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What Role is left for National Authorities within the Single Supervisory Mechanism?

A Critical Assessment of the L-Bank Case

Dr. Martina Anzini

In the context of current cases brought to the European Court of Justice against the European Central Bank (ECB) in its capacity as prudential banking supervisor, the judgement in Landeskreditbank Baden-Württemberg v ECB stands out for its key importance.

The Court has stated that the ECB's competence in the supervision of financial institutions, including the less significant ones, is exclusive, i.e. national supervisory authorities do not retain any autonomous competence under the Single Supervisory Mechanism (SSM). This is not convincing.

- Banking supervision is an integral part of the internal market policy and therefore, qualifies as a shared competence between the Union and the Member States.
- As a consequence, the Court's interpretation of the SSM Regulation is inconsistent with the Treaties and thus possibly in breach of the obligation of *interprétation conforme*.

Martina Anzini is analyst in the financial markets department at cep| anzini@cep.eu

cep | Kaiser-Joseph-Straße 266 | 79098 Freiburg | Germany | Telephone +49 761 38693-0 | www.cep.eu

1 Legal and factual background

The Single Supervisory Mechanism (SSM) is a system[1] that regulates the respective roles of the European Central Bank (ECB) and the national supervisory authorities (National Competent Authorities or "NCAs") in carrying out the prudential supervision of banks within the European Monetary Union (EMU).[2] It was established by a Council Regulation ("SSM Regulation")[3] as the first pillar of the Banking Union, with the aim of ensuring the consistency and effectiveness of prudential supervision of credit institutions throughout the Eurozone and a uniform implementation of the single rulebook for financial services[4].

Its main function is to fill the gap (acutely perceived during the crisis) between a highly integrated financial sector and poor coordination of national supervisory policies[5]. It does so by entrusting the ECB with exclusive competence to carry out specific prudential supervisory tasks *vis à vis* all credit institutions established in the participating Member States[6] and, even when the credit institution is not under the direct supervision of the ECB, by placing ultimate responsibility for the effective and consistent functioning of the SSM upon the ECB[7]. In the latter case, the relevant NCA exercises direct prudential supervision[8], while the ECB is empowered to carry out specific actions *vis à vis* the NCAs in order to fulfil its systemic responsibility[9]. The practical arrangements for the implementation of this framework were defined by the ECB in consultation with the NCAs[10] under the SSM Framework Regulation (Regulation No. 468/2014).[11]

Therefore, in the context of the SSM, a credit institution may well find itself under the direct supervision of the ECB. According to Article 6(4) SSM Regulation, this is the case when a bank is recognised as *significant* based on the following, non-cumulative criteria: (i) its size[12], (ii) its importance for the economy of the EU or any participating Member State[13] or (iii) the significance of its cross-border activities[14].

However, even if one of those three criteria is fulfilled, the bank may still be re-classified as less significant if certain "particular circumstances" come into play. Under Article 70 SSM Framework Regulation, such particular circumstances must be "specific and factual" and render "the classification of a supervised entity as significant inappropriate, taking into account the objectives and principles of the SSM Regulation and, in

1 "Single supervisory mechanism" (SSM) means the system of financial supervision composed by the ECB and national competent authorities of participating Member States [Article 2(1)(9), 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 (O.J. 2013, L 287/63)]. As of today, the group of Member States participating in the banking union is identical with the group of Eurozone Member States. The SSM is not an institution, nor does it possess a legal personality (GREN J., The Eurosystem and the Single Supervisory Mechanism: institutional continuity under constitutional constraints, ECB Legal Working Paper Series, No. 17, July 2018, p. 19).

2 Non-EMU Member States can also take part in it if a close cooperation is established according to Article 7, SSM Regulation.

3 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 (O.J. 2013 L 287/63).

