



EUROPEAN CENTRAL BANK

EUROSYSTEM

ESCB Legal Conference 2018

6-7 September 2018

December 2018

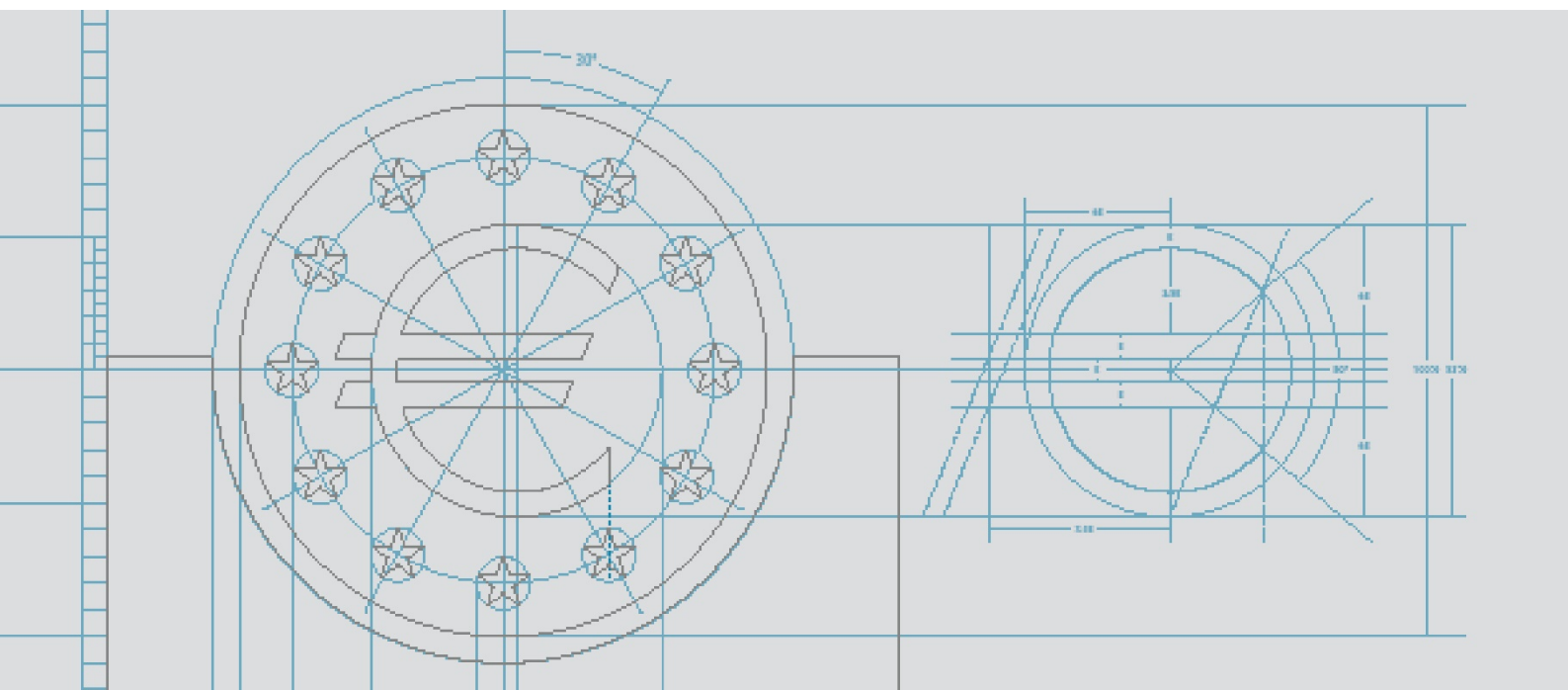




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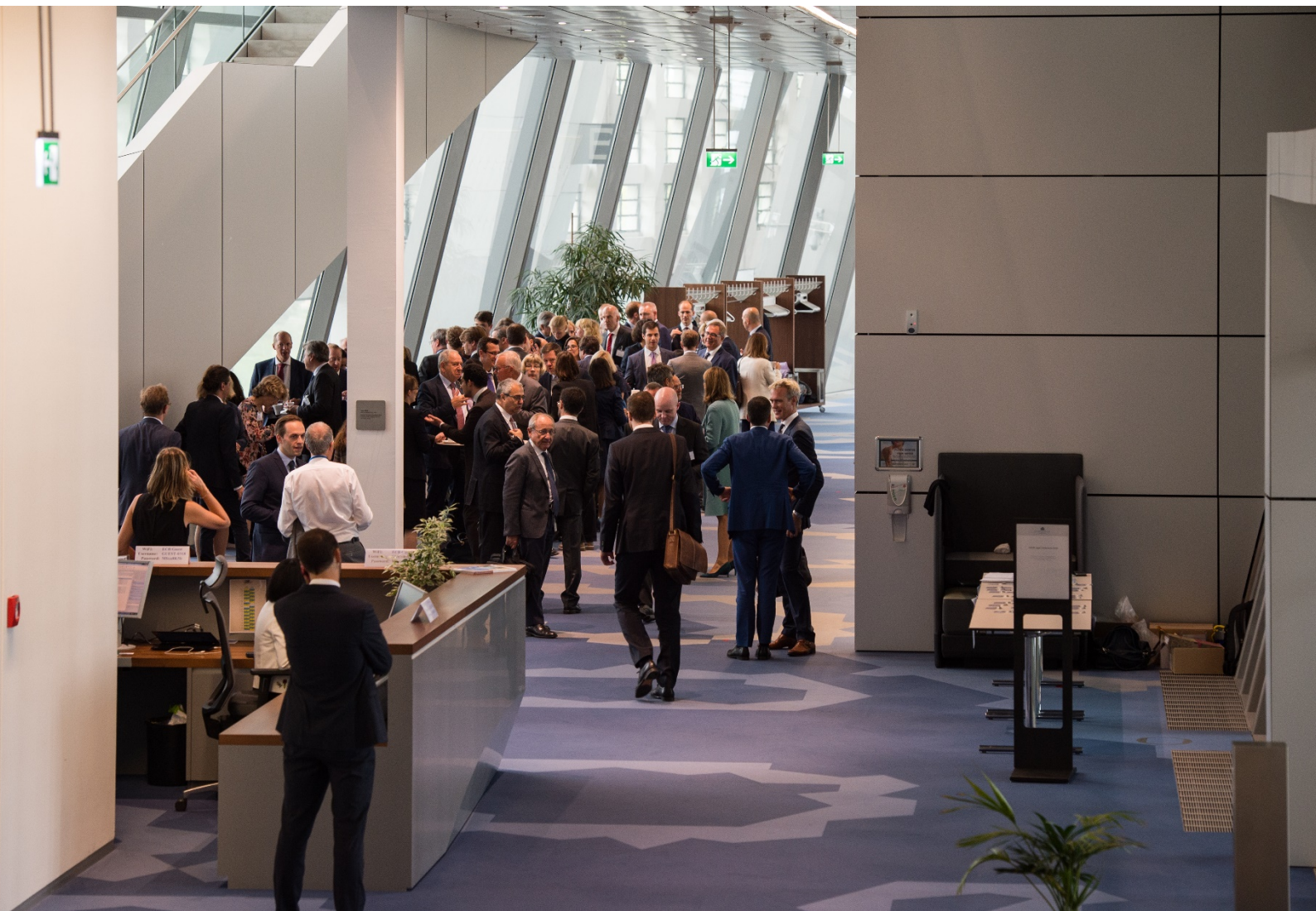
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Introductory remarks

By Chiara Zilioli¹

Ladies and Gentlemen,

Good morning, and welcome to the 2018 ESCB Legal Conference!

It is my great pleasure, looking into the audience, to see that many friends and colleagues from across Europe, and also some from the other side of the globe, are here with us in Frankfurt to participate in our two days of legal reflection.

These Conferences are a perfect illustration that we, as Europeans, are united in our diversity.

Our Member States and our cultures are as diverse as our respective national legal traditions.

Our unity comes from the unique legal system of the Treaties, which, as the Court of Justice stated already in 1964, has become “an integral part of the legal systems of the Member States”. I am speaking, of course, of the well-known case *Costa v ENEL*.²

As you are aware, the ECB’s Directorate General Legal Services hosts a Legal Conference every year. And, always in the spirit of diversity, we like to vary its format, in alternate years.

In 2017 we focused on the academic and judicial perspective, with speakers from diverse fields, to bring together the big picture of where Europe – and central banking – is heading.

This year, in 2018, we want to turn our attention to the specific legal issues that we as lawyers meet every day in our central banking and supervisory work.

Some of the topics on the agenda are ones which have occupied us in the recent past. For example:

- the relationship between a primary objective and a fundamental principle;
- the external delegation of tasks;
- tackling banks that are failing or likely to fail; and
- the inviolability of the ECB’s archives in a decentralised system such as the Eurosystem.

¹ Director General Legal Services, European Central Bank, Professor at the Law Faculty of the Goethe University in Frankfurt am Main.

² [Costa v ENEL](#), ECLI:EU:C:1964:66.

All of these are not theoretical but real topics, which have led to detailed analyses and triggered heated discussions in our corridors and in our committees.

Other topics in our Conference look more into the future.

- How is technology affecting the way in which lawyers work?
- What can a European Master Agreement offer us in a post-Brexit environment?
- What role can central banks play as benchmark administrators?

All of these topics are very important for us lawyers. Moreover, they demonstrate that central banking is not exclusively the domain of economists.

Both the Single Market and the Economic and Monetary Union were established by the Treaties within a Union founded on the rule of law. In the words of Jean Monnet, “[the] union cannot be based exclusively on men of good will. Rules are indispensable.”³

Let me add that in this environment **lawyers are indispensable**.

The lawyers’ task is to protect the Eurosystem from political interference and ensure that the necessary adaptation to legal, economic and technological changes does not jeopardise the continued adherence to the fundamental principles agreed in the social contract. While drawing on the experiences of the past, we must anticipate and tackle the legal complexities of the future.

In pursuing this task, the most valued asset of the ECB’s Directorate General Legal Services is the network of lawyers in the Eurosystem and in the ESCB, alongside that established with lawyers in other Union institutions, in other central banks, in international financial institutions and from private practice. This has become *our* Community of practising lawyers which is a treasured source of legal dialogue on contemporary issues in central banking. On the other hand, your presence here means you also have a responsibility: do not hold back from raising questions, provoking debate and sharing your ideas and knowledge during the panel discussions. We are counting on you to bring your unique expertise to the table, today and tomorrow, and to exchange your thoughts and solutions across borders.

Ladies and Gentlemen, thank you for being here and contributing to our reflections. I very much hope you will enjoy the Conference, and I look forward to the presentations and fruitful discussions. Let us make this Conference the **Single Market for legal reasoning!**

It is my pleasure and privilege now to give the floor to the Executive Board Member responsible for the Directorate General Legal Services, Yves Mersch, who is also the patron of our Legal Conferences. His keynote speech will deal with a very interesting topic: Financial stability and the ECB.

³ [Speech](#) by Jean Monnet, President of the High Authority, at the opening session of the Common Assembly, 11 September 1952.

Keynote speech



Financial stability and the ECB

By Yves Mersch¹

1 Introduction

The recent crisis put financial stability at the centre of public discussions on how to improve economic resilience. What should the institutional architecture of financial stability look like and what should be the role of central banks in this context? While such questions have largely been settled regarding *price* stability, no similar consensus exists when it comes to *financial* stability. There is neither a settled institutional template for financial stability nor a consensus about the role of central banks. The economic literature has suggested various models, some of which have been tested around the world.² In my speech today, however, I will not go into the economics of financial stability. I will instead approach the issue from a *legal* perspective. The question I will address is: what role does EU law ascribe to the ECB in contributing to the stability of the financial system?

When we talk about the *role* of the ECB from a legal perspective, we are essentially referring to its tasks, mandates and competences. In the compound EU legal order, these are covered by a set of basic principles. First and foremost, the EU is a union based on the rule of law.³ This means that every action taken by EU institutions needs to be founded on Union law and ultimately on the Treaties. This fundamental constitutional value has two manifestations.

First, the *principle of conferral* requires that the EU should act only within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objectives set out therein.⁴ Moreover, in exercising its competences, the EU must respect the principles of subsidiarity and proportionality.⁵ Second, the *principle of institutional balance* provides that all EU institutions must act in accordance with the powers conferred on them by the Treaties and respect the competences of other EU institutions. These two principles should guide the discussion on the role of the ECB in financial stability. They also highlight the fact that getting the answer right is ultimately a rule-of-law issue.

As I will argue today, the authors of the Treaties did not make financial stability an ECB objective. The ECB's only primary responsibility is price stability. The Treaty-makers did not provide either for specific financial stability-oriented instruments or for a dedicated financial stability institutional set-up at the Union level, if I abstract from

¹ Member of the Executive Board, European Central Bank.

² See "Central bank governance and financial stability: A report by a Study Group chaired by Stefan Ingves", Bank for International Settlements (2011).

³ Article 2 of the TEU.

⁴ Article 5(2) of the TEU.

