competitive distortions and regulatory arbitrage if the internationally agreed rules were applied only to a subset of European banks.[1386]

The United States, on the other hand, adopts a different regulatory approach by implementing the Basel III framework in a tiered manner.[1387] In the U.S., a lighter regulatory regime exists for smaller institutions, while a more demanding system applies to medium and larger banks. American law differentiates between 'non-advanced approaches' for institutions with total assets between $15 billion and $250 billion, and 'advanced approaches' for those with assets of $250 billion or more.[1388] Banks under the advanced approaches must comply with capital floors as mandated by the “Collins Amendment”, calculate risk-weighted capital ratios using both the standardized and advanced approaches and adhere to the higher of the two for compliance.[1389] These banks also face multiple capital

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[1381] ibid, 158.

[1382] ibid.

[1383] Lehmann (n.1379), 21.

[1384] Rainer Masera, ‘CRR/CRD IV: The Trees and the Forest’ (2014) 67 (271) PSL Quarterly Review 381.

[1385] European Commission, ‘Capital Requirements - CRD IV/CRR – Frequently Asked Questions’ available at: < ec.europa.eu/commission/presscorner/detail/en/memo_13_272> accessed 1 November 2016.

[1386] ibid.

[1387] Rainer Masera, ‘US Basel III Final Rule on Banks’ Capital Requirements: A Different-Size-Fits-All Approach’ (2013) 66 PSL Quarterly Review 390; Justin Chircop and Zoltán Novotny-Farkas, ‘The Economic Consequences of Extending the Use of Fair Value Accounting in Regulatory Capital Calculations’ [2016] Journal of Accounting and Economics 1 et seq

[1388] Masera (n 1387), 390.

[1389] Lehmann (n 1379), 22.

ratio calculations regarding leverage ratios, from which non-advanced approach banks are exempt.[1390]

Defining what makes a financial institution "systemically important" is inherently complex and prone to subjectivity, which ultimately leaves it vulnerable to criticisms regarding a level playing field.[1391] This complexity becomes evident through the various studies aiming to identify systemic banks in Europe, with each study presenting a slightly different set of systemic financial institutions.[1392] The outcomes of these studies depend heavily on the specific variables used to measure bank activities and the chosen cut-off points for bank size and the extent of cross-border operations. While arbitrary cut-off points are acceptable in academic and empirical work, they can create significant issues of fairness if used to dictate the regulatory treatment of different banks.[1393]

Nevertheless, it can be argued that local oversight may be more appropriate for supervising smaller banking institutions with limited international activities. The resolution tools outlined in the BRRD are robust enough to alter incentives for excessive risk-taking and address moral hazard issues, as they can be applied to manage potential recapitalisations of failing banks in the Eurozone periphery by imposing losses on the bank's shareholders and junior creditors. Since these banks generally do not pose systemic risks, the bail-in tool can be effectively used without fear of contagion from the losses incurred by the bailed-in creditors. This ensures that shareholders and bondholders absorb the losses due to excessive risk-taking, aligning with the EBU principle of reducing taxpayer-funded bailouts. Additionally, given their typically small size, applying the sale to a private purchaser to reorganise these banks is simpler.

In addition, as local constituents will primarily bear the responsibility of rescuing failing banks, this situation will encourage NCAs and politicians to perform their supervisory roles and take pre-emptive actions to curb excessive risk-taking. In situations where accessing the ESM funds becomes necessary, it will be approached with caution. The handling of the Eurozone sovereign debt crisis has shown that core member states are hesitant to extend

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[1390] ibid.

[1391] Martin Čihák and Jörg Decressin, 'The Case for a European Banking Charter" (2007) IMF Working Paper available at: < https://www.imf.org/external/pubs/ft/wp/2007/wp07173.pdf> accessed on 20 October 2024, 13.

[1392] ibid.

[1393] ibid.

financial aid to periphery Eurozone countries without imposing stringent conditions. This stance has made it clear to investors and local constituents in the Eurozone periphery that they will absorb losses if risks materialise, thereby reinforcing market discipline. Additionally, to address potential concerns about the effectiveness of local regulations or supervision, the ECB could be granted powers to intervene in specific cases where issues are identified. Such an intervention mechanism would act as a safeguard, ensuring effective oversight.

Conversely, periphery states should maintain active involvement in the supervision of core banks within the EBU framework. While the operations of periphery banks do not pose significant risks to core member states, the activities of large core banks can substantially impact periphery countries. As already explained in Chapter 3 (*The Heated Negotiations Over the EBU),* core member states do not have incentives to address risks that may affect the Eurozone periphery. Therefore, it is crucial for periphery states to proactively manage these potential risks by being involved in the oversight of core credit institutions. By engaging in the supervision of core banks, periphery states can stay informed about systemic risks and advocate for appropriate policy measures to mitigate these risks at an earlier stage.

8.2.2 Objectives

The SSM is designed to assign specific tasks to the ECB with the goal of enhancing the safety and soundness of credit institutions and ensuring the stability of the financial system within the EU and its Member States.[1394] The SSM mandates that these tasks be carried out with full regard for the unity and integrity of the internal market based on the equal treatment of credit institutions to prevent regulatory arbitrage.[1395] In performing its tasks, the ECB shall take into account the various business models, types and sizes of credit institutions.[1396] Furthermore, the SSM requires the Supervisory Board and the Steering Committee to act independently and objectively in the interests of the Union as a whole, free from the influence of Union bodies, national governments or other public or private entities.[1397]

[1394] SSM Regulation, Article 1.
[1395] ibid.
[1396] ibid.
[1397] ibid, Article 26(1).

This integrated approach emphasises the collective interests of the EU rather than concentrating on risks specific to individual countries, aiming to promote financial stability and integrity within the internal market. However, this rigid method of addressing the distinct circumstances of individual countries presents a notable challenge for the Eurozone. Managing the banking system of a nation, particularly during an economic downturn, necessitates a nuanced approach.