4 Considerandum No. 12, SSM Regulation.

5 See Schoenmaker D., The Financial Trilemma, Economics Letters, Vol. 111, 2011, p. 57-59.

6 Such tasks, listed by Article 4(1), encompass authorising credit institutions and monitoring compliance with prudential requirements imposed on credit institutions in the areas of own funds requirements, securitisation, large exposure limits, liquidity, leverage and reporting.

7 Article 6(1), SSM Regulation.

8 However, it cannot exercise the powers under (a) and (c) of Article 4 (1), which belong to the exclusive domain of the ECB.

9 Article 6(5), SSM Regulation.

10 Article 6(7), SSM Regulation.

11 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) (O.J. 2014, L 141/1).

12 Article 6(4)(i), SSM Regulation; Article 50 ff., Regulation 468/2014

13 Article 6(4)(ii), SSM Regulation; Article 56 ff., Regulation 468/2014

14 Article 6(4)(iii), SSM Regulation; Article 59 - 60, Regulation 468/2014

particular, the need to ensure the consistent application of high supervisory standards"[15]. Also, the term "particular circumstances" is subject to a strict interpretation[16].

The case at hand revolves precisely around whether such particular circumstances may apply to Landeskreditbank Baden-Württemberg (L-Bank), whose assets exceed the critical threshold of 30 billion euros thus making it *prima facie* a significant credit institution. The core question was whether the bank's peculiar *status* as the development and investment bank of the German state of Baden-Württemberg, entirely owned by the State and governed under public law, could amount to a particular circumstance under Article 70, SSM Framework Regulation.

The ECB came to the conclusion that it could not. L-bank's submissions on the sufficiency of national prudential supervision to attain the objectives of the SSM Regulation were deemed irrelevant by the ECB. In fact, according to the ECB, L-bank had *failed to prove* that the national supervisor was in a better position than the ECB to safeguard the objectives of the SSM Regulation and that the ECB's direct supervision was therefore inappropriate in the light of the specific circumstances of the case, as required by Article 6(4) SSM Regulation and Article 70 Framework Regulation[17]. This interpretation was upheld by the Administrative Board of Review, whose opinion was essentially incorporated into the ECB's final decision[18].

2 Proceedings before the General Court

In March 2015, L-Bank went before the General Court to challenge the ECB's final decision which defined L-Bank as a significant credit institution. It essentially claimed that the ECB had incorrectly applied Article 6(4) SSM Regulation and Article 70 Framework Regulation because it had based its assessment of the bank's significance solely upon size.

Notably, L-Bank criticised the ECB's narrow interpretation of the particular circumstances which make it inappropriate to classify a supervised entity as significant under Article 70. It regarded the interpretation as being in complete contradiction to the SSM Regulation. The German credit institution argued that the inappropriateness of the ECB's direct supervision referred to under Article 70 constituted an indeterminate legal concept defining the limits set on the action of an EU institution (i.e. the ECB) and must therefore be interpreted in line with the principles governing the use of EU competences, i.e. those of proportionality (Article 5(3) TEU) and subsidiarity (Article 5(4) TEU)[19]. L-Bank maintained that the application of such principles made the extension of the ECB's direct supervision to a specific credit institution dependent upon whether the supervision carried out by the NCA was *not sufficient* for protecting financial stability[20]. In the case at hand, the weak risk profile of the applicant, albeit disregarded by the ECB[21], suggested that the exercise of prudential supervision by the German authority was sufficient and, therefore, in line with the criteria set forth by the SSM legal framework[22].

The Fourth Chamber of the General Court in its extended composition dismissed the application. It essentially did so by taking a different stance to L-Bank on the allocation of competences for prudential banking supervision.

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15 Article 70 (1), (SSM Framework Regulation).
16 Article 70 (2), (SSM Framework Regulation).
17 L-Bank, T-122/15, para. 31-32.
18 L-Bank, T-122/15, para. 31.
19 See Article 5(2) and (3) TEU.
20 L-Bank, T-122/15, para. 35.
21 L-Bank, T-122/15, para. 116.
22 L-Bank, T-122/15, para. 36.