⁵ Article 5(3) and (4) of the TEU.

the coordination role of the European Systemic Risk Board (ESRB). And without an objective and dedicated instruments, the Treaties could not have conferred on the ECB a stand-alone task. In financial stability, thus, the ECB has only a limited, contributory role according to the Treaties.

2 Financial stability in ECB law

2.1 Financial stability: a protean concept

The Treaties do not contain a definition of financial stability. Like price stability, financial stability is an objective of public policy. Unlike price stability, however, financial stability remains a protean concept, with various manifestations and different understandings of its basic aspects.

First, the notion of financial stability is nebulous and much more difficult to capture than price stability. The term financial stability is sometimes used in a very broad way to cover objectives and institutions that encompass the stability of the economy as a whole and also include the financial stability of governments, as in the Treaty establishing the European Stability Mechanism or in the title of the European Financial Stability Facility (EFSF). In my speech today, I will use the term financial stability in a narrow sense to refer to the “stability of the financial system”, which is the wording used in Article 127(5) of the TFEU.

But even within this narrow meaning, there is no single or even widely accepted definition of financial stability.⁶ Some authors and institutions have tried to arrive at a positive definition of financial stability by describing its essential features, while others start from its absence – financial *instability*. The ECB approaches financial stability in terms of systemic risk: financial stability is a state whereby the build-up of systemic risk is prevented.⁷ In turn, systemic risk is “the risk that the provision of *necessary financial products and services* by the financial system will be impaired to a point where economic growth and welfare may be materially affected”. Simply put, financial stability means that the financial system is expected to withstand unforeseeable events or shocks without major disruption and to continue providing its services to the economy.⁸ Compare this definition with the much more concrete ECB definition of price stability, which is a year-on-year increase in the Harmonised Index of Consumer Prices for the euro area of below 2%. In the pursuit of price

⁶ Garry J. Schinasi, “Defining Financial Stability”, *IMF Working Paper* WP/04/187 (2004), p. 3; William A. Allen and Geoffrey Wood, “Defining and achieving financial stability”, *Journal of Financial Stability*, Vol. 2 (2006).

⁷ “Financial stability and macroprudential policy”. The notion of financial stability is often discussed in terms of the concept of systemic risk. Gabriele Galati and Richhild Moessner, “Macroprudential policy – a literature review”, *DNB Working Paper*, No 267 (2010), p. 13.

⁸ So that individuals can still access their accounts, businesses can still operate payments, and banks can refinance themselves by borrowing from each other or the central bank. Some of the definitions of financial stability include the notion that economic actors can operate without fear of disruption, of financial *instability*, as a material factor in their decisions, Allen and Wood, “Defining and achieving financial stability”, p. 160.

stability, the ECB aims to maintain inflation rates below, but close to, 2% over the medium term. These two definitions clearly illustrate that, when it comes to financial stability, we are operating at a much more abstract level, with considerably vaguer metrics.⁹

Financial stability and monetary policy also differ in terms of the instruments they use to pursue their objectives. Monetary policy has a fairly settled set of tools – first and foremost, at least in conventional times, the short-term interest rate. Financial stability, however, has neither a primary instrument nor a standard taxonomy of instruments. Instead, there are various different instruments, ranging from those from the toolbox of the supervisory regulations (Article 5 of the SSMR), such as maximum loan-to-value limits and countercyclical capital buffers, to taxation, as well as interest rates. Could this become an example of policymaking with other people's instruments?

Some of these instruments are used at national level, while others are deployed in a certain sector or with regard to an individual financial institution. Many of these instruments which have financial stability as their stated aim advance macroprudential policies. And so macroprudential policies, like financial stability, are often a concept onto which “anyone could project their own sense of priorities”¹⁰ – priorities that often compete with each other.

Third, unlike price stability, financial stability does not fall under the exclusive competence of a single institution. Instead, various actors at national, supranational and international level are given different roles and responsibilities in pursuing financial stability. Finance ministries, supervisors, expert bodies (the ESRB, national macroprudential committees and/or regulators which diverge widely in terms of their powers and composition), central banks and the Basel-based Financial Stability Board have all been ascribed a role in financial stability.

Thus, in all these respects, financial stability is still not a settled field of public policy in the same way that price stability is. And this is not just a matter of theoretical interest. It also has a bearing on the question of who should ultimately be responsible in this field: experts or political bodies. I will come back to this point at the end of my speech.

2.2 What is the role of the ECB in the field of financial stability?

Let me now come to my basic question. *What role does EU law, and especially primary EU law, foresee for the ECB in the field of financial stability?*

The basic Treaty provision to start from is Article 127 of the TFEU under the chapter on monetary policy, which contains the objectives and tasks of the ECB/ESCB. This Article does not explicitly point to any clear, unambiguous role for the ECB regarding

⁹ Although internationally the definitions of price stability may differ, they are close enough for there to be plenty of common ground. See Allen and Wood, “Defining and achieving financial stability”, p. 153.

¹⁰ Paul Tucker, “[The objectives of financial stability policy](#)”.

financial stability. Financial stability is *not* among the objectives of the ECB enshrined in the first paragraph of Article 127. The primary objective is defined there as being the maintenance of price stability. And, without prejudice to this objective, the ECB has a mandate to support the general economic policies in the Union with a view to contributing to the general objectives of the Union. Nor is financial stability one of the four basic tasks referred to in the second paragraph of Article 127. First in the list is, of course, the basic task of defining and implementing the monetary policy of the Union. This basic task is accompanied by certain monetary tools, specifically provided for in primary law.¹¹ As I already mentioned, *no* such tools are provided for in the area of financial stability.

2.3 The ECB's contributory role in financial stability

The only explicit reference to financial stability in Article 127 is in the fifth paragraph. This paragraph sets out the ESCB's duty to "contribute" to the smooth conduct of policies pursued by "competent authorities" relating to the stability of the financial system. Thus, the ESCB is given a contributory role in the field of financial stability. That contribution can be exercised through its monetary policy task or its supervisory task, both of which embed financial stability as a contribution to competent authorities.

What is the scope of the ECB's contributory role?

The concept of a "contribution" appears not just in Article 127 of the TFEU. It is also used by the Treaties to describe the allocation of powers and to demarcate competences between the Member States and the EU in a variety of fields. For example, Article 170(1) of the TFEU provides that "the Union shall *contribute* to the establishment and development of trans-European networks in the areas of transport, telecommunications and energy infrastructures". The same formulation is used in Article 169(1) of the TFEU regarding consumer protection. In these fields, the EU has a shared competence with the Member States. There is, however, a significant difference between these Articles and Article 127(5). In the case of such shared competences, the EU is given the power to contribute directly *to the achievement of the objectives*. When it comes to financial stability, however, the ECB is tasked with contributing to the *smooth conduct of policies pursued by the competent authorities*. There is a critical difference here.¹² If the ECB were tasked with contributing to the attainment of financial stability, it would – like the EU in the field of networks – have leeway to identify policies that better serve the achievement of this aim. However, the ECB's role in contributing to financial stability would instead seem to be equivalent to the category of Union competences with the narrowest

¹¹ E.g. conduct open market and credit operations, and impose minimum reserve requirements under Articles 18 and 19 of the Statute of the ESCB.

¹² This is not to say that the Union competence in the field is also coordinating – this is a question of vertical competence allocation.

possible scope, namely supplementary or supporting competences.¹³ In these fields, the EU can only support *actions of the Member States*¹⁴ “without thereby superseding their competence in these areas”.¹⁵

Thus it is clear that the ECB has *neither exclusive powers* in the field of financial stability nor competence to act on its own. “Contribution” does not establish a competence for independent and stand-alone action. To contribute to the attainment of an aim is to *support* it; the basic identification of how the aim of financial stability is to be achieved thus lies with other “competent” institutions. And so does the primary responsibility.

Exactly how the ECB should carry out this contributory role is not specified in either the Treaty or the Protocol on the Statute of the European System of Central Banks and of the European Central Bank (Statute of the ESCB) – unlike monetary policy, for which the ECB’s functions and operations are set out in detail. The ECB can use its usual tools, to the extent that they are suitable, to contribute to financial stability. The ECB’s *advisory functions* are of great relevance in this context. Article 127(4) of the TFEU calls for consultation on the basic tasks listed in the preceding paragraph. Only then does paragraph (5) mention financial stability, but the Council decision implementing this part of the Treaty also included the obligation to consult on national acts that influence the stability of financial institutions and markets. Regarding Union legislation, in the chapter on prudential supervision, Article 25 of the Statute of the ESCB states that the ECB “*may offer advice to and be consulted by the Council and the Commission on the scope and implementation of Union legislation*” relating to the stability of financial system. According to Article 141(2) of the TFEU, for Member States with a derogation the ECB “shall ... hold consultations concerning issues falling within the competence of the national central banks and affecting the stability of financial institutions and markets”.

In any case, the contributory role of the ECB needs to support its monetary policy tasks or the tasks conferred upon it relating to the prudential supervision of credit institutions and other financial institutions.

2.4 Monetary policy and financial stability

As Article 25 of the Statute of the ESCB refers to prudential supervision, Article 127(5) is the only reference to the ECB/ESCB. It is also interesting to note that the advisory functions are mentioned in the Treaty after the basic tasks and before financial stability, while in the Statute they follow Article 3.3.

This leads to the following considerations:

¹³ See also Article 165(1) of the TFEU “The Union shall contribute to the flowering of the culture in the Member States [...]” and Article 173(3) of the TFEU “[t]he Union shall contribute to the development of quality education [...]”.

¹⁴ Article 6 of the TFEU.

¹⁵ Article 2(5) of the TFEU. Moreover, “legally binding acts of the Union” relating to these areas “shall not entail harmonisation of Member States’ laws or regulations”.

First, it should be noted that the ECB, when pursuing the objective of maintaining price stability, follows a two-pillar strategy that takes account of monetary and economic analysis, and includes financial stability considerations. The ECB's two-pillar strategy forms the basis for the Governing Council's overall assessment of the risks to price stability and its monetary policy decisions.

Moreover, the ECB may use its ancillary policy tools to address financial stability to the extent that this is necessary to carry out its basic tasks.¹⁶ Under such circumstances, financial stability is not the ultimate aim of ECB policy but a means to fulfil its basic tasks. In principle, this applies to all the basic tasks of the ECB listed in Article 127(2) of the TFEU, but it is most important for monetary policy. Financial stability, namely the proper functioning of the financial system, is necessary for the transmission of monetary policy.¹⁷ In *Gauweiler*, the Court accepted that measures intended to preserve the monetary transmission mechanism may be regarded as pertaining to the objective of maintaining price stability, thus falling within the mandate of the ECB.¹⁸ Addressing issues of financial stability in order to promote price stability is therefore possible with two caveats:

First, price stability enjoys primacy. Within the current legal framework, and by contrast with other jurisdictions, price stability is the ECB's only primary objective. If there is a conflict between price stability, which is primarily concerned with the business cycle, and financial stability, which is more concerned with the financial cycle, and some trade-off between the two is required, the Treaties require primacy to be given to price stability. Financial stability cannot take precedence over price stability.

Second, financial stability-related policies need to comply with the principle of proportionality. According to Article 5(4) of the TEU, Union institutions shall observe the principle of proportionality when exercising the competences conferred on them. The principle of proportionality was also used by the Court of Justice to assess the legality of the ECB's Outright Monetary Transactions (OMT) programme as a means to achieve price stability. According to the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties.¹⁹ This means that ECB policies regarding financial stability that serve monetary policy need to be appropriate for maintaining price stability and should not go beyond what is necessary to achieve this objective.²⁰

In principle, therefore, financial stability-oriented instruments can be used if necessary to carry out the basic tasks, but subject to serving the primary objective of price stability and within proportionality limitations.

¹⁶ Implied powers regarding activities that are corollary to the Union's main fields of competence and flow from the powers expressly conferred on it in the Treaties.

¹⁷ Georgios Psaroudakis, "The Scope for Financial Stability Considerations in the Fulfilment of the Mandate of the ECB/Eurosystem", *Journal of Financial Regulation*, Vol. 4 (2018), pp. 130-131.

¹⁸ Case C-62/14, *Gauweiler and Others v Deutscher Bundestag*, ECLI:EU:C:2015:400, para. 50.

¹⁹ Article 5(4) of the TEU.

²⁰ Case C-62/14, *Gauweiler and Others v Deutscher Bundestag*, para. 67.

2.5 Financial stability and the prudential supervision of credit institutions

The other aspect of ECB involvement in financial stability is through the ECB's prudential supervisory role. Article 127(6) of the TFEU (also reflected in Article 25 of the Statute of the ESCB) permits the Council to confer specific tasks upon the ECB concerning the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings. This provision was activated through the establishment of the Single Supervisory Mechanism (SSM) under the SSM Regulation. As made explicit in the SSM Regulation, the Union legislator conferred prudential supervisory tasks on the ECB with a view to contributing to financial stability within the Union and each Member State.²¹

Article 5 of the SSM Regulation also makes provision for certain macroprudential tasks and tools. These competences to require capital buffers to be held by credit institutions in addition to own funds requirements, including countercyclical buffer rates and other measures aimed at addressing systemic or macroprudential risks, are conferred on national authorities. This reflects the fact that primary responsibility for macroprudential policies lies with national authorities. If deemed necessary, the ECB, instead of national authorities, may apply higher requirements for capital buffers than those applied by the national authorities and more stringent measures aimed at addressing systemic or macroprudential risks. The procedure for adopting these top-up ECB measures may be triggered only at the initiative of the national authorities, emphasising the national character of macroprudential competences.