In certain situations, it will be necessary to depart from the principle of equal treatment and instead tailor regulatory measures to the specific economic conditions of individual Member States.[1398] Economic environments within the EU can vary significantly and a one-size-fits-all approach may not always be effective.[1399] Flexibility in supervisory decisions is therefore essential to address these disparities.[1400] The Eurozone sovereign debt crisis illustrated the limitations of centralised decision-making from Frankfurt or Brussels, even when those decisions aimed to bolster financial stability across the Eurozone.[1401] As detailed in Chapter 6 (*Bank Resolution Cases in Practice Under the EBU*), the EBA capital exercise during the crisis sought to restore investor confidence by mandating EU banks to recognise losses and boost equity capital to ensure adequate capitalisation.[1402] Although the intention was to restore investor confidence in Eurozone banks, this policy destabilised periphery member states such as Cyprus.[1403] The stringent application of rules designed with larger economies in mind placed undue pressure on smaller banks in these regions.

More broadly, during the Eurozone sovereign debt crisis, the ECB's responsiveness varied significantly between core and periphery states. The ECB showed leniency by applying looser standards for monetary operations to large banks in core countries. Throughout the crisis, the ECB not only reduced its main interest rates to near zero but also introduced monetary tools like the Long-Term Refinancing Operations and Quantitative Easing programs.[1404] These instruments had fewer conditions for core banks, allowing major

[1398] Stiglitz (n 20), 130-131.

[1399] ibid.

[1400] ibid.

[1401] ibid.

[1402] In respect of the detrimental impact of the EBA Capital exercise on Cypriot banks, see section 6.2.2 (*Analysis of the resolution of the Cypriot banks in light of the power framework*) of Chapter 6.

[1403] ibid.

[1404] Fontan (n 531).

financial entities to transfer risk-laden private assets to the ECB's public balance sheet, primarily benefiting central banks in Paris and Frankfurt.[1405] Moreover, due to the ECB's lack of oversight on liquidity usage, banks engaged in carry-trade operations by borrowing liquidity for three years to purchase assets with a similar maturity at higher rates, thus making a profit from the spread. Mario Draghi himself admitted to these problematic carry-trade actions before the European Parliament.[1406]

Conversely, the ECB displayed inflexibility towards periphery Eurozone countries by insisting on the strict implementation of fiscal policies and adjustment programme, often overlooking the unique economic situations of the periphery economies during the Eurozone sovereign debt crisis.[1407] For example, significant pressure was exerted by the ECB to force stringent reforms on periphery nations as the crisis progressed. A notable case is the Irish government being pressured by former ECB President Jean-Claude Trichet into guaranteeing all Irish banks' debts under threat of cutting off liquidity, which would have forced Ireland out of the Eurozone if they did not comply.[1408] Similarly, in Cyprus, the ECB threatened to cut ELA, intensifying the liquidity crisis of the island's two largest credit institutions.[1409] In Greece, during the 2015 announcement of a referendum on the third bailout programme, the ECB discontinued ELA to Greek banks.[1410] This action was widely seen as an effort to destabilize the leftist government and alter its policies.[1411] Additionally, the ECB played a critical role in designing financial aid programmes for periphery Eurozone member states during the crisis, advocating for harsh austerity measures.[1412] While the IMF often supported more moderate reforms, the ECB pushed for sweeping restrictive fiscal policies.[1413] This stringent approach to enforcing austerity on periphery states contrasted

[1405] Philippine Cour-Thimann, 'Monetary Policy and Redistribution: Information From Central Bank Balance Sheets in the Euro Area and the US' (2016) 64(3) Review of Economics 293.

[1406] Fontan (n 531), 176; Mario Draghi, 'Speech of Mario Draghi at European Parliament', 14 July 2014.

[1407] Levi (n 722).

[1408] Castle (n 60).

[1409] European Central Bank (n 832).

[1410] Robert Peston,'Greece Debt Crisis: ECB 'To End' Bank Emergency Lending' (bbc.co.uk, 28 June 2015) available at: < https://www.bbc.co.uk/news/world-europe-33303105> accessed 3 November 2024.

[1411] ibid.

[1412] Levi (n 722), 2.

[1413] ibid.

sharply with the leniency shown towards providing liquidity to core banks in the Eurozone.[1414]

To mitigate the risks faced by periphery economies in the Eurozone, EBU institutions should strengthen the ECB's responsibility to explicitly consider the impact of its supervisory decisions on these member states. Although the ECB currently provides reasons for its decisions, incorporating mandatory economic impact assessments could ensure a thorough evaluation of their effects on various Eurozone economies. Supervisory decisions often involve complex trade-offs between objectives. If a specific measure is shown to be particularly detrimental to periphery states as compared to core ones, adjustments should be made to ensure that its implementation does not adversely affect the Eurozone periphery economies. For instance, when the EBA capital exercise was implemented, stringent regulatory requirements were more manageable for stronger economies but posed significant challenges for periphery ones. In such cases, the ECB could consider phased implementations or provide temporary relief measures for periphery states. A staggered timeline for meeting capital requirements could be introduced, giving banks in periphery economies more time to adjust without compromising overall financial stability. Alternatively, the ECB could design support mechanisms, such as providing access to liquidity facilities or offering regulatory forbearance on a temporary basis, to help these economies manage the transition. These economic impact assessments can also include feedback loops from affected countries, providing a platform for member states to raise concerns and suggest adjustments. If the ECB maintains its stance despite objections from periphery states, it should clearly justify the reasons for taking measures that may destabilize those economies without making necessary adjustments. Enhanced transparency and public scrutiny would help prevent the ECB's decisions from being unduly influenced by the interests of core credit institutions and member states, thereby fostering more balanced supervision within the Eurozone. Transparency facilitates better stakeholder engagement. When all stakeholders, including periphery states and smaller member countries, have access to the reasoning and data behind supervisory decisions, it encourages a more inclusive dialogue. This reduces the ability of more powerful states to dominate the

[1414] ibid.

decision-making process through political tactics. Such inclusive engagement ensures that diverse perspectives are considered, leading to more balanced and equitable policies.