After pointing out that L-Bank had not challenged the compliance of Article 70 of the SSM Framework Regulation with the principles of proportionality and subsidiarity, the General Court observed that, based on the text of Article 70(1), the criterion for allocating supervisory competence to the NCA instead of the ECB was not – as suggested by the applicant – that of the "lack of necessity" of the ECB's supervision, but rather that of the "inappropriateness" of such supervision. According to the consolidated case-law of the Court of Justice of the European Union (CJEU) on the principle of proportionality, "appropriateness" is defined as "suitability for achieving the objectives pursued by the legislation", i.e., in this case, the objectives of the SSM Regulation[23]. According to this literal interpretation, the standard for excluding the ECB's direct supervision is different - and much more restrictive - than that identified by the applicant.

The General Court acknowledged that L-Bank had ruled out the legitimacy of such a literal interpretation by claiming that it ran counter to the principles of subsidiarity and proportionality. It observed, however, that this critique was unfounded as it relied on the erroneous assumption that NCAs had retained their own prerogatives within the SSM[24]. Instead, the General Court sided with the ECB and the Commission by affirming that, first, by establishing the SSM Regulation, the Council had intended to make the ECB the holder of an exclusive competence in the area of prudential supervision. In its view, the tasks conferred on the ECB by Article 4(1) SSM Regulation give the ECB a genuinely exclusive domain[25]. Secondly, the General Court specified that if Article 6, regulating "Cooperation within the SSM", assigns different responsibilities in respect of such tasks and strikes a line between significant and non-significant entities for the purpose of identifying the direct supervisor, this is only to allow the "*decentralised implementation*" of the system[26].

This understanding of the competence of the ECB in the context of banking supervision led the General Court to strike down the claims put forward by L-Bank concerning the principles of subsidiarity and proportionality. It first ruled out the applicability of the principle of subsidiarity in this case, as it does not cover the exercise of exclusive competences, which was what the ECB's competence to carry out direct supervision was found to be[27].

Secondly, the General Court found that the principle of proportionality is not applicable either. First and foremost, the operation of the SSM does not involve national competences, because the NCAs are merely called upon to implement an exclusive competence of the Union[28]. While the ECB's observance of the principle of national implementation of EU law, established by Article 291(1) TFEU, could theoretically be invoked in this case, such a claim would be equally unfit to support an interpretation of the SSM Regulation that runs counter to the Regulation's own logic: the Regulation itself strikes a balance between the conflicting necessities of, on the one hand, keeping the implementation of EU law in the hands of national authorities as far as possible and, on the other, offering an adequate safeguard to the objectives of the SSM regulation, and this balance cannot be called into question through the proportionality review[29].

[23] L-Bank, T-122/15, para. 45.
[24] L-Bank, T-122/15, para. 49.
[25] "[I]t is at the stage of the definition of tasks entrusted to the ECB by Article 4(1) of the [SSM Regulation] that the competences between the ECB and the national authorities were distributed" (L-Bank, T-122/15, para. 56).
[26] L-Bank, T-122/15, para. 63.
[27] L-Bank, T-122/15, para. 65.
[28] L-Bank, T-122/15, para. 72.
[29] L-Bank, T-122/15, para. 73-76.

3 Opinion of the Advocate General and Judgement of the Court of Justice

Following the rejection of its application, L-Bank lodged an appeal before the Court of Justice. It lamented, *inter alia*, that the interpretation of the SSM framework offered by the General Court was not only erroneous for the same reasons submitted previously, but was also in breach of a consolidated principle of legal interpretation which prohibits the interpreter from rendering a legal provision meaningless. According to L-Bank, the interpretation proposed by the judgement makes it practically impossible to identify a factual element, which could amount to a "particular circumstance" under Article 6(4) SSM Regulation.

Advocate General Hogan and the Court of Justice, however, fully validated the approach taken by the General Court.