The microprudential and macroprudential tools contained in the SSM Regulation are thus specific aspects of the financial stability mandate of the ECB, which is based on the specific authorisation in Article 127(6) of the TFEU. Neither the SSM Regulation in general, however, nor Article 5 in particular confers a general competence on the ECB in the fields of financial stability and macroprudential policy.

3 Democracy, independence and financial stability

When we interpret the competences of public institutions we are essentially discussing the limits of their powers. As with any discussion on public powers, the aspect of legitimacy also needs to be considered. In the field of financial stability and macroprudential policies, a multitude of institutions are involved, such as parliaments, EU political institutions, national governments, and expert bodies at both the European and the national level. Some of these actors derive their legitimacy from their independent expertise, others from their democratic accountability. What role each of them should play in achieving financial stability is intimately connected with the source of their legitimacy.

²¹ See Article 1, first para.; see also recitals (2), (5), (15), (16), (24), (27), and (55) of Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

This brings me back to the first point of my speech: financial stability might be an objective less well suited to independent expertise-based bodies than a price stability objective. Even though the Treaty does not give a definition of price stability, it is an objective that is quantifiable. The ECB Governing Council aims to maintain inflation rates below, but close to, 2% over the medium term. Putting a figure on price stability makes monetary policy more transparent and provides a clear and measurable yardstick against which European citizens can hold the ECB accountable. For financial stability no such clear yardstick exists. Without clear objectives, however, it is much more difficult to measure the performance of independent, expertise-based institutions and hold them to account.²² Beyond that, the pursuit of financial stability often involves choices with stronger distributional implications. This is an additional argument in favour of the ultimate responsibility remaining in the political sphere. Financial stability is thus a policy area where expert bodies and politically accountable institutions are called on to cooperate, with no one having exclusive responsibility. In this field, expert bodies with strong guarantees of independence, such as the ECB, might be better suited to “contributing” in an advisory capacity while the “ultimate responsibility” is rather borne by institutions embedded in political accountability arrangements at the national level. Otherwise political pressures to adopt one or the other stance in questions of financial stability might also threaten central bank independence.

4 Conclusions

At the time the Treaties were drafted, financial stability and the potential differences between financial and business cycles were not a primary consideration. The Treaty provisions do not point towards a clear, unambiguous role for the ECB. Certain economic approaches may now suggest different ways of coping with financial stability challenges that, on some occasions, would involve a wider role for central banks. But the ECB, as an institution bound by the rule of law, has to operate within the limits set by the Treaties.

Article 127(5) of the Treaty implies that the ECB has only a contributory and supporting role with regard to financial stability. This role is partly discharged through its advisory role in the preparation of EU or national acts. Beyond that, the ECB’s financial stability role is embedded within the ECB’s basic monetary policy task and the ECB’s microprudential supervisory tasks. The specific macroprudential tasks contained in the SSM Regulation are supplementary in nature, and do *not* confer any general competence on the ECB in the field of macroprudential policy.

These are primarily legal conclusions that also reflect the relative positions of public institutions in terms of independence and accountability. Beyond these considerations, however, there are political and economic considerations that have not been addressed here.

²² See Paul Tucker, “[The objectives of financial stability policy](#)”.

Panel 1

The relevance of the principle of an open market economy for monetary policy

ELA, Article 123 TFEU and State aid

The General Court touched on Article 123 TFEU in its recent rulings in *Chrysostomides* and *Bourdouvali* where it had some remarks on ELA. According to it:

- ELA does not come within the single monetary policy and is not part of the functions of the ESCB;
- the conditions to be met before ELA can be granted must be in line with Article 123 TFEU; and
- while the financing of solvent banks by means of ELA is compatible with Article 123 TFEU, any provision of ELA in case of underlying solvency problems would clearly infringe Article 123 TFEU.

Those dicta on ELA connect back to the Commission's analysis of when providing ELA may constitute State aid for the purposes of Article 107(1) TFEU in point 62 of the 2013 Banking Communication.

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Introduction to the panel on the relevance of the principle of an open market economy for monetary policy

By Frederik Malfrère¹

This panel has assumed the challenge of diving into an interesting EU constitutional law topic that is tainted with some controversy. While it is clear that the principle of an open market economy is relevant for the exercise of the competences of the European Union, the concrete legal implications of this principle are far from apparent.

It is safe to assume that the principle of an open market economy includes the broad ingredients that are of paramount importance for economic and monetary policy: free markets, free competition and an efficient allocation of resources. In the words of the former Advocate General Siegbert Alber, “[a]s part of the strategy to foster growth and employment, while achieving price stability, it is essential to improve the operation of product and service markets, to stimulate competition, to foster invention and innovation and to ensure efficient price setting”.² Does this mean that the principle of an open market economy serves only as an interpretative lens for the Treaty provisions when it becomes relevant? Or is this principle also able to limit the exercise of the competences of the Union?

In the context of economic policy, which has remained within the competence of the EU Member States³, the Court of Justice ruled that the principle enshrined in Articles 119 and 120 TFEU is a general principle whose application calls for complex economic assessments that are a matter for the legislature or the national administration. It does not impose on public actors clear and unconditional obligations on which individuals may rely.⁴ Thus, *prima facie*, the principle of an open market economy would not appear to impose hard limits on public sector intervention. However, the Court did not go as far as the Advocate General did in his opinion⁵ to say that this general principle, on its own, has no binding legal effect and is to be viewed only in conjunction with the other provisions of Union law that define its content more closely. Hence, the question of whether and to what extent the principle of an open market economy limits the exercise of the competences of the Union is still an open question.

¹ Head of the Institutional Law Division at the European Central Bank (ECB). The author wishes to thank Alina Grosu, legal expert in the Directorate General Legal Services, for her advice in and contribution to the preparation of this paper.

² Opinion of Advocate General Siegbert Alber in Case C-9/99 *Échirolles Distribution*, ECLI:EU:C:2000:299, para. 48.

³ Apart from the Union competence on the setting of coordination arrangements.

⁴ Case C-9/99 *Échirolles Distribution*, ECLI:EU:C:2000:532, para. 25.

⁵ Opinion of Advocate General Siegbert Alber in Case C-9/99, paras. 49 and 50.

What about monetary policy and Article 127(1) TFEU? How is the principle of an open market economy to be interpreted by the Court in this specific context? What is the significance of market forces in the area of monetary policy?

In view of the limited case law scrutinising monetary policy measures,⁶ the lack of jurisprudence on the principle of an open market economy in the context of monetary policy speaks neither for nor against the existence of concrete legal implications. The few views expressed in legal doctrine provide no further guidance as they display the whole spectrum of possible interpretations, starting from the position that the reference to the principle of an open market economy in Article 127(1) TFEU is merely a generic statement of respect for market economics in the workings of the European System of Central Banks (ESCB),⁷ to the contention that the principle of an open market economy may impose substantial limitations on the definition and implementation of measures of monetary policy.⁸

Within the ESCB, the principle of an open market economy has been discussed for quite some time, and not only in the context of specific monetary policy measures. To give you a few examples, its implications have been assessed in connection with TARGET2 and TARGET2-Securities, as well as in relation to the production of banknotes and the provision of emergency liquidity assistance. As one may imagine, the discussions outside the narrow monetary policy context revolved around the “free competition” ingredient captured by the principle. They also addressed the question of the applicability of the Treaty rules on competition to ESCB actions in general, as well as in specific contexts such as the applicability of State aid rules to the provision of liquidity by central banks.⁹

This time, the panellists have focused in essence on whether the principle of an open market economy places hard limits on the exercise of monetary policy and, if so, where those limits would lie. Below is an attempt to briefly summarise their approach to these key questions, as reflected in the three papers that follow.

⁶ To date, only one judgement of the Court of Justice in Case C-62/14 *Gauweiler and Others*, ECLI:EU:C:2015:400.

⁷ See Lastra, R.M., *Legal Foundations of International Monetary Stability*, Oxford, 2006, p. 216. Following this reasoning, it is difficult to hold the ECB accountable for its actions on the basis of the principle of an open market economy.

⁸ See Pfisterer, V.M., “Containing Enormity: EU Constitutional Principles and their Application to Unconventional Monetary Policy”, *Journal of International Banking Law and Regulation*, 2018, p. 238; Tuori, K., “Enlarged Scope and Competences of the ECB: Economic Constitutional Analysis”, *Legal Studies Research Paper Series No 25*, University of Helsinki, 2012, p. 19. For a more nuanced approach, see Tridimas, T., “Community Agencies, Competition Law, and ESCB Initiatives on Securities Clearing and Settlement”, *Yearbook of European Law 2009*, p. 273; Smits, R., *The European Central Bank: Institutional Aspects*, Kluwer Law International, 1997, p. 190-191.

⁹ According to point 62 (Section 5) of the 2013 *Banking Communication* (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, OJ C 216, 30.7.2013, p. 11-12): “The ordinary activities of central banks related to monetary policy, such as open market operations and standing facilities, do not fall within the scope of the State aid rules. Dedicated support to a specific credit institution (commonly referred to as “emergency liquidity assistance”) may constitute aid unless the following cumulative conditions are met: (a) the credit institution is temporarily illiquid but solvent at the moment of the liquidity provision which occurs in exceptional circumstances and is not part of a larger aid package; (b) the facility is fully secured by collateral to which appropriate haircuts are applied, in function of its quality and market value; (c) the central bank charges a penal interest rate to the beneficiary; (d) the measure is taken at the central bank’s own initiative, and in particular is not backed by any counter-guarantee of the State.”

1 Karen Kaiser: The objective of price stability and the principle of an open market economy: what trumps?

Ms Kaiser aims to derive a standard for establishing the limits imposed by the principle of an open market economy on the exercise of the Eurosystem's competence for monetary policy by tackling the relationship between this principle and the primary objective of price stability.

To that end, Ms Kaiser examines first the general relationship between objectives and principles. She argues that objectives and principles guide the exercise of the competences of the Union at opposite ends, in the sense that objectives tend to push for the extension of the Union's competence, while principles impose limits to this extension. Although, as a rule, objectives and principles are ranked equally, in the event of conflict between them, principles may trump objectives. Ms Kaiser holds that a conflict presupposes an unjustifiable interference of the attainment of an objective with a principle.

In the second step of her analysis, Ms Kaiser notes the difficulties in establishing an interference of the attainment of the objective of price stability with the principle of an open market economy. One of the reasons for such difficulties is that the concepts of price stability and open market economy are economically and legally interdependent. Thus, by pursuing the objective of price stability in the exercise of the Eurosystem's competence for monetary policy, the ECB contributes to – rather than interferes with – an open market economy. Another reason is that the concept of an open market economy as such is open to interpretation. Ms Kaiser takes the view that, in the specific context of the Eurosystem's competence for monetary policy, a free market economy is qualified to the extent that primary law acknowledges the public need to set the price of money centrally and to exercise control over the money supply. However, this qualification does not exclude that the implementation of monetary policy may interfere with the remaining elements of a free market economy.

The logical consequence of this is that an interference with the principle of an open market economy can be justified depending on the circumstances of the case in question. If assessed as part of the principle of proportionality, the interference is justified when the benefits to price stability outweigh the costs to an open market economy. This notwithstanding, the principle of an open market economy maintains its own relevance that goes beyond the proportionality test. In particular, the exercise of the Eurosystem's competence for monetary policy must be interpreted in the light of the principle of an open market economy and restricted in its effect limiting the open market economy. What is more, given that the principle of an open market economy constitutes the underlying thread of the provisions laid down in Title VIII ("Economic and monetary policy") of the Treaty, it serves as a benchmark for the interpretation of other provisions, such as the monetary financing prohibition laid down in Article 123(1) TFEU.

2 Clovis Hopman: Monetary policy and the principle of an open market economy with free competition

Mr Hopman aims to develop more concrete parameters for a review of monetary policy measures from the perspective of the principle of an open market economy with free competition.

Mr Hopman starts by pointing out that the principle of an open market economy with free competition is clearly meant to delimit the powers of the ESCB. He notes, however, that the firmness of its delimitation function is matched by the broadness of the concept of an open market economy with free competition. There is no hard borderline to determine when operations undertaken by the Eurosystem cease being compliant with the principle of an open market economy. This is all the more so as the *raison d'être* of a central bank is to have an effect on markets through its actions. Instead, the appropriate interpretation might be suggested by reading the principle of an open market economy together with the principle of proportionality.¹⁰

Mr Hopman further proposes cumulative criteria to assess the compliance of monetary policy measures with the principle of an open market economy. He contends that the interventions of the Eurosystem may be more distortive for an open market economy with free competition if they (1) target a specific asset class (with strong effects on relative prices), (2) entail large purchases of a certain class of asset, (3) last for a long period of time, (4) take place in illiquid markets, and (5) use instruments that can have a strong market interference.