A significant challenge within the EBU resolution framework is the public interest assessment performed by the SRB. When a bank is deemed as failing or likely to fail, the SRB has the authority to decide on resolving the bank if it is in the public interest to do so. This assessment involves a comparison between resolution and insolvency, specifically evaluating how each scenario achieves the outlined resolution objectives. The SRB's primary resolution objectives include ensuring the continuity of critical functions, preventing significant adverse effects on financial stability, protecting public funds by minimising reliance on extraordinary public financial support, safeguarding retail depositors and protecting client funds and client assets.[1415] Under the current framework, resolution can only be chosen if insolvency cannot achieve the resolution objectives to the same extent. However, as noted in Chapter 6 (*Bank Resolution Cases in Practice*), this wide margin of discretion has resulted in divergent applications. Politicians and banks in core countries have exploited these discrepancies to advocate for local reorganisation of banks rather than pursuing resolutions at the EU level.

One of the primary issues within the current institutional framework is the lack of a clear hierarchy among its resolution objectives. This absence of prioritisation allows EBU policymakers to claim success based on criteria that may conveniently align with their interests at any given time. Although these objectives are crucial, they are not arranged in a hierarchical order, meaning no single dominant objective constrains the pursuit of others. For example, the aim of avoiding adverse effects on financial stability can conflict with the goal of minimising reliance on public financial support. The lack of a clear hierarchy among these objectives enables SRB policymakers to introduce their personal interpretations when deciding how to balance these equally-ranked goals. This flexibility effectively places those involved in the decision-making process in the position of evaluating their own performance, potentially leading to subjective and biased decision-making processes.

More importantly, the current framework illuminates a lack of alignment in "public interest" assessments across various EU resolution regimes. The geographic scope for assessing

[1415] BRRD, Article 32.

financial stability, in particular, requires greater harmonisation. Presently, the public interest test under the SRM focuses on financial stability at both the national and banking union levels. In contrast, the public interest test assessment under the European Commission's state aid rules allows for regional considerations relating to financial stability to be taken into account. This discrepancy in scopes can result in fragmented and sometimes conflicting assessments of financial stability, thereby undermining the consistency and effectiveness of resolution strategies across the EU.

To address these inconsistencies and enhance the overall effectiveness of bank resolutions, greater deference should be given to the SRB's judgement on these matters. The current text of the SRM stipulates that resolution should be chosen only when normal insolvency proceedings would not meet the resolution objectives to the same extent. The EU Commission's proposal for the amendment of the SRM suggests clarifying this article to state that national insolvency proceedings should be selected as the preferred strategy only when they achieve the framework's objectives more effectively than resolution, not merely to the same extent. This amendment is a step in the right direction, as keeping insolvency as the default option raises the burden of proof for resolution authorities to show that resolution is not in the public interest.

Additionally, while the resolution objective aims to minimise reliance on public financial support, it does not adequately consider industry-funded safety nets that could be utilised to protect failing credit institutions. As highlighted in Chapter 6 (*Bank Resolution Cases in Practice Under the EBU*), Italy introduced the Atlante fund, a private fund designed to purchase non-performing loans, which provided support to struggling banks.[1416] The SRM framework should be adjusted to ensure that all forms of support reasonably expected to be used to assist an ailing credit institution are considered during the public interest assessment. If liquidation aid is anticipated in the insolvency counterfactual, resolution should be pursued, with decisions made at the EU level.

Moreover, harmonising the geographic scope for financial stability assessments and aligning the public interest test criteria would prevent NCAs and domestic politicians from exploiting differing regimes for their benefit. The argument is not against considering

[1416] See section 6.5 (*Analysis of the Recapitalisation of MPS and Liquidation of the Venetian Banks in Light of the Power Framework*) of Chapter 6.

regional impacts, but rather ensuring it is not misused to shield entities that engaged in excessive risk-taking from incurring losses. The liquidation of several Italian banks underscored the complexities of implementing the bail-in tool, especially given the potential for significant losses among retail investors. To mitigate this risk, the resolution framework should be revised to include a stringent suitability test, making it more challenging for credit institutions to sell instruments that may become subject to bail-in to retail clients.[1417] The regulatory approach in BRRD II, which mandates a suitability assessment before subordinated instruments are offered to retail investors, is an essential reform.[1418] Additionally, under the BRRD II member states can strengthen investor protection by enforcing a minimum denomination limit for securities sold to retail investors, with the threshold set at no less than EUR 50,000.[1419]

8.2.3 Representation

Both the SSM and the SRM rely significantly on NCAs for their operational tasks and for coordinating cross-border activities among national authorities involved in the decision-making process. Even where supranational decision-making exists, it is not free from national biases. The ECB, for instance, relies heavily on NCAs for day-to-day supervisory activities. NCAs are tasked with collecting information and preparing draft supervisory decisions for the ECB's Supervisory Board. However, NCAs in core member states lack incentives to inform the ECB about systemic risks affecting periphery states, knowing that ECB intervention may be detrimental to their own interests.[1420] Additionally, NCAs together constitute a majority of the voting members on the ECB's Supervisory Board, which is the primary decision-making body within the SSM.

At the SRB, decision-making structures have been established that grant member state representatives a dominant role in critical supranational decisions, particularly in individual cases.[1421] At first glance, it appears that supranational members of the SRB hold

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[1417] Tatiana Farina, Jan Pieter Krahnen, Irene Mecatti, Loriana Pelizzon, Jonas Schlegel and Tobias H. Troger, 'Is There a 'Retail Challenge' to Banks' Resolvability? What Do We Know About the Holders of Bail-in-able Securities in the Banking Union?' (2022) Economic Governance Support Unit (EGOV) Directorate-General for Internal Policies available at: < https://www.europarl.europa.eu/RegData/etudes/IDAN/2022/733729/IPOL_IDA(2022)733729_EN.pdf> accessed 20 October 2024, 14.

[1418] BRRD II, Art. 44(a)(1)-(4).

[1419] ibid., Art 44(a)(5).

[1420] Carletti et al (n 562).