Notably, as well as expressing full support for the General Court's narrow literal interpretation of the "particular circumstances" referred to by Article 6(4) SSM Regulation, A.G. Hogan observed that it was in line with the rationale behind the whole post-financial crisis legislation, of which the SSM Regulation was a part. In his view, the SSM Regulation was inspired by a lack of confidence in the accuracy of the evaluations concerning the systemic or non-systemic nature of financial risks and is thus based on the assumption that *any* credit institution of the relevant size poses a systemic risk to financial stability. This was confirmed by the fact that the nature of the risk which a specific credit institution poses to financial stability was not cited as a factor of significance under the SSM Regulation. The Regulation was equally silent on other factual elements, such as the legal structure of the banking entity, the legal regime applicable to its activity and its business model, thus making them irrelevant. In fact, the SSM Regulation stated under Article 1 that the ECB was to carry out its tasks having "full regard to the different types, business models and sizes of credit institutions". Such diversity should therefore be adequately reflected in the supervisory activity of the ECB but does not justify the exclusion of the latter to the benefit of NCAs[30].

A.G. Hogan also stated that in raising the proportionality issue, L-Bank appeared to be challenging the validity of Article 6(4) SSM Regulation itself rather than the decision of the ECB.

He openly expressed his suspicion that, by raising such a plea in reference to the ECB's decision the applicant was seeking to obtain a judicial interpretation of the relevant legislation that, while favourable to L-Bank was in clear contradiction of the text and the spirit of the law[31]. Additionally, in his view, L-Bank's aim in this regard was to make it more likely that it would be considered a less significant credit institution and thereby shift the burden of proof onto the ECB.

Finally, according to the A.G., there were no concrete grounds for L-Bank to be considered as less significant: had there been any valid argument for requalifying the institution as less significant, L-Bank, in consideration of its means and longstanding experience in the financial sector, would certainly have found one[32].

[30] Opinion of A.G. Hogan of 5 December 2018, C-450/17 P, EU:C:2018:982, para. 38.
[31] Opinion of A.G. Hogan, C-450/17 P, para. 61-63.
[32] Opinion of A.G. Hogan, C-450/17 P, para. 74.

4 Comment

Notwithstanding the rejection of its claims, the applicant will not be affected by the judgement. This is due to the modification of Article 2(5), Capital Requirements Directive (2013/36/EU)[33], a provision that sets forth a list of institutions to be excluded from the direct supervision of the ECB under the SSM Regulation. The amendment has included L-Bank in the list[34].

The relevance of the judgement, however, goes beyond this particular case because for the first time the CJEU addressed the question of the distribution of powers between the ECB and NCAs within the SSM.

As will be illustrated below, the definition of the ECB's prudential supervisory competence as "exclusive" is not convincing. Since this EU action is an integral part of the internal market policy, it is better defined as a shared competence between the Union and the Member States. In this sense, therefore, the Court's interpretation of the SSM Regulation seems to be inconsistent with the Treaties and, thus, in breach of the obligation of *interprétation conforme* (i.e. the obligation to give preference to an interpretation that brings the provision in line with the Treaty).

4.1 Distribution of roles within the SSM: The General Court chooses one of the possible interpretations

Co-existing within the SSM Regulation are two different interpretations of the ECB's role as prudential supervisor: (1) that of the ECB as the sole competent supervisor and of the SSM as a decentralised system of prudential supervision and (2) that of the SSM as a system of inter-institutional cooperation among prudential supervisors, each with their own competences. They mirror the original divide between the different negotiating positions of, on the one hand, the French delegation, that pushed for a full Europeanisation of prudential supervision affecting any bank, and, on the other, the German delegation that wanted to preserve an autonomous field of competence for NCAs regarding less significant credit institutions[35].