Mr Hopman finally suggests that the reference to an efficient allocation of resources explains the rationale of the delimitation of the ESCB's powers by way of requiring the ESCB to act in accordance with the principle of an open market economy. In normal circumstances an open market economy with free competition favours an efficient allocation of resources. Interestingly, when markets fail, the premise that the principle of an open market economy favours an efficient allocation of resources would no longer hold. Arguably, in such situations, monetary policy measures that would normally be at odds with the principle of an open market economy become acceptable.

3 Leo Flynn: The application of the principle of an open market economy in the area of economic policy: lessons to be learned for monetary policy

Mr Flynn tackles the justiciability of the principle of an open market economy and draws attention to the decisional practice of other EU institutions, which could serve as a source of inspiration for the practical aspects of giving effect to this principle.

¹⁰ For this interpretation, Mr Hopman refers to the view expressed by Ms Kaiser in her contribution to this panel.

On the first point, Mr Flynn stresses that, irrespective of their direct effect, all provisions of EU law are a full part of the legal system and are capable of legal effects other than the conferral of rights or the attribution of obligations. Any interpretation of legal norms within the scope of the Union legal order must ensure the coherence of lower norms with their hierarchical superior ones while also reading legal norms of the same hierarchical rank in a harmonious manner so far as it is possible to do so. Given that the principle of an open market economy with free competition can shape how secondary legislation of the Union is interpreted and play a role in delineating the scope of the provisions of primary law, this principle is of legal relevance and so is justiciable.

On the second point, Mr Flynn reveals examples from the practice of the Council and the Commission in the context of multilateral economic surveillance, where one finds a repeated insistence on the roles of open markets and of free competition in enhancing long-term economic performance. He notes that the principle of an open market economy with free competition is not amenable to a “unique right answer” as to how it should be implemented in a given Member State. An open market economy with free competition is compatible with a wide variety of institutional arrangements and visions of how the State and the market interact. At the same time, Mr Flynn is of the view that the decisional practice in the field of economic policy does indicate that some answers are wrong and, from that, guidance can be taken for other fields of Union law, including monetary policy. In addition, Mr Flynn notes that the principle of an open market economy connects tightly with the precepts underlying such an open market, including maintaining the rule of law. A market is an artefact requiring, inter alia, respect for property rights and the enforceability of contractual claims. Without those elements, the foundations for transactions between individuals who do not know one another, and who may never deal with one another again, will be absent.

Finally, after exploring the role of the principle of an open market economy under Articles 121, 122 and 126 TFEU, Mr Flynn considers whether other provisions in the economic policy chapter might express, among their various goals, the principle of an open market economy with free competition. That reading is, in his view, apposite for Articles 123(1), 124 and 125 TFEU.

The objective of price stability and the principle of an open market economy: what trumps?

By Karen Kaiser¹

The question of whether the objective of price stability² or the principle of an open market economy³ *trumps* in the event of conflict, i.e. ultimately defines the limits of the exercise of the Eurosystem's competence for monetary policy, has not been chosen at random. The aim of this paper is to examine whether one might better understand the relationship between the objective of price stability and the principle of an open market economy by thinking about it in terms of playing cards.⁴

1 Relationship between objectives and principles

1.1 Definition of objectives and principles

Objectives and principles are commonly defined as guiding the exercise of the competences of the European Union. Pursuant to primary law, the Union shall “pursue”⁵ and “advance”⁶ the objectives and “respect”⁷ and act “in accordance” and “in compliance”⁸ with the principles. Legal doctrine accordingly holds that objectives stipulate the intended effects of the exercise of the Union competences in social reality, while principles limit this exercise.⁹ As such, objectives and principles do not only guide the exercise of the Union competences, they guide the exercise of the

¹ Senior Legal Counsel, Directorate General Legal Services, European Central Bank. The author wishes to thank A. Duering, A. Grosu, F. Hammermann, F. Holm-Hadulla, C. Hopman, C. Kroppenstedt, F. Malfrère and K. Raible for valuable comments on an earlier version of this paper.

² The objective of price stability is laid down in Article 3(3) of the Treaty on European Union (OJ C 202, 7.6.2016, p. 13) (TEU), Articles 119(2), 127(1) and 282(2) of the Treaty on the Functioning of the European Union (OJ C 202, 7.6.2016, p. 1) (TFEU) and Article 2 of the Statute of the European System of Central Banks (ESCB) and the European Central Bank (ECB) (OJ C 326, 26.10.2012, p. 230) and mentioned in Articles 140(1), first indent, 141(2), 219(1) and (2) TFEU and Articles 1 and 4 of Protocol No 13 on the Convergence Criteria (OJ C 115, 9.5.2008, p. 281).

³ The principle of an open market economy is laid down in Article 119(1) and (2) TFEU (“open market economy with free competition”) and – in the specific context of the Eurosystem's competence for monetary policy – in Article 127(1) TFEU and Article 2 of the Statute of the ESCB and the ECB (“open market economy with free competition, favouring an efficient allocation of resources”).

⁴ In a trick-taking card game where trumps are permitted, a trick can be won not only by the player who has played the highest-ranked card of the suit led, i.e. the suit of the first card played in the trick, but also by a trump card, which outranks all cards of the suit led.

⁵ Article 21(3) TEU.

⁶ Article 13(1) TEU.

⁷ Article 21(3) TEU.

⁸ Article 127(1), third sentence, TFEU.

⁹ von Bogdandy, A., “Founding Principles”, in von Bogdandy, A. and Bast, J. (eds.), *Principles of European Constitutional Law*, 2nd edition, 2010, p. 11 (23).

Union competences at opposite ends. Objectives – such as the objective of price stability – tend to push for the extension of the Eurosystem's competence for monetary policy, while principles – such as the principle of an open market economy – impose limits on this extension.

1.2 Order of objectives and principles

The playing cards analogy may help us to understand the order of objectives and principles. Objectives and principles can be perceived as each symbolising a suit, namely diamonds, hearts, spades or clubs if we take French playing cards as an example. Just as the Ace of Hearts may rank higher than other playing cards of the same suit, certain objectives may rank higher than other objectives. This is the case with the objective of price stability, which ranks higher than other objectives in the area of monetary policy. It is primary, while other objectives are secondary.¹⁰ The fact that certain objectives may rank higher than other objectives cannot define the relationship between objectives and principles, however. The fact that the objective of price stability is primary only denotes that it ranks higher than other objectives, not that it ranks higher than principles.¹¹ Just as there is no order between the suits unless defined in the rules of a given card game, the question of whether objectives or principles rank higher or may be elevated above their equal rank in the event of conflict can only be answered by the rules laid down in primary law.

1.2.1 Equal rank as the rule

As primary law does not define the order between objectives and principles, they share equal rank. This means that the objective of price stability takes precedence unless the principle of an open market economy can be elevated above its rank, i.e. unless it can trump the objective of price stability,¹² in the event of conflict. The rules laid down in primary law need to be interpreted to ascertain whether such a possibility exists.

1.2.2 Elevation above equal rank as the exception

In the early stages of integration, objectives were more important than principles. In contrast to States as the original and complete subjects of international law, international organisations are derivative subjects of international law wielding only a

¹⁰ Articles 119(2), 127(1) and 282(2) TFEU.

¹¹ See, however, Selmayr, M., in von der Groeben, M., Schwarze, J. and Hatje, A. (eds), *Europäisches Unionsrecht*, 7th edition, 2015, Article 282 TFEU, para. 54; Selmayr, M., "Das Recht der Europäischen Währungsunion", in Müller-Graff, P.-C. (ed.), *Europäisches Wirtschaftsordnungsrecht*, 2015, para. 123.

¹² In a trick-taking card game, the player who leads to a trick is usually allowed to play any card from his or her hand. The other players must follow suit if they can, i.e. they must play a card of the same suit if possible. A player who cannot follow suit may "sluff" a card, i.e. play a card of a different suit. The trick is won by the player who has played the highest-ranked card of the suit led, i.e. the suit of the first card played in the trick, unless the rules of the game permit to trump.

limited set of competences. As the attainment of the objectives for which international organisations were founded is their *raison d'être*, objectives are crucial to establishing the limits of these competences. The International Court of Justice accordingly held that an act appropriate for the fulfilment of an attributed objective of international organisations is not *ultra vires*, i.e. beyond their competences.¹³

The original European Economic Community was just such an international organisation wielding only a limited set of competences. Accordingly, the European Court of Justice stated early on that Union law is to “be interpreted and applied in the light of” the objectives.¹⁴ Objectives may therefore serve as an interpretative lens favouring legal arguments pushing for the marginal extension of competences, the limits of which were not entirely clear and need judicial clarification.¹⁵ As the European Court of Justice has not specified the Treaties’ objectives in a manner that would determine the policies of the Union,¹⁶ this is done by acknowledging a wide margin of appreciation or discretion as to the measures to be taken.¹⁷

However, the interpretation of primary law depends on the status of integration. It has been observed in legal doctrine that the transformation of the Union into something more than an international organisation and something less than a State has changed the perception of what objectives are.¹⁸ This transformation has been accompanied by both the “constitutionalisation” of the Union legal order (objectives became less and principles became more important)¹⁹ and the demand for a catalogue of Union competences, i.e. a new ordering of competences or additional rules for their exercise (objectives have lost their “competence-enabling function”)²⁰. As a result, objectives no longer determine the limits of Union competences but instead oblige the Union to continuously pursue them in the exercise of its competences.²¹

¹³ *Certain Expenses of the United Nations (Article 17, Paragraph 2, of the Charter) (Advisory Opinion)* [1962] ICJ Rep 151, at 168.

¹⁴ See for example the judgment in *Istituto Chemioterapico Italiano S.p.A. and Commercial Solvents Corporation v Commission*, cases 6 and 7/73, ECLI:EU:C:1974:18, para. 32.

¹⁵ Potvin-Solis, L., “Compétences partagées et objectifs matériels”, in Neframi, E. (ed.), *Objectifs et compétences dans l’Union européenne*, 2013, p. 29 (76 et seq.); Larik, J., “From Specialty to a Constitutional Sense of Purpose: On the Changing Role of the Objectives of the European Union”, *ICLQ*, 2014, p. 935 (938).

¹⁶ von Bogdandy, A., “Founding Principles”, in von Bogdandy, A. and Bast, J. (eds.), *Principles of European Constitutional Law*, 2nd edition, 2010, p. 11 (37). In addition, the European Court of Justice uses the term “objective” in a very informal way. Sometimes it refers to “objectives” in the literal sense, i.e. as they are set out in the Treaties, but it has also referred to “financial stability”, which is not in itself an objective set out in the Treaties, as a “higher objective”, see Judgment in *Pringle v Ireland*, C-370/12, ECLI:EU:C:2012:756, para. 135.

¹⁷ See for example the judgment in *Vodafone Ltd and Others v Secretary of State for Business, Enterprise and Regulatory Reform*, C-58/08, ECLI:EU:C:2010:321, para. 52.

¹⁸ See in particular Larik, J., “From Specialty to a Constitutional Sense of Purpose: On the Changing Role of the Objectives of the European Union”, *ICLQ*, 2014, p. 935.

¹⁹ See Larik, J., “From Specialty to a Constitutional Sense of Purpose: On the Changing Role of the Objectives of the European Union”, *ICLQ*, 2014, p. 935 (952).

²⁰ See Reimer, F., “Ziele und Zuständigkeiten, Die Funktionen der Unionszielbestimmungen”, *EuR*, 2003, p. 992 (993); von Bogdandy, A. and Bast, J., “Federal Order of Competences”, in von Bogdandy, A. and Bast, J. (eds.), *Principles of European Constitutional Law*, 2nd edition, 2010, p. 275 (278).

²¹ Larik, J., “From Specialty to a Constitutional Sense of Purpose: On the Changing Role of the Objectives of the European Union”, *ICLQ*, 2014, p. 935 (938).

This is also demonstrated by a comparison of different versions of the Treaties. A previous version stipulated that “[t]he Community shall act within the limits of the powers conferred upon it by this Treaty and of the objectives assigned to it therein”.²² By contrast, the current version states that “the Union shall act only *within the limits of the competences* conferred upon it by the Member States in the Treaties to *attain the objectives therein*” (Article 5(2) TEU).²³

1.2.3 Conclusion

As a rule, objectives and principles share equal rank. By way of exception, principles – such as the principle of an open market economy – may be elevated above their rank, i.e. trump objectives, in the event of conflict. This conclusion is not surprising. As we know from the *Gauweiler* case, the principle of proportionality would have had the potential to trump the objective of price stability. However, there was no conflict.²⁴ This shows that the question of what ultimately defines the limits of the exercise of the Eurosystem’s competence for monetary policy is an issue not only of rank but of rank and conflict. Conflict presupposes that the attainment of an objective interferes with a principle in a way that is unjustified.