[1421] Troeger and Kotovskaia (n 507).

considerable power when making decisions regarding failing credit institutions. As noted in section 2.3.3 (*The SRM*), when the SRB deliberates on resolution measures concerning specific institutions or cross-border groups, the national resolution authorities of member states where a subsidiary or entity covered by consolidated supervision is established will participate in the executive session. If a consensus is not reached among the session's members, decisions are made by a simple majority vote, consisting of the Chair and the four other full-time Board members. In such cases, representatives of the national resolution authorities are excluded from voting and no participant in the session possesses veto rights. In the event of a tied vote, the Chair has the casting vote.

However, the executive session is empowered to make decisions only when the use of the SRF does not exceed €5 billion in liquidity or €10 billion in capital provisions to failing credit institutions.[1422] The threshold is set so low that, in almost every resolution of cross-border banks in the Eurozone, decisions will ultimately be made by the SRB plenary session, in which the NCAs of all member states participate. Additionally, the plenary session is responsible for making decisions on significant issues related to the organisation and financing of the SRB.

The plenary session governs extraordinary financing measures, including ex-post contributions[1423], borrowing from other resolution-financing arrangements[1424], borrowing on the market and from public financial arrangements[1425] and the mutualisation of national resolution-financing arrangements in group resolutions involving entities in non-participating member states[1426]. Crucially, decisions made by the plenary session require either a majority representing at least 30% of the contributions to the SRF or a supermajority of two-thirds of the Board members, which must also represent 30% of SRF contributions (this threshold was 50% during the eight-year transition period).[1427] The more stringent supermajority requirement applies if additional funds raised exceed those available to the SRF. In essence, unqualified supranational decision-making power only prevails when

[1422] SRM Regulation, Article 50(1)(d).

[1423] ibid, Article 71.

[1424] ibid, Article 72.

[1425] ibid, Articles 73 and 74.

[1426] ibid, Article 78.

[1427] ibid., Article 52(3).

resolution objectives can be achieved through schemes funded primarily by private sector involvement without necessitating substantial public sector liquidity support. In all other cases involving significant SRF contributions, national dominance shapes the resolution decisions.

These voting structures grant core member states significant leverage in the decision-making process. It would be irrational for the SRB executive session to propose a resolution scheme involving a substantial SRF contribution if it anticipates that the required approval of the plenary session will not be achieved.[1428] This has important ramifications for the incentives of supranationally-appointed Board members. Whenever they foresee that the orderly resolution of a failing institution or group requires significant public support, which at the supranational level must come from the SRF, they will need to be more accommodating to the interests of core member states that control the majority of the funds. Without their support, the policy measures proposed by the SRB executive session will not gain approval in the plenary session, as coalition-building among core NCA representatives can easily outvote the five full-time independent SRB members.

The role of the NCAs in the SSM should be reduced within the decision-making process of the Supervisory Board. While there is a pragmatic reason for involving NCAs in day-to-day supervisory tasks due to their local expertise and the sheer number of banks requiring supervision, which precludes a single entity from managing them all, the current structure results in operational inefficiencies and potential conflicts of interest. As noted in section 4.4.4 (*Decision-making process*) of chapter 4 of this thesis, one key finding of the European Court of Auditors' Report is that JSTs are predominantly staffed by NCAs, with a composition ratio of approximately two-thirds NCA staff and one-third ECB staff.[1429] This imbalance often leads to conflicting reporting lines, where JST staff report to the JST coordinator for supervisory tasks but remain administratively under their respective NCA management. Additionally, JST coordinators are sometimes from the same country as the supervised bank, which contradicts the ECB's own guidelines.[1430] Moreover, the ECB's

[1428] Troeger and Kotovskaia (n 507), 8.

[1429] European Court of Auditors (n 495), paras 129-130.

[1430] ibid, para 123.

involvement in on-site inspections is notably low, with only 8% of inspectors being ECB staff, compared to 92% from NCAs.[1431]

To ameliorate these conflicts of interest, it is essential to strengthen the role and presence of ECB staff within JSTs. Specifically, the IMF argues that having on-site inspection teams headed by ECB staff would enhance the ECB's direct control and oversight, mitigating potential national biases.[1432] Furthermore, rotating staff from different nationalities within these teams can prevent the dominance of national interests and promote a more diverse and impartial supervisory perspective. Rotational staffing ensures that supervisors are not overly aligned with the institutions they oversee or the NCAs they are part of.[1433] Additionally, decisions by the Supervisory Board should be made solely by the independent members if there is a disagreement among NCAs affected by specific decisions, who should not participate in the voting process. This would increase the power of the independent members of the Supervisory Board in making decisions, though it would not entirely remove national interests from the equation as NCAs will still participate in the process.

Regarding the SRB, the current threshold for the SRF, which limits the executive session's decision-making authority to situations involving up to €5 billion in liquidity or €10 billion in capital provisions, creates an imbalance in the supervisory process. This threshold constrains the executive session's autonomy and centralises decision-making power in the plenary sessions, where core member states have significant influence due to their higher financial contributions. Consequently, this structure makes the SRB decision-making process overly responsive to the interests of wealthier core member states, often to the detriment of the Eurozone periphery.

Joseph Stiglitz's critique of the governance structures of the IMF and the World Bank highlights a significant issue that also applies to public bodies like the SRB.[1434] Historically, in democratic processes, wealth has not been a qualification for voting rights.[1435] For example, richer individuals do not possess more votes even in economic matters.[1436] The

[1431] ibid, para 154.
[1432] Carletti et al (n 562), 41.
[1433] ibid.
[1434] Stiglitz (n 417), 120.
[1435] ibid.
[1436] ibid.

justification for a system of one-euro-one-vote rather than one-man-one-vote within the SRB is that it ostensibly operates as a commercial enterprise with shareholders.[1437] Larger shareholders, i.e., core countries, have more votes just as they would in a private corporation.[1438] This analogy, however, is far from persuasive.[1439] In the private sector, shareholders dissatisfied with a company's decisions can simply sell their shares. This mechanism of exit is not available in the same manner for public organisations like the SRB, which have far-reaching impacts on all member states and citizens within the Eurozone. The SRB's primary objective should be to ensure financial stability and manage the resolution of failing banks in a way that serves the interests of the entire European Union, rather than prioritising the concerns of its wealthiest member states. There is a risk that core member states could influence resolutions to favour their own economies or financial sectors, potentially undermining the stability and equitable treatment of the entire Eurozone.