According to the General Court, several textual elements in the SSM Regulation support the former view. Among them, the ECB's prerogatives *vis à vis* NCAs are particularly important. The most significant one, according to the General Court, is the ECB's ability to remove the direct prudential supervision of an entity from an NCA by asserting the unspecified need to "ensure the consistent application of high supervisory standards", whereas the contrary is only possible in the presence of "particular circumstances", the meaning of which is subject to restrictive legal interpretation[36].

Despite the numerous elements listed by the General Court to support its view[37], other references within the SSM Regulation point in a different direction, as generally occurs where a politically sensitive piece of legislation is concerned[38]. For example, according to Recital No 15, "[s]pecific supervisory tasks which are crucial to ensure a coherent and effective implementation of the Union's policy relating to the prudential

[33] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (O.J. L 176, 27.6.2013, p. 338).

[34] 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 (O.J. 2019, L 150/253)

[35] D'Ambrosio R., Lamandini M., La "prima volta" del Tribunale dell'Unione Europea in materia di Meccanismo di Vigilanza Unico, Giurisprudenza commerciale, 2017, 44.4, p. 597-598.

[36] L-Bank, T-122/15, para. 59-62.

[37] L-Bank, T-122/15, para. 53-63.

[38] As pointed out by D'Ambrosio in D'Ambrosio R., Lamandini M., *La "prima volta"*, p. 598.

supervision of credit institutions should be conferred on the ECB, while other tasks *should remain with national authorities*"[39]. Even more importantly, the ECB's prerogatives mentioned above can only be exercised in a framework to be established "in consultation with the NCAs"[40]. Apart from such inconsistencies, however, the Court's argument is unconvincing principally because it relies on an interpretation of the nature of the ECB's competences under Article 127(6) TFEU that is irreconcilable with the Treaties.

4.2 The nature of the ECB's competences under the SSM

Under Article 127 (6) TFEU the Council, acting by means of regulations in accordance with a special legislative procedure, may, unanimously and after consulting the European Parliament and the ECB, confer specific tasks upon the ECB that concern policies relating to the prudential supervision of credit institutions[41]. This formulation leaves no doubt as to the fact that the ECB has its own competences regarding banking supervision, provided that it is empowered by the Council.

It is however less clear what kind of competences the ECB holds under the SSM.

The General Court qualified the ECB competences as exclusive. To support its assertion, it simply made reference to the text of Article 4(1) SSM Regulation, which sets forth a list of supervisory tasks conferred on the ECB. According to this provision, the ECB, while carrying out such tasks, exercises an *exclusive competence* in respect of *all* credit institutions. Additionally, it mentions Article 6 SSM Regulation, which entrusts the ECB with responsibility for ensuring the "effective and consistent functioning of the SSM"[42].

While reviewing the legitimacy of the General Court's conclusions on this question, the Court stated that what was at stake was "the scope of the ECB's competences". It then hastily validated the related reasoning by wholly relying on the wording of Article 4(1) SSM Regulation (i.e. by express reference to the "exclusive competence" of the ECB to carry out the enumerated tasks in reference to "all" credit institutions)[43].

The question the Court should have asked itself was not, however, what is the *scope* of the ECB's competences, but what is their *nature*, which depends upon the relevant area of EU action.

In this regard, the SSM Regulation displays the usual ambiguity that characterises the SSM and the Banking Union as a whole, i.e. the inextricable link between internal market and financial stability considerations, which prompt EU action[44]. This does not come as a surprise, as the Banking Union was conceived as a compensation chamber for adjusting the complex interplay between the internal banking market and the European Monetary Union. However, the openness of the SSM to non-Euro countries seems to make internal market integration considerations necessarily dominant.

As a consequence, prudential supervision under the SSM qualifies as a "shared competence" under Article 4 (2)(a) TFEU[45].