2 Conflict between the objective of price stability and the principle of an open market economy

2.1 Interference with the principle of an open market economy

While the playing cards analogy may help us to understand the order of objectives and principles,²⁵ it does not help to establish whether the attainment of the objective of price stability interferes with the principle of an open market economy. By definition, playing cards interfere with one other since they can be clearly distinguished by the number of pips or face on each card. Objectives and principles cannot be identified as clearly, however, and as such are not so easy to distinguish. Rather, they are open to interpretation, meaning that interference with principles is more difficult to establish. This is especially true for the principle of an open market economy for two reasons.

²² Article 3b(1) of the Treaty establishing the European Community (Maastricht consolidated version).

²³ See also Article 3(6) TEU, pursuant to which the Union “shall pursue its objectives by appropriate means commensurate with the competences which are conferred upon it in the Treaties”, and Article 352 TFEU, pursuant to which the Union may only act to attain one of the objectives set out in the Treaties “within the framework of the policies defined in the Treaties”.

²⁴ See the judgment in *Gauweiler and Others*, C-62/14, ECLI:EU:C:2015:400, para. 92.

²⁵ See Section 1.2 above.

2.1.1 Definition of an open market economy

It is difficult to establish whether the attainment of the objective of price stability interferes with the principle of an open market economy, because primary law does not define the abstract legal term “open market economy”. What is more, individual economic systems can only be used to the extent that primary law clearly identifies with them. However, bearing in mind that the wording of the principle of an open market economy seems to reject a centrally planned economy²⁶ (or a “social market economy”²⁷), one way to interpret the abstract legal term “open market economy” is to start with the opposite economic system and assess if and to what extent primary law deviates from it.²⁸

Unlike a centrally planned economy, a free market economy is an economic system that is governed strictly by the forces of supply and demand, with little or no public sector influence. Primary law provides for certain elements of such a free market economy. These include free competition,²⁹ private autonomy of market participants, including individual and entrepreneurial freedom of action and equal rights,³⁰ and an anonymous coordination process that can determine who can provide access to scarce goods and services, and at what price³¹.

At the same time, however, primary law does not exclude public sector influence. Rather, depending on the individual policy area concerned, primary law permits public sector influence in varying degrees.³² Legal doctrine, therefore, takes the view that the abstract legal term “open market economy” has to be interpreted in the specific context of the competences exercised by the Union.³³ This finds support in the case-law of the European Court of Justice, pursuant to which “general principles

²⁶ Tridimas, T., “Community Agencies, Competition Law, and ESCB Initiatives on Securities Clearing and Settlement”, *Yearbook of European Law*, 2010, p. 216 (271); Krajewski, M., *Grundstrukturen des Rechts der öffentlichen Dienstleistungen*, 2011, p. 157.

²⁷ Article 3(3) TEU mentions a “social market economy” as a general objective of the Union. Since there are considerable differences between a “social market economy” and an “open market economy” and the abstract legal term “open market economy” was retained as a specific objective of the Eurosystem when the abstract legal term “social market economy” was introduced by the Treaty of Lisbon, Article 3(3) TEU may not be used to interpret.

²⁸ Tuori, K., “Enlarged Scope and Competences of the ECB, Economic Constitutional Analysis”, *Legal Studies Research Paper Series Paper No 25*, University of Helsinki, 2012, p. 7. Here, the abstract legal term “open market economy” is not interpreted. Instead, it is argued that the concept of the European economic constitution is built on the ordo-liberal school, meaning that the theoretical basis of the principle of an open market economy should as a minimum be cross-checked with ordo-liberal theories.

²⁹ Article 119(1) and (2) as well as Article 127(1) TFEU and Article 2 of the Statute of the ESCB and the ECB explicitly list free competition as an element of an open market economy.

³⁰ See for example the judgments in *Bagnasco and Others*, C-215/96 and C-216/96, ECLI:EU:C:1999:12, para. 45 et seq., *Société thermale d'Eugénie-les-Bains*, Case C-277/05, ECLI:EU:C:2007:440, para. 21 and *Commission v Italy*, C-518/06, ECLI:EU:C:2009:270, para. 66: “contractual freedom”, and the opinion of Advocate General Kokott in *Samira Achbita and Centrum voor gelijkheid van kansen en voor racismebestrijding v G4S Secure Solutions NV*, C-157/15, ECLI:EU:C:2016:382, para. 134: “freedom to conduct a business”.

³¹ Hatje, A., “The Economic Constitution within the Internal Market”, in von Bogdandy, A. and Bast, J. (eds), *Principles of European Constitutional Law*, 2nd edition, 2010, p. 589 (596 ff.).

³² In particular, and reminiscent of a centrally planned economy, the elimination or limitation of the elements mentioned is expressly allowed in agricultural policy and in the area of the European Atomic Energy Community.

³³ Tridimas, T., “Community Agencies, Competition Law, and ESCB Initiatives on Securities Clearing and Settlement”, *Yearbook of European Law*, 2010, p. 216 (273; footnote 239); Krajewski, M., *Grundstrukturen des Rechts der öffentlichen Dienstleistungen*, 2011, p. 158.

of the common market [...] are to be applied in conjunction with the respective chapters of the Treat[ies] devoted to their implementation".³⁴

In the specific context of the Eurosystem's competence for monetary policy, a free market economy is qualified to the extent that primary law acknowledges the public need to centrally set the price of money and exercise control over the money supply.³⁵ By virtue of this monopoly, the central bank is able to influence money market conditions and, via this influence, steer the economy in a way conducive to the objective of price stability.³⁶ However, this qualification does not exclude that the *implementation* of monetary policy, such as the design of the operational framework, may interfere with the remaining elements of a free market economy.³⁷

2.1.2 Interdependence between price stability and an open market economy

That the abstract legal term "open market economy" is open to interpretation is not the only reason why it is difficult to establish whether the attainment of the objective of price stability interferes with the principle of an open market economy. The situation is further complicated because price stability and an open market economy are economically and legally interdependent. Economically, an open market economy depends on price stability.³⁸ Primary law has therefore recognised price stability as part of the abstract legal term "open market economy" in the specific context of the Eurosystem's competence for monetary policy. It has even been chosen at a higher constitutional level than is normally the case for central banks.³⁹

By pursuing the objective of price stability in the exercise of the Eurosystem's competence for monetary policy, the ECB is therefore contributing to rather than interfering with an open market economy. This underlines that the comparison of objectives and principles with playing card games is indeed limited. While a Jack of Spades is still a Jack of Spades irrespective of the presence of an Ace of Hearts,

³⁴ See the judgments in *Gianni Bettati and Safety Hi-Tech Srl*, C-341/95, ECLI:EU:C:1998:353, para. 75 and *Échirolles Distribution SA and Association du Dauphiné and Others*, C-9/99, ECLI:EU:C:2000:532, para. 22. Similarly, with specific reference to the principle of an open market economy, see the opinion of Advocate General Trstenjak in *Caja de Ahorros y Monte de Piedad de Madrid v Asociación de Usuarios de Servicios Bancarios (Ausbanc)*, C-484/08, ECLI:EU:C:2009:682, para. 91.

³⁵ ECB, *The monetary policy of the ECB*, 3rd edition, p. 55.

³⁶ If the supply of the monetary base was not monopolised, the costs resulting from bad management of such supply would not remain with the market participants concerned but would endanger the economy as such. In economic terms this is referred to as an "externality", which is the basic rationale for public sector intervention provided by neoclassical economics: see Pigou, A. C., *The Economics of Welfare*, 1920.

³⁷ Hatje, A., "The Economic Constitution within the Internal Market", in von Bogdandy, A. and Bast, J. (eds.), *Principles of European Constitutional Law*, 2nd edition, 2010, p. 589 (595).

³⁸ See for example Hatje, A., "The Economic Constitution within the Internal Market", in von Bogdandy, A. and Bast, J. (eds.), *Principles of European Constitutional Law*, 2nd edition, 2010, p. 589 (598). It is even held that price stability depends on an open market economy, based on the understanding that prices have to reflect the scarcity of goods and services: see Hammermann, F. and Flanagan, M., "What explains persistent inflation differentials across transition economies?", *Economics of Transition*, 2009, p. 297 (305).

³⁹ Tuori, K., "Enlarged Scope and Competences of the ECB, Economic Constitutional Analysis", *Legal Studies Research Paper Series Paper No 25*, University of Helsinki, 2012, p. 16.

there is no such dichotomy between price stability and an open market economy. They blend into each other, but only up to the point at which the attainment of the objective of price stability starts interfering with the principle of an open market economy. This point is difficult to ascertain, as it is tantamount to a situation in which price stability can no longer be considered to be part of an open market economy.

2.2 Justification for interference with the principle of an open market economy

The fact that principles need to be honed to be applied to specific cases with correct results and that the abstract legal term “open market economy” has to be interpreted in the specific context of the competences exercised by the Union suggests that the limits resulting from the principle of an open market economy are of a relative nature. This means that an interference with the principle of an open market economy is not unjustifiable from the outset, but may be justified depending on the circumstances of the particular case in question.

Irrespective of whether the justification for interference with the principle of an open market economy is assessed in isolation or as part of the principle of proportionality,⁴⁰ this also means that there is no conflict between the objective of price stability and the principle of an open market economy if the implementation of monetary policy is proportionate to the objective of price stability. In particular, the benefits for price stability and the costs for an open market economy have to be weighed up to prevent disadvantages arising which are manifestly disproportionate to the objective of price stability.⁴¹

Based on the case-law of the European Court of Justice, pursuant to which complex economic assessments are a matter for the legislature or the executive,⁴² the ECB enjoys broad discretion when weighing up the benefits for price stability and the costs for an open market economy. The complexity of this economic assessment is underlined by two facts. First, as price stability and an open market economy are economically and legally interdependent, it is difficult to assess the point at which the disadvantages for an open market economy become manifestly disproportionate to the objective of price stability.⁴³ Second, the interests in maintaining price stability

⁴⁰ Reumann, U., *Die Unabhängigkeit der Europäischen Zentralbank, Zwischen Selbstbestimmung und vertragsmäßiger Zusammenarbeit mit der Gemeinschaft*, 2001, p. 92; Tuori, K., “Enlarged Scope and Competences of the ECB, Economic Constitutional Analysis”, *Legal Studies Research Paper Series Paper No 25*, University of Helsinki, 2012, p. 19; Pfisterer, V. M., “Containing Enormity: EU Constitutional Principles and their Application to Unconventional Monetary Policy”, *Journal of International Banking Law and Regulation*, 2018, p. 218 (236).

⁴¹ The proportionality *stricto sensu* applies to the exercise of the Eurosystem’s competence for monetary policy; see the judgment in *Gauweiler and Others*, C-62/14, ECLI:EU:C:2015:400, paras. 67 and 91.

⁴² For the legislature, see for example the judgment in *Afton Chemical Limited v Secretary of State for Transport*, C-343/09, ECLI:EU:C:2010:419, para. 28; for the executive, see the judgment in *Commission v Council*, C-121/10, ECLI:EU:C:2013:784, para. 98. See also Tridimas, T., “Community Agencies, Competition Law, and ESCB Initiatives on Securities Clearing and Settlement”, *Yearbook of European Law*, 2010, p. 216 (272), with explicit reference to the principle of an open market economy.

⁴³ See Section 2.1.2 above.

and safeguarding an open market economy may gain more or less weight depending on the market conditions and the economic outlook at the point the ECB acts.⁴⁴

To determine whether and to what extent an interference with the principle of an open market economy from the implementation of monetary policy can be justified, it is useful to distinguish between the choice of instruments and the design of the operational framework.

2.2.1 Choice of instruments

Primary law has decided which instruments the ECB may revert to by qualifying a free market economy in the context of the Eurosystem's competence to define and implement monetary policy. As this decision implies a balance between the interests of maintaining price stability and safeguarding an open market economy, it is safe to assume that the choice of an instrument provided by primary law generally complies with the principle of an open market economy, while the choice of an instrument not provided by primary law does not.

Although the instruments that primary law puts at the ECB's disposal have therefore been cleared, the principle of an open market economy remains relevant for the choice of instruments for two reasons. First, to the extent that Article 20 of the Statute of the ESCB and the ECB allows the Governing Council to decide upon the use of other operational methods of monetary control, these methods must comply with the principle of an open market economy. Second, the choice of instruments is not only a question of quality but also one of quantity. Simultaneous use of different instruments could overburden the open market economy and therefore no longer be necessary to attain the objective of price stability.⁴⁵

2.2.2 Design of the operational framework

As far as the design of the operational framework is concerned, the principle of an open market economy requires that sufficient safeguards be put in place to ensure that the effects of the implementation of monetary policy on the open market economy are proportionate.⁴⁶ Primary law itself contains such safeguards (e.g. lending must be based on "adequate collateral"⁴⁷), explicitly calls on the ECB to establish such safeguards (e.g. in the form of "general principles for open market

⁴⁴ Tridimas, T., "Community Agencies, Competition Law, and ESCB Initiatives on Securities Clearing and Settlement", *Yearbook of European Law*, 2010, p. 216 (273).

⁴⁵ Bindseil, U., *Monetary Policy Implementation, Theory, Past, and Present*, 2004, p. 240 et seq., advocating a parsimonious approach to the implementation of monetary policy from an economic perspective: "[...] complexity always means additional resource use, risk of misunderstandings, and a higher likelihood of mistaken decisions [...]".