To mitigate such conflicts of interest, the resolution decisions should be made exclusively by independent members of the SRB. Additionally, it is essential that the SRF be administered by the SRB without direct interference from member states. At present, centralised oversight enables banks from core Eurozone nations to expand into periphery regions. This expansion subjects periphery countries to significant risks posed by these core banks' operations. Nonetheless, if such risks materialise, core countries maintain substantial control over the resolution process through their influence on resolution funds, thereby protecting their own interests. This creates an unfair scenario in which the burdens of financial instability are disproportionately borne by periphery states. These countries remain exposed to the negative impacts of banking activities conducted by institutions based in core countries, leading to an unequal financial environment.

8.2.4 Decision-making process

The SRM is not a singular institution but rather a framework designed to manage banking crises by allocating various responsibilities and powers to multiple bodies. These include the SRB, the European Commission, the Council of the European Union, the ECB and the NCAs in participating member states. This fragmented architecture introduces numerous

[1437] ibid.
[1438] ibid.
[1439] ibid.

veto points, complicating decision-making and allowing special interest groups and their political supporters multiple venues to exert influence. As discussed in section 2.3.3 (*The SRM*), once the SRB adopts a resolution scheme, it is forwarded to the European Commission, which must either approve the scheme or raise objections to its discretionary aspects.[1440] If these objections pertain to significant changes in the use of the SRF or the assessment of "public interest," the decision then falls to the Council, which decides by a simple majority vote.[1441]

The Commission's role in this approval process, regardless of the specific criteria of the assessments, is generally less contentious. This is because the Commission, staffed by specialist supranational personnel, operates as a truly European authority with institutional mechanisms designed to ensure impartial decision-making, relatively free from individual member states' special interests. In contrast, the Council, comprising the 27 finance ministers from EU member states who represent their national governments' positions also plays a pivotal role in critical resolution decisions.[1442] This dynamic highlights that, under certain conditions, national interests can outweigh supranational crisis management efforts.[1443]

The Council's ability to reject the "public interest" assessment grants it considerable power, as it can override the SRB's supranational authority and delegate the task of liquidating the failing credit institution to national authorities.[1444] Although the Council can only intervene if prompted by the Commission, this is not a substantial barrier in practice, particularly if a majority of member states exert pressure on the Commission to propose Council involvement.[1445] The Council's participation politicizes the decision-making process, disproportionately affecting periphery countries by making them vulnerable to the electoral considerations of core member states.[1446]

[1440] SRM Regulation, Article 18.
[1441] ibid.
[1442] Troeger and Kotovskaia (n 507), 7.
[1443] ibid.
[1444] ibid.
[1445] ibid, 7-8.
[1446] ibid.

Politicians often prioritize short-term electoral benefits over long-term financial stability.[1447] For example, when the SRB addresses a failing institution in the Eurozone periphery, politicians may seek to reduce SRF support if core credit institutions are not at risk from the periphery bank's failure. Since the SRF is funded by credit institutions, those without exposure to losses may prefer stringent bail-in measures during a periphery crisis to avoid contributing to the SRF. Conversely, if the SRB is dealing with a failing bank in a core country, politicians might contest the public interest assessment to facilitate domestic liquidation of the bank, thereby protecting domestic taxpayers and disregarding the negative impacts on periphery states.

The involvement of the Council in the decision-making process is unnecessary and counterproductive, as it politicises the process and enables core member states to intervene in order to protect domestic interests. When the SRB anticipates that the Council might interfere with a resolution scheme, the Board may be dissuaded from proposing such a scheme in the first place. Removing the Council's involvement diminishes the risk of decisions being influenced by national political agendas. This ensures that resolutions are based on objective financial and regulatory criteria rather than political considerations. This shift would benefit periphery states, which often find their interests sidelined by the core member states with stronger political influence.

8.2.5 Rule-making power

National laws continue to play a significant role in bank resolutions, as highlighted in Chapter 6 (*Bank Resolution Cases in Practice*). Loopholes in the resolution process are often exploited by member states to circumvent the strict discipline of the BRRD. Supervisors and resolution authorities may resort to precautionary recapitalisation procedures or, as noted above, if a bank is considered failing or likely to fail, may argue against public interest by claiming that resolution objectives can be proportionally achieved through regular insolvency proceedings.[1448]

[1447] Gadinis (n 453), 331.

[1448] See the analysis of the recapitalisation of the Venetian banks in section 6.5 (*Analysis of the Recapitalisation of MPS and Liquidation of Venetian Banks in Light of the Power Framework*) of Chapter 6.

Even after a resolution is initiated at a supranational level by the SRB, NRAs are crucial in implementing the resolution scheme, allowing them to express their national interests.[1449] Any SRB resolution decision can only be executed through NRA action.[1450] NRAs have the discretion to decide which specific resolution measures to apply when implementing the SRB's resolution scheme. They can define resolution actions and potentially influence the SRB to adopt changes to the resolution scheme. Ultimately, NRAs may employ bridge-bank or asset separation strategies to provide hidden support to the failing credit institution. Domestic banks or investment firms might be encouraged or incentivised to purchase these assets, possibly through guarantees or favourable terms, thus spreading risk and ensuring asset management by specialised entities.

In such scenarios, national laws play an important role in addressing failing credit institutions, leading to uneven conditions for investors across countries and varying funding conditions for banks within the EBU. When comparing resolution and insolvency outcomes, the SRB cannot consider using public funds during the public interest assessment, whereas a national government may decide that liquidation under its national insolvency regime requires public funds, which the Commission has approved under the 2013 Banking Communication. It is more challenging to utilise the industry-funded SRF under the Single SRM than to use public funds for precautionary recapitalisation, according to the 2013 Banking Communication. In some countries, the national insolvency regime for banks includes a comprehensive toolkit to ensure the continuity of critical functions and a sale-of-business tool, minimising value destruction during liquidation. In others, applying national laws may lead to less strict solutions, such as 'voluntary liquidation' following a failing or likely-to-fail determination. Additionally, creditor claims hierarchies in national insolvency regimes vary considerably.