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[39] See also Considerandum No 28, SSM Regulation.
[40] Article 6(7), SSM Regulation.
[41] Tasks can be transferred also concerning the supervision of other financial institutions, with the exception of insurance undertakings.
[42] L-Bank, T-122/15, para. 20-22.
[43] L-Bank, C-450/17 P, para. 37-38.
[44] See Recitals No 2, 5 and 6, SSM Regulation.
[45] D'Ambrosio R., Meccanismo di Vigilanza Unico, in Enciclopedia del Diritto, Annali IX, 2016, p. 589 ss.

4.3 The SSM and Article 127 TFEU: the need for an *interprétation conforme*

In view of the above, the General Court should have carried out a more accurate assessment as to the nature of the ECB's competence within the SSM and its implications. Indeed, the interpretation offered by the General Court generates inconsistencies between the SSM Regulation and the Treaties.

This approach is hardly in line with the consolidated case law of the Court. According to the Court – as specifically recalled by the General Court itself[46] –, if the wording of secondary law is open to more than one interpretation, preference should be given to the interpretation which renders the provision consistent with the Treaty rather than to the interpretation which leads to its incompatibility with the Treaty[47].

5 Conclusion

Some commentators have said that the Court's statements about the division of competences in the area of prudential supervision, leading to the definition of the latter as an exclusive EU competence, were superfluous[48]. However, the applicant itself called into question the compliance of the ECB's decision with the principles of subsidiarity and proportionality, thus forcing the Court to take a stance on the matter. In this respect, the Court has opened itself up to criticism for having hastily described the ECB's supervisory competence as exclusive, even though such competence can only be ascribed in the area of internal market integration under Article 4 (2)(a) TFEU and is therefore shared between the Union and the Member States. Thus, the Court should have carried out a subsidiarity and proportionality review of the decision, as requested by the applicant.

Also, the line of reasoning chosen by the Court substantially deprives NCAs and banks of any useful guidance as to where the boundaries between the ECB's and the NCAs' scope for intervention actually lie.
Finally, relevant constitutional proceedings are currently pending before the German Constitutional Court (Bundesverfassungsgericht). The applicants have raised, *inter alia*, the question of whether the transfer of banking supervision to the ECB under the SSM is appropriately covered by Article 127 (6) TFEU. According to the applicants' interpretation of the provision, the ECB should have been given only "special tasks" related to the prudential supervision of credit institutions, whereas the SSM Regulation seems to have triggered the transfer of the entire supervisory competence. Accordingly, the consent granted by the German government should be seen as unconstitutional.[49]According to a press release by the German Constitutional Court, the judgement will be delivered on July 30 2019.[50] Nothing so far suggests that the Constitutional Court might decide to refer a question for a preliminary ruling to the CJEU concerning the compliance of the SSM Regulation with Article 127 (6) TFEU: indeed, the press release mentions the word "judgement", whereas a preliminary ruling could only be referred through a decision. However, if such a referral should take place, it would likely include the above question and, given the L-Bank judgment, it seems appropriate to assume that the CJEU would hardly take a minimalist stance towards the ECB's prerogatives.

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[46] L-Bank, T-122/15, para. 41.
[47] Judgement of 4 May 2016, Philip Morris Brands e.a., C-547/14, EU:C:2016:325, para. 70; judgement of 13 July 2018, Banque postale v BCE, T-733/16, EU:T:2018:477, para. 34, 35.
[48] D'Ambrosio in D'Ambrosio R., Lamandini M., La "prima volta", pp 594-599.
[49] Press Release No. 73/2018 of 05 September 2018, [Ref: 2 BvR 1685/14, 2 BvR 2631/14], available at https://www.bundesverfassungsgericht.de/SharedDocs/Pressemitteilungen/EN/2018/bvg18-073.html;jsessionid=425D6B8F4506898464BC3BBE5A99A23E.1_cid394
[50] Press Release No. 41/2019 of 14 June 2019, [Ref: 2 BvR 1685/14, 2 BvR 2631/14], accessible at https://www.bundesverfassungsgericht.de/SharedDocs/Pressemitteilungen/EN/2019/bvg19-041.html.