⁴⁶ Tuori, K., "Enlarged Scope and Competences of the ECB, Economic Constitutional Analysis", *Legal Studies Research Paper Series Paper No 25*, University of Helsinki, 2012, p. 19.

⁴⁷ Article 18.1, second indent, of the Statute of the ESCB and the ECB.

and credit operations”⁴⁸), or sub-forms of the principle of an open market economy, such as the principle of market neutrality,⁴⁹ apply directly by default. The closer the implementation of monetary policy gets to having a major impact on the individual elements of a free market economy that are not qualified in the specific context of the Eurosystem’s competence for monetary policy, the more crucial these safeguards become.

2.2.3 Conclusion

It is difficult to establish whether the attainment of the objective of price stability interferes with the principle of an open market economy, because the abstract legal term “open market economy” is open to interpretation and price stability and an open market economy are economically and legally interdependent. Once established, such interference is justified if the implementation of monetary policy is proportionate to the objective of price stability. There are two reasons why this does not mean that the principle of an open market economy has no relevance beyond the principle of proportionality.

First, as a free market economy is qualified in the specific context of the Eurosystem’s competence for monetary policy to the extent that primary law acknowledges the public need to exercise control over the money supply, the principle of an open market economy highlights the remaining significance of the elements of a free market economy that are not qualified for the implementation of monetary policy. On a formal level, the ECB needs to examine the compliance of its measures with the principle of an open market economy and give an adequate statement of the reasons for its decisions. On a substantial level, the exercise of the Eurosystem’s competence for monetary policy must be interpreted in the light of the principle of an open market economy and restricted in its effect limiting the open market economy.⁵⁰

Second, the relevance of the principle of an open market economy is not confined to Article 119(1) and (2) as well as Article 127(1) TFEU and Article 2 of the Statute of the ESCB and the ECB. Rather, the principle of an open market economy constitutes the underlying thread of the provisions on economic and monetary policy laid down in Title VIII of the Treaty on the Functioning of the European Union. This means that the principle of an open market economy serves as a benchmark for the

⁴⁸ Article 18.2 of the Statute of the ESCB and the ECB. See in particular Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (ECB/2014/60) (OJ L 91, 2.4.2015, p. 3).

⁴⁹ See Reumann, U., *Die Unabhängigkeit der Europäischen Zentralbank, Zwischen Selbstbestimmung und vertragsmäßiger Zusammenarbeit mit der Gemeinschaft*, 2001, p. 93: “Wettbewerbsneutralität”; opinion of Advocate General Wathelet in *Weiss and Others*, C-493/17, ECLI:EU:C:2018:815, para. 74: “As the ECB and the Commission point out, to exclude the purchase of bonds with a negative yield from the PSPP would be contrary to the principle of market neutrality, which forms part of the principle of an open market economy with free competition, a condition of the ESCB’s activity pursuant to Article 127(1) TFEU”.

⁵⁰ This is similar to the “Wechselwirkungslehre” in German constitutional law, pursuant to which laws that restrict freedom of speech must themselves be interpreted in the light of the fundamental significance of freedom of speech and restricted in their effect limiting freedom of speech.

interpretation of other provisions, most prominently the monetary financing prohibition laid down in Article 123(1) TFEU. Pursuant to the case-law of the European Court of Justice, the purchase by Eurosystem central banks of public sector bonds of euro area Member States on the secondary market does not have an effect equivalent to that of a purchase on the primary market if a market price has been established for such public sector bonds prior to them being purchased on the secondary market.⁵¹ The European Court of Justice thus implicitly reverts to the principle of an open market economy in order to ascertain that the purchase of public sector bonds by Eurosystem central banks does not unduly influence the financing conditions of euro area Member States.

If the principle of an open market economy is properly understood as a benchmark for the interpretation of other provisions on economic and monetary policy laid down in Title VIII of the Treaty, much of what has been developed in the context of the monetary financing prohibition for the purchase of public sector bonds by Eurosystem central banks can therefore be applied to the purchase of private sector bonds in the context of the principle of an open market economy.

3 Outcome

In many official sets of rules for card games, the rules specifying the penalties for various infractions occupy more pages than the rules specifying how to play. This is not the case in primary law, where the rules specifying the penalties are short and clear. If the exercise of the Eurosystem's competence for monetary policy is challenged before the European Court of Justice, non-compliance with the principle of an open market economy will lead to the measure taken being ruled invalid. By contrast, the rules specifying how to play are more numerous and open to interpretation. Since the principle of an open market economy trumps the objective of price stability in the event of conflict, any interference with the principle of an open market economy from the implementation of monetary policy needs to be justified according to the standards of proportionality.

⁵¹ See the judgment in *Gauweiler and Others*, C-62/14, ECLI:EU:C:2015:400, para. 81, and the opinion of Advocate General Cruz Villalón in *Gauweiler and Others*, C-62/14, ECLI:EU:C:2015:7, para. 252.

Monetary policy and the principle of an open market economy with free competition

By Clovis Hopman¹

Having a large degree of discretion in the choice of instruments comes with the obligation to respect certain principles and select those instruments carefully. In legal parlance, Article 127 of that Treaty states for example that in pursuing its objectives, the Eurosystem "(...) shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources (...)"²

The European System of Central Banks (ESCB) is endowed with tasks it needs to fulfil, objectives it needs to pursue in the fulfilment of those tasks, as well as instruments to enable it to fulfil these tasks and achieve these objectives. However, the Treaties set also limits to the powers of the ESCB. These include the prohibition on monetary financing (Article 123 TFEU) as well as a number of principles of law. One well known principle that was scrutinized at length in the *Gauweiler*³ ruling of the Court of Justice is the principle of proportionality. In this paper, I will focus on a principle of law that, in the context of monetary policy, has received much less attention in both the academic literature and jurisprudence – the principle of an open market economy with free competition.

Article 127(1) TFEU, which is part of the Treaty chapter on monetary policy, reads as follows: *The primary objective of the European System of Central Banks (hereinafter referred to as "the ESCB") shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union. **The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 119.*** (Emphasis added).

I will elaborate, in particular, on two striking aspects regarding the principle of an open market economy with free competition. First, the drafting of the principle of an open market economy with free competition is clearly meant to delimit the powers of the ESCB. The firmness of this delimitation is matched, however, by the broadness of the concept of "an open market economy with free competition". Given the absence of jurisprudence, I will make an attempt to sketch what this concept may entail in the realm of monetary policy. Second, the Treaty asserts that the principle of

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² Yves Mersch, at panel "Europe's Economic and Monetary Policy" during the Ambrosetti Conference on the Outlook for the Economy and Finance, Villa d'Este, Cernobbio, 9 April 2016.

³ Case C-62/14 *Gauweiler and Others*, ECLI:EU:C:2015:400, paras. 67 and 91.

an open market economy with free competition favours an efficient allocation of resources. I will investigate the possible legal ramifications of this assertion.

1 Limits to monetary policy set by the principle of an open market economy with free competition

When Article 127(1) TFEU (which is echoed in Article 2 of the ESCB Statute) was first drafted, its wording was somewhat different. In the Draft Statute as submitted by the Committee of Governors, the ESCB was required to “act consistently with free and competitive markets”. This was changed, however, into an assertion to bind the ESCB to “the principle of an open market economy with free competition, favouring an efficient allocation of resources”. According to Smits⁴ (1997) the rewording of compliance with the principles of open market and free competition emphasizes the importance attached by the authors of the Treaty and the Statute to these methods of operation.

Indeed, the current wording (the ESCB “shall act in accordance” with the principle) is quite forcing.⁵ Moreover, the ESCB is bound to act in accordance with the principle of an open market economy with free competition in the same Article that enumerates the ESCB’s objectives: the means by which the ESCB can pursue these objectives are immediately limited by the Treaty, as the ESCB is required to act in line with the principle of an open market economy with free competition and thus does not have recourse to monetary policy measures that violate this principle. According to Smits (1997), the repetition of the principle of an open market economy with free competition in Article 119 TFEU, to which Article 127(1) TFEU refers, could be seen as a desire to give this principle a more eminent place in the Treaty. He argues that it makes it “difficult” for the ESCB to adopt monetary control measures that are contrary to free competition among financial institutions.⁶

While it thus seems clear that the ESCB cannot adopt monetary policy measures that violate the principle of an open market economy with free competition, it is not clear at all when precisely that principle is violated. There is no sharp demarcation line in terms of where certain operations by the ESCB suddenly cease to be compliant with the principle of an open market economy with free competition. Also, it should be acknowledged that the *raison d’être* of a central bank is to have an effect on markets through its actions.⁷ Obviously, the principle of an open market economy with free competition cannot be interpreted such that *all* forms of central bank intervention are off limits. In the absence of case law, it is hard to know how monetary measures are limited by the principle of an open market economy with free

⁴ René Smits, *The European Central Bank. Institutional aspects*, p. 181-182.

⁵ The language used in the Treaty to invoke principles of law varies. See the contribution by Karen Kaiser, entitled *The objective of price stability and the principle of an open market economy: what trumps?*, in this book.

⁶ René Smits, *The European Central Bank. Institutional aspects*, p. 191.

⁷ For example by driving the short term interest rate away from equilibrium.

competition. When speculating on what the interpretation of the principle of an open market economy may look like, there are two issues that may be worth highlighting.

First, there is a grey-scale where monetary measures may become more and more at odds with the principle of an open market economy with free competition. This raises the question how such measures should be weighed against the ESCB's primary objective to maintain price stability. If several measures are available, where one of them is problematic from the perspective of the principle of an open market economy with free competition, the ESCB may be required to resort to other measures that are more in line with that principle. But if no monetary measures are available that are fully in line with the principle of an open market economy with free competition, that same problematic measure may perhaps be acceptable. This interpretation would be suggested if the principle of an open market economy with free competition is read in conjunction with the principle of proportionality⁸ and, in particular, with the necessity test thereof.⁹ Indeed, in *Gauweiler*, the Court of Justice ruled that "it should, in the second place, be established whether such a programme does not go manifestly beyond what is necessary to achieve those objectives",¹⁰ and recalled that the ESCB itself acknowledges that "the purchase of government bonds on secondary markets is permitted only in so far as it is necessary to achieve the objectives of that programme and that such purchases will cease as soon as those objectives have been achieved".¹¹ These considerations were made in relation to the proportionality of the programme, but their legal relevance may extend to the principle of an open market economy with free competition. As argued below, this consideration is of particular relevance in the context of monetary policy near the "zero lower bound".

Second, the absence of case law implies that not only no clear demarcation line exists in terms of when a monetary policy measure crosses the line but, what is more, it is not even clear what general considerations come into play when assessing whether monetary policy measures are in line with the principle of an open market economy with free competition. An attempt to speculate on some of the considerations coming into play in a framework assessing the ESCB's monetary policy measures by the principle of an open market economy with free competition may look as follows. The proposed criteria should be understood to be cumulative, and I emphasize that they are of a qualitative rather than a quantitative nature.

First, monetary policy measures that have strong effects on relative prices may be more distortive of the open market and more at odds with the notion of "free competition" than measures that address the general price level. For example, steering short term interest rates (in combination with forward guidance) has effects on the entire yield curve and changes a wide range of prices through the monetary

⁸ See the contribution by Karen Kaiser, entitled *The objective of price stability and the principle of an open market economy: what trumps?*, in this book.

⁹ According to the settled case-law of the Court of Justice, "the principle of proportionality requires that acts of the EU institutions be appropriate for attaining the legitimate objectives pursued by the legislation at issue and do not go beyond what is necessary in order to achieve those objectives" (Case C-62/14 *Gauweiler and Others*, para. 67).

¹⁰ Case C-62/14 *Gauweiler and Others*, para. 81.

¹¹ Case C-62/14 *Gauweiler and Others*, para. 82.

policy transmission mechanism. Interventions in a specific asset class, on the other hand, could have a disproportionate effect on the pricing of that particular asset and, in my view, are more distortive of the market.

Second, the larger the share of a certain class of assets that the ESCB purchases, the more at odds these purchases are in my view with the principle of an open market economy with free competition.

Third, prolonged interventions are more problematic than short ones.

Fourth, interventions in illiquid markets are – from the perspective of the principle of an open market economy with free competition – more problematic than interventions in liquid ones.

Finally, a fifth criterion may be whether the ESCB has “built in” incentives not to use specific monetary policy instruments that constitute strong market interference. Penalties such as higher interest rates, or other incentives that discourage the use of these instruments by market participants, bring them more in line with the principle of an open market economy with free competition.

Summing up: large scale, long term ESCB interventions in specific illiquid markets affecting the prices of only a limited set of assets without incentives to discourage the usage of the instruments are more likely to violate the principle of an open market economy with free competition, especially if the ESCB has other monetary measures by which it can achieve its objectives.

2 How to favour an efficient allocation of resources?

Remarkably, Article 127(1) TFEU not only delimits the powers of the ESCB by demanding it to act in accordance with the principle of an open market economy with free competition, it also explains the reasoning behind this delimitation: doing so favours an efficient allocation of resources. This is remarkable for at least three reasons.