To address these discrepancies in bank insolvency, greater alignment is needed. Harmonising national insolvency laws is complex and time-consuming due to the EU's subsidiarity principle, unless specific provisions applicable to the banking sector are separated from national insolvency regimes to increase consistency. Another approach could involve tightening state-aid rules to eliminate opportunities for providing state aid similar

[1449] SRM Regulation, Article 28.

[1450] ibid.

to the aid given during the liquidation of the two Veneto banks in June 2017, ensuring that the same burden-sharing arrangements required by the SRM apply to failing credit institutions. Aligning state-aid burden-sharing requirements in liquidation with those in the SRM, would reduce uncertainties and dissuade member states from opting for national liquidation regimes to protect domestic constituencies.

8.2.6 Control of financial flows

Even if the SRB adopts the resolution scheme in respect of a failing bank, it may still lack the financial capacity to effectively manage the business models of large banks during resolution due to liquidity and solvency challenges. The SRB does not have direct access to central bank funds nor a substantial fiscal backstop to provide the necessary capital and liquidity to stabilise a major failing bank. The financial link between the SRF and ESM offers limited relief, as the credit line, capped at €68 billion, is inadequate.[1451] Additionally, governance structures hinder its swift availability during crises, further complicating the SRB's ability to act decisively. Without adequate liquidity and capital, the SRB may not be the robust entity it needs to be. Therefore, it is essential to increase the financial capacity of the SRF to ensure it can address systemic crises across the EU, not just in periphery states.

Control over SRF decisions should also not rest with member states. As highlighted in section 4.4.3 (*Control of Scarce Resources*) of Chapter 4, the SRF was established through an international treaty outside EU law, allowing domestic courts in core member states to impose national agendas on the decision-making process. [1452] This treaty includes numerous safeguards to protect the fiscal sovereignty of core member states, enabling them to block fund distribution to periphery states. The SRB can only seek financial support from the ESM if core member states agree, given the voting structures that require their consent for the SRF to raise external financing. Even if the SRB seeks backing from the ESM, core countries exert significant control over the ESM decision-making process and are unlikely to support the SRF if such decision does not align with their domestic interests.

The notion of centralised supervision and the promotion of integrated EU banking groups, with centralised capital and liquidity buffers at the group level, is fundamentally at odds

[1451] Eurogroup (n 730).

[1452] Asimakopoulos (n 376), 126.

with the retention of resolution funds under the control of member states. This current setup places periphery states in a precarious position. They lose the authority to impose additional capital and liquidity requirements to protect their domestic financial systems, yet, in the event of a crisis, they are subjected to the preferences of core countries who control the resolution funds. This model disproportionately exposes periphery states to significant financial risks emanating from core countries, without providing them the necessary tools or power to mitigate those risks effectively.

There was no need for the SRF and ESM to be established through international treaties that allow national judiciaries and parliaments to interfere in the decision-making process. EU funds must be governed solely by EU law ensuring accessibility for Eurozone periphery states without restrictive conditionalities. The institutional safeguards in these treaties, which enable core member states to threaten withdrawal if decisions threaten their fiscal sovereignty, should be removed. Similarly, the voting structures related to SRF and ESM funding should be reformed to eliminate the veto power of core member states over fund usage. Independent EU bodies should oversee fund allocation, ensuring decisions are made in the interest of the EU as a whole, including its periphery member states, rather than catering to the interests of specific countries.

8.2.7 Control of information flows

As the preceding chapters demonstrated, the influence of core member states in EU forums is largely due to their ability to obtain necessary information from credit institutions, processing this information with their multidisciplinary expertise and publicly delivering assessments that can skew financial sector policy discussions. This situation disadvantages Eurozone periphery states. Presidents, prime ministers, legislators and the general public in these periphery states often lack effective mechanisms to obtain information about the actions of NCAs in core states and their potential impacts.

Even when such information is available, the system's complexity hampers efforts to persuade EU bodies or the public at large that certain measures are detrimental to their economies. Core policy officials wield significant influence in shaping and maintaining the *status quo* within the EU. They don't just interpret regulatory frameworks, but they actively direct them. This means they play an integral role in steering economic policies in ways that favour their home industries. By leveraging substantial resources, including extensive

research departments and participation in key international forums, these officials ensure that law enforcement and interpretation align with their interests. This creates a regulatory environment that supports the circumstances of core jurisdictions, often at the expense of periphery economies within the Eurozone.

The relationship between power and knowledge is crucial in this context.[1453] Dominant states control the discourse that shapes international norms and legal principles, reflecting their interests and perspectives. The insistence on austerity measures during the Eurozone sovereign debt crisis exemplified this dynamic. The narrative that there was no alternative policy option disregarded the socio-economic realities of less influential periphery economies. This control, both material and ideological, underscores the role of powerful actors in maintaining existing power structures and perpetuating their dominance within the regulatory landscape.

In light of these concerns, establishing a new EU body with the authority to acquire any necessary information to evaluate EU financial regulations could address fundamental flaws in interpreting EU financial rules.[1454] The law creating this institution should unequivocally grant it immediate access to any information from regulatory authorities and financial institutions deemed necessary. This new body would resemble the concept of the "Sentinel" proposed by James R. Barth, Gerard Caprio Jr. and Ross Levine.[1455] The Sentinel was envisioned as an independent entity that would scrutinize information received by US regulatory bodies, aiming to ensure thorough oversight and transparency.[1456] Similarly, the new EU body would serve as an independent overseer, ensuring that financial regulations are applied consistently and effectively, without undue influence from any specific member state or financial entity. This EU body would only be responsible for delivering reports to the EU legislative and executive branches assessing whether financial regulations effectively ensure the safe operation of the financial system, particularly considering spillover effects on Eurozone periphery economies. Importantly, this body would not have

[1453] For a general discussion over how information and knowledge can become important sources of power, see Michel Foucault, *Discipline and Punish: The Birth of the Prison* (first published 1975, Penguin Books 1977); Antonio Gramsci, *Selections from the Prison Notebooks* (Quintin Hoare and Geoffrey Nowell Smith eds, Lawrence and Wishart 1971); Herbert Marcuse, *One-Dimensional Man: Studies in the Ideology of Advanced Industrial Society* (Routledge 2002)

[1454] James R Barth, Gerard Caprio Jr and Ross Levine, *The Guardians of Finance: Making Regulators Work for Us* (MIT Press 2012).