First, even though the Treaty does not elaborate on this, price stability, too, is widely considered to contribute to an efficient allocation of resources. It thus appears that the primary objective of price stability and its limitation by the principle of an open market economy with free competition contribute to a common goal. This does not, of course, imply that the primary objective of price stability and the principle of an open market economy with free competition necessarily work in concert. Quite the contrary: the legally interesting situation is where a conflict between the two arises. If such a conflict could not theoretically exist, the principle of an open market economy with free competition would never be binding and the Treaty would have omitted it.

Second, by the assertion that an open market economy with free competition favours an efficient allocation of resources, the Treaty takes a stance in a long standing debate amongst economists. It is by no means generally accepted that an open market with free competition always favours an efficient allocation of resources. The

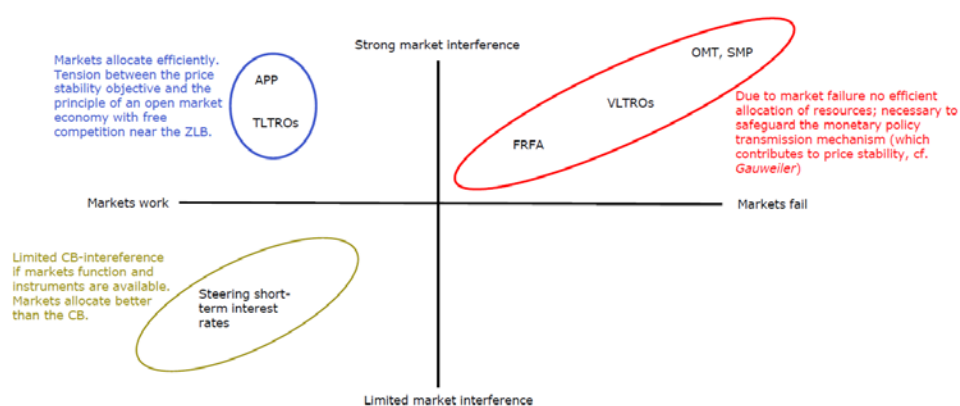
very existence of a central bank acknowledges that markets fail to always distribute resources efficiently and that some level of monetary intervention is necessary. This holds true not only in monetary policy but also in fiscal policy, where many economists are of the view that the government should play a role in stabilizing the business cycle. However, opponents of an interventionist role of the government or central bank may point out that government restraint may cause economic damage on the short term, but that it has the self-cleansing effect of “creative destruction” in the longer term and distributes resources to more productive segments of the economy. This view would justify restraint on behalf of governments. The important legal point here is that it appears that the ESCB is not free in this debate: the Treaty binds it to act in accordance with the principle of an open market economy.

Third, and most interestingly, the question arises what the legal interpretation of the provided *ratio legis* of the principle of an open market economy with free competition is. If it is merely limited to a stance in an economic debate, there would be little legal added value to it. An interpretation along the following line of reasoning is therefore worth considering. In normal circumstances an open market economy with free competition favours an efficient allocation of resources. The ESCB should therefore not use monetary policy measures that violate that principle. Such were the circumstances under which the Treaty was written, and under which the euro area functioned during its first decade. However, there may be circumstances under which the assumption of a functioning open market economy with free competition breaks down – and such circumstances have plagued the euro area during its second decade. Arguably, under circumstances where markets fail, *the premise of the principle of an open market economy with free competition – i.e. that it favours an efficient allocation of resources – no longer holds*. Perhaps then, under such circumstances, monetary policy measures that would normally be at odds with the principle of an open market economy with free competition become acceptable. While the *Gauweiler* ruling does not mention the principle of an open market economy, elements of this ruling do support this reading. For example, the Court of Justice considers that, “it should be recalled that this *programme is intended to rectify the disruption of the ESCB’s monetary policy* which arose as a result of the particular situation of government bonds issued by certain Member States. *In those circumstances, the ESCB was fully entitled to take the view that a selective bond-buying programme may prove necessary in order to rectify that disruption*”¹² (my emphasis).

This provides an interesting perspective to classify different monetary policy “regimes” as illustrated in the figure below.

¹² Case C-62/14 *Gauweiler and Others*, para. 89.

Figure 1



The normal regime presented by the bottom-left part of the figure is characterized by the monetary conditions present before 2007. Markets functioned properly and the ESCB influenced monetary conditions by using measures that were – in terms of the criteria provided earlier – in line with the principle of an open market economy with free competition. To a large extent, the ESCB relied on steering short-term interest rates.

The market failure regime in the top-right corner shows the opposite situation. Over the last decade, both the interbank market and the market for certain government bonds failed, impairing the monetary policy transmission mechanism. This prompted the ESCB to intervene with several measures, such as the “fixed rate full allotment” (FRFA: enabling financial institutions to borrow as much as they needed, provided that they had adequate collateral), the Securities Markets Programme¹³ (SMP) and the announcement of its successor, the Outright Monetary Transactions¹⁴ (OMT). These measures were more at odds with the cumulative criteria I proposed earlier (for example, OMT would presumably constitute large scale purchases of specific illiquid government bonds, affecting mainly the prices of these bonds). However, considering the teleological arguments considered here, they were also more justified because the premise of the principle of an open market economy with free competition – that it favours an efficient allocation of resources – very plausibly no longer held true for the conditions under which OMT were to be employed. Under these exceptional circumstances, it was plausible that strong central bank interference led to a better allocation of resources.

The zero lower bound (ZLB) regime is the monetary regime of the past few years. During this period, markets functioned and thus the premise of the principle of an open market economy with free competition did hold, just like it did in the pre-crisis era. Monetary conditions differed from that era, however, because the ESCB’s main instrument under normal conditions – the short term interest rate – reached the ZLB

¹³ Decision of the European Central Bank of 14 May 2010 establishing a securities markets programme (ECB/2010/5), OJ L 124, 20.5.2010, p. 8.

¹⁴ [Outright Monetary Transactions](#).

and became therefore ineffective. In view of deflation risks, the ESCB considered that in order to continue to achieve its primary objective of price stability, it had to employ other monetary measures, such as the Asset Purchase Programme¹⁵ (APP), including the *Public Sector Purchase Programme*¹⁶ (PSPP), and the *Corporate Sector Purchase Programme*¹⁷ (CSPP). In this third regime, the tension between the ESCB's primary objective and the principle of an open market economy with free competition is, in my view, the strongest.¹⁸ It should be noted that the ESCB explicitly asserts in its legal acts that the PSPP is in accordance with the principle of an open market economy. At the same time, the ESCB acknowledges that the principle of an open market economy with free competition does delimit the ESCB's competences, as reflected by a speech by Mr Mersch, where he argues: "Furthermore, the relevant securities [purchased by the ESCB under the PSPP] are also subject to an issue share limit and an issuer limit, which preserve market functioning. These features are compliant with the requirement to act in accordance with the principle of an open market economy."¹⁹

3 Conclusion

The principle of an open market economy with free competition delimits the powers of the ESCB. However, at the moment, it is not possible to say where exactly these limits are. This paper attempts to sketch three regimes where different considerations may dominate.

In the normal regime that prevailed prior to 2007, an open market economy with free competition favours an efficient allocation of resources. Moreover, under these conditions, various monetary policy instruments were available to the ESCB. Under these circumstances, the ESCB should use those instruments that are least at odds with the principle of an open market economy with free competition.

In the market failure regime, an open market economy with free competition may not favour an efficient allocation of resources. If the *ratio legis* of the principle no longer holds, this may justify market intervention.

Finally, in the zero lower bound regime, markets do function but the instrument that is least at odds with the principle of an open market economy with free competition – the short-term interest rate – is not available. The ESCB therefore has to resort to

¹⁵ For an overview of the APP, please see [Asset purchase programmes](#).

¹⁶ Decision (EU) 2015/774 of the European Central Bank of 4 March 2015 on a secondary markets public sector asset purchase programme (ECB/2015/10), OJ L 121, 14.5.2015, p. 20.

¹⁷ Decision (EU) 2016/948 of the European Central Bank of 1 June 2016 on the implementation of the corporate sector purchase programme (ECB/2016/16), OJ L 157, 15.6.2016, p. 28.

¹⁸ Decision (EU) 2015/774, recital 6 states that "The PSPP complies fully with the obligations of the Eurosystem central banks under the Treaties (...) and does not impair the operation of the Eurosystem in accordance with the principle of an open market economy with free competition". This is reiterated in recital 1 of Decision (EU) 2017/100 of the European Central Bank of 11 January 2017 amending Decision (EU) 2015/774 on a secondary markets public sector asset purchase programme (ECB/2017/1), OJ L 16, 20.1.2017, p. 51.

¹⁹ Yves Mersch, at panel "Europe's Economic and Monetary Policy" during the Ambrosetti Conference on the Outlook for the Economy and Finance, Villa d'Este, Cernobbio, 9 April 2016.

measures that have stronger distortive effects on markets in order to meet its primary objective of price stability. This means that at some point the constraints set by the principle of an open market economy with free competition may become binding. It is not possible to say when exactly this happens. But the ESCB should take this constraint to its powers into account – which, as we have seen, it already does.

The application of the principle of an open market economy in the area of economic policy: lessons to be learned for monetary policy

By Leo Flynn¹

1 Introduction

A series of general constitutional principles are relevant when considering any aspect of Union law, since they shape the interpretation of individual provisions of the Treaties and inform the measures that the institutions of the European Union take under them. One of them, the principle of an open market economy with free competition, stands slightly apart from other principles because it has a somewhat chequered history.

Article 3 TEU sets out the aim of the Union, namely to promote peace, its values and the well-being of its peoples, and it identifies tools through which those goals are to be achieved, one of which is the establishment of an internal market (Article 3(3) TEU). As regards the internal market, in the EC Treaty in place up to 2009, Article 3(1)(g) EC provided that one of the activities of the European Community was a system to ensure that competition in the internal market is not distorted. Article 3(1)(g) EC therefore directly tied the internal market and undistorted competition. However, such a link no longer appears in the main body of the Treaties. Nevertheless, Protocol No 27 on the internal market and competition (which is a full part of the Treaties) makes clear that the internal market as set out in Article 3 TEU includes a system ensuring that competition is not distorted.

Due to those modifications made by the Treaty of Lisbon, Article 3(3) TFEU is now almost “expressive” in its silence about the role of free competition in the market. It points to a downgrade for the principle of free competition in the market, when compared with Article 3(1)(g) EC as its functional predecessor, notwithstanding the emphasis on the principle’s importance in Protocol No 27 on the internal market and competition. However, that deliberate gap is mitigated by the role given to the principle of an open market economy with free competition in the fields of economic and monetary policy. Article 119 TFEU, which was originally introduced by the Treaty on European Union signed at Maastricht, provides, *inter alia*, that the activities of the Member States and the Union shall include the adoption of an economic policy conducted “in accordance with the principle of an open market economy with free competition”.

¹ Legal Adviser, Legal Service, European Commission. All views expressed are personal.

To some degree, amendments to the Treaties agreed at Amsterdam in 1997 modulate the signal sent by Article 119 TFEU. Less confidence in the market is displayed by the insertion into the Treaty on the Functioning of the European Union of, for example, Title IX of Part Three on Employment and amendments dealing with State intervention in the market in the form of Article 14 TFEU on public services. The Treaties are thus far from sanguine about market outcomes, about the robustness of market structures and about the resilience of the foundations on which markets are constructed.

Due to the lack of litigation directly dealing with the principle of an open market economy with free competition, any prediction of how the Union courts may handle it must be speculative. Given the paucity of case-law on monetary and economic policy, one source of inspiration that could be used for that purpose is to look at how the Court of Justice and the General Court apply the Treaty rules regarding State measures and competition, where the internal market and the goal of an open market economy come together.

There is, however, another possible source of inspiration: seeing how the decisional practice of the Union institutions in the field of economic policy gives effect to the principle of an open market economy with free competition. The purpose of this paper is to take up that challenge, exploring the role of the principle in the area of economic policy.

Title VIII of Part Three of the Treaty on the Functioning of the European Union deals with the economic and monetary policy of the Union. Within it, Article 119 TFEU lays down a series of principles and guidelines that Chapter 1 (economic policy) and Chapter 2 (monetary policy) of Title VIII develop further.

Article 120 TFEU is the first provision in the chapter on economic policy, and it expands on the common principles previously defined in Article 119 TFEU. The main thrust of Article 120 TFEU is to confirm the core role of the Member States in the field of economic policy, while underlining that the aims pursued by national policy must contribute to the Union's overall objectives and that broad guidelines are to be drawn up at Union level for the Member States and the Union. For present purposes, it is noteworthy that the principle of an open market economy with free competition, repeatedly invoked in Article 119 TFEU, also recurs in Article 120 TFEU but that Article 120 TFEU links it to "favouring an efficient allocation of resources". That linked reference could be seen as recognising the role of structural policies in addressing markets' imperfections and their resulting inability to avoid failures.