[1455] ibid, 219.

[1456] ibid.

official power over the ECBs, NCAs, or financial markets and institutions. In other words, it wouldn't alter the existing powers and responsibilities of these bodies. Instead, its role would be limited to providing an informed, expert and independent assessment of regulatory practices and their impacts on Eurozone periphery states.

The establishment of this new EU body will enable it to identify and communicate systemic risks that could impact economies broadly, particularly in the periphery countries. This increased transparency will curb the ability of regulators to obscure their actions or conceal vital information that may have wider repercussions. When a regulator discovers unsafe practices that have persisted over time, there is often hesitation to intervene swiftly, as doing so might reveal previous regulatory failures. However, this new entity would not only face fewer such conflicts of interest, but it would also possess the capacity to advocate for alternative options that challenge core ideologies. This could lead to the promotion of policies that consider the needs and circumstances of all EU economies, rather than reinforcing the dominant narratives favoured by central jurisdictions.

Moreover, in contrast to the ECB and other EU bodies, which may refrain from critiquing other agencies to avoid inter-agency conflicts, this new body would be more willing to voice necessary criticisms. This willingness to critique will ensure that discretionary powers vested in EU policymakers, powers that can sometimes cause substantial harm to Eurozone periphery economies, are exercised more judiciously. The introduction of this body is expected to elevate the quality of discussions and debates on critical financial policies. By fostering a more informed debate, the body would help prevent the dominance of ideologies that solely reflect the market conditions of core states in EU financial policymaking. Although not a flawless solution, it will provide an unbiased assessment of EU financial policies, thereby mitigating the inherent bias in decisions made by EU policymakers. Furthermore, this monitoring body would enhance the performance of officials through its mere existence, as it would lessen the undue advantage currently enjoyed by core member states. This independent oversight could lead to more balanced and equitable financial regulations that consider the diverse economic circumstances within the Eurozone.

8.3 PRACTICAL DIFFICULTIES IN IMPLEMENTING THE ABOVE REFORMS

The implementation of the above reforms is fraught with legal and political constraints that make their realisation particularly challenging. Revising EU law requires broad consensus among member states, each of which may have divergent interests and priorities. In addition, core member states often have weak incentives to pursue these changes, as the current system predominantly favours their interests and maintains their relative positions of power within the Union. In the creation of the EBU core member states have effectively established an institutional framework that allows them to wield power and influence, aligning it with domestic interests and institutions. This configuration often results in policies and regulations that reflect the priorities and economic strategies of core member states, thereby perpetuating their advantageous positions within the EU hierarchy.

However, this approach may ultimately prove counterproductive, even if it appears to serve their interests in the short term, particularly in light of the mounting wave of Euroscepticism.[1457] The preservation of the euro during the Eurozone sovereign debt crisis was largely dependent on the political will of the EU member states, which was exercised often at great domestic political cost. Mainstream governments across the Eurozone were compelled to yield to difficult compromises, while populations in periphery member states endured austerity measures.

The EBU's architecture, though conceptually designed to enhance financial stability and promote integration, continues to be heavily reliant on the political will of the participating member states. The increasing popularity of Eurosceptic parties not only poses a risk to the unity among member states during economic crises but also calls into question the commitment to the core principles of mutual support and collaboration embodied in the EU Treaties. It is the rising strength of these parties that could challenge the political foundation upon which the EBU is constructed, potentially destabilizing the collective resolve needed to effectively manage and mitigate future crises. In sum, core member states may believe that they are securing their own interests by exerting control within the EBU framework,

[1457] Jon Henley, 'Support for Eurosceptic Parties Doubles in Two Decades Across EU' (theguardian.com, 2 March 2020) available at: <https://www.theguardian.com/world/2020/mar/02/support-for-eurosceptic-parties-doubles-two-decades-across-eu> accessed 3 November 2024.

but they risk undermining the very foundation of European economic solidarity. As Euroscepticism continues to gain momentum, it becomes increasingly necessary for these states to reconsider their approach and foster a more inclusive and balanced system that can withstand political shifts and maintain the integrity of the Union as a whole.

8.4 USING THE MASTER'S TOOLS TO DISMANTLE THE MASTER'S HOUSE

In addition to the political obstacles identified above, there is a more fundamental question: can law be used as an instrument to bring about more profound changes in the context of inter-state relationships? Audre Lorde wrote a text in 1979 to which she gave the title: "The Master's Tools Will Never Dismantle the Master's House".[1458] In this work, Lorde argued that employing the instruments and methods derived from a racist patriarchy to scrutinise and challenge the outcomes of that same system would inevitably lead to only the most limited possibilities for meaningful change, if any at all.[1459] Just as Lorde suggested that using the master's tools cannot dismantle the master's house, laws are not immutable truths that can change how the EBU operates but products of specific historical and economic conditions.[1460] Legal norms arise from the social relations and material conditions prevailing at any given time. The form and content of laws evolve alongside changes in these conditions, underscoring their contingent and socially constructed nature.[1461] Therefore, using law as an instrument to change inter-state relationships in the context of the EBU will not bring about significant change, as laws adapt to existing power balances.

The TEU and TFEU establish a framework for member states to collaborate closely, promoting solidarity, peace and prosperity. These treaties outline the principles of free trade and transfer of certain responsibilities to the EU level. Each member state is expected to prioritize sacrificing its individual national interests for the greater good of the EU, grounded in a shared sense of moral righteousness. Idealists advocating for this vision tend to overestimate the role of law and international institutions in ensuring peace and prosperity

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[1458] Audre Lorde, 'The Master's Tools Will Never Dismantle the Master's House' in Audre Lorde, Sister Outsider ([1984] Penguin, London 2019) 103.

[1459] ibid; see Antonios Tzanakopoulos, 'The Marxist's Tools and the Master's House: Marxist Insights for International Law' (ssrn.com, 2023) available at: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4544488> accessed 3 November 2024, cited in relation to comments on the role of law in international politics from a Marxist perspective.

[1460] Pashukanis (n 1339).

[1461] ibid.

across member states. They see these laws as emanations of a higher moral or rational order based on universally accepted principles driving EU member states' actions, as codified in the TEU and TFEU.

However, this perspective is fundamentally flawed as it overlooks the persistent nature of power struggles. As the EU banking system and inter-state relations transform, so do EU laws. The legal constructs under the EBU are deeply intertwined with the structure of the Eurozone banking system. They are a reflection of economic relationships rather than abstract notions of justice.[1462] The EBU operates as a mechanism through which power dynamics are manifested in inter-state relations, legitimizing the behaviours of powerful states while marginalizing weaker ones. This thesis demonstrated that rivalries and competitions for power continue to exist in the EBU. EBU member states are interconnected through economic dependencies, but increased economic interdependence does not inherently foster peace. Rather, free trade and unrestricted movement of capital and labour can result in more frequent conflicts and potential power struggles.[1463] As the Eurozone sovereign debt crisis demonstrated, interdependence means sensitivity, where EU events rapidly affect distant regions. Despite the EU's advocacy for formal equality among member states, real decision-making power rests with the core states. Periphery member states often defer to the core states, a pattern evident during the Eurozone sovereign debt crisis.

EU politics have historically been and likely will continue to be ruthless and perilous. Ideals such as justice and EU law cannot prescribe state behaviour. The behaviour of states is more heavily influenced by power dynamics than by legal norms.[1464] There are inherent limitations to EU law and EU organisations. EU law is often employed as a tool of state interests, especially by core states, which prioritize their national interests over adherence to EU legal norms when conflicts arise. Core states can sometimes disregard EU legal norms without significant repercussions due to their influence and capability to shape the international order. States might use EU law pragmatically to justify actions, build coalitions or enhance their legitimacy on the global stage.[1465] However, this strategic use does not signal a fundamental commitment to EU law itself but rather serves as a tool within broader

[1462] Pashukanis (n 1339).

[1463] Waltz (n 413).

[1464] John J. Mearsheimer, *The Tragedy of Great Power Politics* (W.W. Norton & Company 2001).

[1465] Waltz (n 413).

power politics.[1466] In respect of weaker states, EU law can offer some protection and a framework for resolving disputes. Yet, in major power struggles, legal arguments are secondary to the power capabilities and strategic interests of the involved states.

The challenges within the EBU similarly illustrate a significant disparity between established norms and their practical application. Member states sometimes deviate from agreed-upon standards when it benefits their own interests, resulting in inconsistencies. Powerful states leverage regulatory frameworks to justify actions that secure economic advantages or exert control over weaker economies, perpetuating a financial order that favours their strategic goals. This disconnect underscores that while the EBU sets forth regulations meant to create a stable financial environment, the actual practices of states are frequently driven by their own national priorities. In this context, influential nations exploit regulatory mechanisms to maintain economic dominance, leading to organised hypocrisy within the EBU.[1467]

The manner in which the core member states of the EU manifest their power transcends mere coercion. This exercise of power is intrinsically tied to their adept manipulation of information and the normalisation of certain issues and proposed solutions. Major EU banks exemplify this influence, wielding substantial power to shape policies and regulatory frameworks in a manner that privileges their interests. This pervasive influence extends to the political arena, where legislation is strategically crafted and implemented to benefit core banks' interests. As highlighted in section 8.2.6 (*Control of financial flows*) of this chapter, EU institutions tend to prioritise objectives that safeguard their interests, a tendency that invariably results in the marginalisation of dissenting voices and alternative perspectives. EU institutions, by prioritising uniformity in policy and regulation, contribute to this intellectual conformism, effectively marginalising critical and dissenting voices.[1468] Intellectual and cultural movements that resist this one-dimensionality are crucial. This form of leadership seamlessly integrates the interests of core EU member states within the broader EU framework, thereby sustaining their hegemony and legitimising their authority. To

[1466] Krasner (n 1377).

[1467] ibid.

[1468] Marcuse (n 1453).

challenge and ultimately the *status quo*, it is important to conceive an alternative that intricately weaves together economic, political and ideological transformations.[1469]

8.5 CONCLUSION

This chapter proposed various amendments to the EBU's institutional framework in an effort to create a more equitable environment for all Eurozone member states. It underscored how the existing framework, though aimed at fostering financial stability, often perpetuates inequalities by disproportionately favouring core member states to the detriment of periphery states. Reforms such as redefining the supervisory scope, reassessing objectives, enhancing representation in decision-making bodies, streamlining the decision-making process, harmonising national insolvency laws, bolstering control over financial flows and improving transparency and information dissemination were proposed. These changes aim to recalibrate the decision-making incentives and constraints within the EBU, reducing the undue influence of core states and ensuring more balanced outcomes that reflect the interests of all member states.

However, the practical implementation of these reforms is fraught with challenges. Political negotiations and consensus-building amongst member states with divergent priorities represent significant obstacles. Core member states, benefiting from the current arrangement, may lack the incentive to support reforms that dilute their influence. Yet, it is crucial for these states to contemplate the long-term ramifications of maintaining the status quo, particularly in light of the rising tide of Euroscepticism which threatens the very cohesion and stability of the Eurozone.

The discussion highlighted that legal tools alone are insufficient to dismantle entrenched power structures and that power dynamics often shape the practical application of laws. Ultimately, achieving a balanced EBU that works equitably for all member states calls for a shift in both institutional structures and political mindsets. Cultivating a cooperative spirit that values the prosperity and stability of the entire Eurozone over the interests of individual powerful states is essential. Such a transformation is not merely about legal adjustments but

[1469] Gramsci (n 1453).

necessitates a broader commitment to sharing risks and rewards more fairly among all member states, thereby fostering a more resilient and united European banking system.

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