2 Justiciability of the open market economy principle

The first occasion on which the Court of Justice looked at Article 119 TFEU was in *Échirolles*² and to date it has yet to rule directly on the scope of the principle of an open market economy with free competition laid down in that provision. In his

² Case C-9/99 *Échirolles Distribution*, ECLI:EU:C:2000:532.

Opinion in *Échirolles*, Advocate General Alber took the view that Article 119 TFEU cannot, taken on its own, create obligations for Member States, and that it is primarily linked to the economic and monetary union rather than to other substantive areas of Union law.³ The Court confined itself to stating that the provision did not create direct legal effects for individuals and embodied “a general principle whose application calls for complex economic assessments which are a matter for the legislature or the national administration”.⁴

However, it is also important to realise that, irrespective of their direct effect, all provisions of Union law are a full part of the legal system and are capable of legal effects other than the conferral of rights or the attribution of obligations. Under Article 19 TEU the Court of Justice must ensure that “in the interpretation and application of this Treaty the law is observed”. In that light, the Court has regularly emphasised the importance of the rule of law in the constitutional order of the Union. That commitment is expressed in several distinct forms in the jurisprudence of the Court of Justice, including the rules of legal interpretation that the Court uses. Any interpretation of legal norms within the scope of the Union legal order must ensure the coherence of lower norms with their hierarchical superior ones while also reading legal norms of the same hierarchical rank in a harmonious manner so far as it is possible to do so.

That relevance for the interpretation of other parts of Union law of provisions that do not create rights or obligations for individuals is clear from the role of recommendations in the case-law of the Court of Justice. The Court held in *Grimaldi*⁵ that because recommendations have, in accordance with Article 288 TFEU, no binding effect, they could not create rights upon which individuals can rely. Yet, such measures form part of the Union legal order and may have certain legal effects. It ruled that: “The national courts are bound to take recommendations into consideration in order to decide disputes submitted to them, in particular where they cast light on the interpretation of national measures adopted in order to implement them or where they are designed to supplement binding [Union] provisions.”⁶

In a comparable manner, secondary legislation of the Union must be interpreted in conformity with the provisions of the Treaty, and in conformity with the general principles of Union law.

As a result, even if the principle of an open market economy with free competition articulated in Articles 119 and 120 TFEU creates no rights or obligations for individuals, the principle is not devoid of legal effects. It can shape how secondary legislation of the Union is interpreted and play a role in delineating the scope of other provisions of primary law.

³ Opinion of Advocate General Siegbert Alber in Case C-9/99 *Échirolles Distribution*, ECLI:EU:C:2000:299, paras. 47 to 49.

⁴ Case C-9/99 *Échirolles Distribution*, para. 25.

⁵ Case C-322/88 *Grimaldi*, ECLI:EU:C:1989:646, para. 16.

⁶ Case C-322/88 *Grimaldi*, para. 18.

While the principle is therefore of legal relevance and so is justiciable, the Court's ruling in *Échirolles* explains that it is a general principle under which the legislature or administration must make "complex economic assessments". The corollary of that feature of the principle is that the Union courts will accord a wide margin of discretion and evaluation to decision-makers, whose actions must be in line with that principle. A person using it to claim that a given measure breached the principle must satisfy the Union courts that the decision-maker made a manifest error of appreciation. In concrete terms, an applicant would have to adduce evidence showing that the institution's assessment that the contested decision stayed within the principle's limits was implausible or improbable.

3 The architecture of economic policy surveillance – an overview

The principal means used to coordinate the Member States' economic policies is a process of multilateral surveillance in which the Council is the main forum for decision-making, albeit with the involvement of the European Council. Article 121 TFEU provides a means of coordinating economic policies in general, while Article 126 TFEU polices the Member States' obligation to conduct a responsible fiscal policy. Article 126 TFEU thus constitutes (along with Article 121 TFEU) the base for Union legislation on fiscal oversight of the Member States.

Those provisions set the framework for the two arms of the Stability and Growth Pact (SGP), a framework for preventing and correcting excessive government deficits adopted in 1997 in the form of two regulations. Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies⁷ is the "preventive arm" of the SGP, while Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure⁸ is its "corrective arm". The operation of the SGP in turn intertwines with the various steps of the so-called European Semester.

The next section of this paper will examine how the principle of an open market economy with free competition is expressed in the Union institutions' practice under the European Semester, while the following section will see if this principle can be discerned in the more fiscally-oriented procedures of the SGP's corrective arm and allied mechanisms.

⁷ Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (OJ L 209, 2.8.1997, p. 1).

⁸ Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ L 209, 2.8.1997, p. 6).

4 The European Semester

Created in 2010, the European Semester is an annual process in which the Commission and the Council review the economic performance and the budgetary policies of Member States. In the first half of each year, Member States submit for review national reform programmes. They also transmit, depending on whether they use the euro, stability or convergence programmes. In July the Council adopts country-specific recommendations (CSRs), taking a view on those national plans, and the Member State concerned should build on its CSR in the second half of the year when it prepares its budget for the following year along with other measures to improve its economic performance.

If we look at the content of the CSRs adopted by the Council, we see the consistent calls for Member States to conduct themselves in line with the principle of an open market economy with free competition. A survey of the CSRs adopted in 2016 provides multiple examples of such advice to the Member States. Some deal essentially with promoting free competition, while others identify a need for market-opening measures and liberalisation.

In the first category, Italy received, for example, a recommendation to take action in 2016 and 2017 to “swiftly adopt and implement the pending law on competition”. The CSR for Denmark called on it to “enhance productivity and private sector involvement by increasing competition in the domestic services sector”, while the Council recommended that Finland “continue pursuing efforts to increase competition in services, including in retail”.

In the second category, the Council called on Spain to liberalise market access, explaining that “tackling obstacles to access to the professional services sector is likely to improve productivity in other sectors that use those inputs. Apart from the transposition of the Services Directive into Spanish law, there has been no progress on a horizontal reform of the regulatory framework for regulated professions and professional associations, other than in the area of professional board certification of projects. The reform [aimed at defining the professions requiring registration in a professional organisation, increasing transparency and accountability of professional bodies, opening up unjustified reserved activities and safeguarding market unity in the access to and exercise of professional services in Spain] was not adopted”.

Poland received a comparable recommendation, in which the Council called upon it to “take measures to remove obstacles to investment in transport, construction and energy infrastructure”. The ambit of that recommendation is better understood by looking at its corresponding recital: “bottlenecks and deficiencies in transport, energy and communication networks persist. Investment activity is hampered by barriers in relation to the functioning of the public administration, taxation, the environment for research, development and innovation activities, and lengthy contract enforcement. Weaknesses in managerial and administrative capacity have a negative effect on the timely implementation of investment projects in the railway sector and other transport, energy and telecommunication infrastructure projects”. That explanation for the Council’s call to Poland to remove obstacles makes clear that the hindrances

in question covered diverse aspects of its regulatory, legal, fiscal and policy environment.

All such CSRs build on the Treaty-based imperative to foster an open market economy with free competition. While they are far-reaching as to the aspects of Member States' conduct that they put under review, the specified CSRs ultimately seek to advance that principle.

The recommendations made by the Commission in May each year, which are the basis on which the Council ultimately adopts the CSRs in July of the same year, are based on the so-called "country reports" that the Commission publishes every February. Unlike the CSRs and certain other outputs of the European Semester process, the country reports have no legislative basis. They are staff working documents, prepared by the services of the Commission and intended to be analytical texts that are essentially descriptive in nature. However, by pointing to strengths and weaknesses in the Member States' performance across the greater part of their economy, they underpin the analysis of the Commission when preparing its recommendations to the Council. In that respect, it should be underlined that an intense exchange precedes the release of the country reports, with informal dialogue between the Commission's services and the authorities of the Member State concerned. As a result, when the country report becomes public, the latter are not taken unawares of what its contents are likely to be. That procedure seeks to increase the degree of "national ownership" of the analysis/diagnosis in the country reports and to augment the extent to which Member States buy into the CSRs that they will later on receive.

That preparatory process also means that there is no "one size fits all" approach to what is meant by the principle of an open market economy with free competition in the context of the European Semester. Differing national policy preferences can be incorporated into the CSRs, as it can be seen from the manner in which State ownership is treated in the 2016 CSRs.

For Croatia, the Council recommended, in 2016, that that Member State "advance the divestment process of [S]tate assets and reinforce the monitoring of [S]tate-owned enterprises' performance and boards' accountability, including by advancing the listing of share of [S]tate-owned enterprises". It is well-known that the Union legal order is neutral with regard to public and private ownership, pursuant to Article 345 TFEU, neither of which is favoured per se over the other. The CSR for Croatia does not display hostility towards or scepticism about State-ownership. Instead, it reflects the fact that that Member State had chosen to lower the level of the State's direct presence in the economy, and the Council called on it to do so in an effective manner that would boost economic performance and safeguard public finances. By contrast, in the same year for Slovenia the CSR recommended to it to "improve the governance and performance of [S]tate-owned enterprises". Since it makes no mention of the disposal of State assets, that CSR has a very different emphasis to the Croatian recommendation. The corresponding recital explains the variation in approaches, by outlining that in 2016 Slovenia had adopted a strategy on the management of State ownership in which the Member State "confirms the extent

of the State's current involvement in the economy and shifts the focus towards the improved performance of the [S]tate-owned enterprises".

The principle of an open market economy with free competition connects tightly with the precepts underlying an open market, including maintaining the rule of law. A market is an artefact requiring inter alia respect for property rights and the enforceability of contractual claims. Without those elements, the foundations for transactions between individuals who do not know each other and who may never deal with one another again will be absent. And those elements require, in turn, that courts will adjudicate in an independent fashion and will be expected to do so when disputes are brought before them.

In recent years, the CSRs adopted in the European Semester have pointed to that link. In the 2017 CSR to Poland, the Council noted in a recital that investment activity in that Member State had declined significantly in 2016 and that legal changes for which there had been limited public consultation had affected business confidence. The recital went on: "Legal certainty and trust in the quality and predictability of regulatory, tax and other policies and institutions are important factors that could allow an increase in the investment rate. The rule of law and an independent judiciary are also essential in this context. Addressing serious concerns related to the rule of law will help improve legal certainty." It is noteworthy that the recital in question did not correspond to a specific recommendation to Poland. The drafting of the recital makes clear, moreover, that the concerns it articulates about the rule of law and the independence of the judiciary have an instrumental role here, in that they are not set out as values in their own right. Instead, it is because they contribute to the effective functioning of the market that a CSR is justified in calling for the Member State to address the worries expressed by the Council. Other ways of approaching rule of law concerns in the European Semester could be problematic, as the Union institutions should not use the legal base for economic policy measures (Article 121 TFEU) for action that should in fact be grounded on other primary law provisions.

In the 2018 CSR addressed to Hungary, the Council voiced comparable views about the importance of legal certainty as a bedrock both for free competition and for an open market. Speaking about issues affecting, in the services sector, an efficient allocation of resources, productivity and innovation, the Council stated that, "[T]here is a continuous trend to entrust certain services to [S]tate-owned firms specifically created for these purpose, to the detriment of open competition. Unpredictability of the legal framework is a further problem, especially in the retail sector, which in recent years has been faced with frequent changes to regulations. [...] A stable regulatory environment favourable to competition is needed". This served as a statement of reasons for the recommendation received by Hungary, to "strengthen competition, regulatory stability and transparency in the services sector, in particular in retail".

In the field of economic policy, the European Semester rests on Article 121(2) TFEU and, in respect of the Member States' stability or convergence programmes, on Regulation (EC) No 1466/97. In addition, the European Semester is also the vehicle through which the procedure to prevent and correct macroeconomic imbalances laid

down in Regulation (EU) No 1176/2011⁹ is pursued. Part of the “Six Pack” adopted in 2011 to draw on initial lessons from the economic and sovereign debt crisis, that regulation also involves an annual cycle of surveillance. While its timetable is tied to, and culminates in, the process of adopting CSRs between May and July each year, the macroeconomic imbalances procedure (MIP) reaches back to the preceding year. The MIP begins in November when the Commission adopts an alert mechanism report (AMR). The AMR makes a qualitative economic and financial assessment based on a scoreboard with a set of indicators that the Commission uses to compare each Member State’s performance for a given indicator with indicative thresholds.

The AMR identifies Member States that may be experiencing imbalances, that is macroeconomic developments that adversely affect or could adversely affect the proper functioning of their economy, or that of the EMU, or that of the Union as a whole. For the Member States that the AMR identifies, the Commission will conduct an in-depth review, presenting the results of its examination in February alongside the publication of the country reports. The Commission will then make one of three findings for each Member State: no imbalance, economic imbalance, or excessive imbalance (meaning severe imbalances that jeopardise or risk jeopardising the proper functioning of the EMU). The Council makes recommendations to Member States experiencing imbalances in the context of the European Semester, in the form of the CSRs it adopts in July.

The individual indicators that underpin the scoreboard do not cast much light on the principle of an open market economy with free competition. Even so, one feature in the recent AMRs points to the substantive understanding of that principle in terms of economic policy. The principle does not limit itself to standing back from market operations and letting them play out without intervention. The logic of Regulation (EU) No 1176/2011 is that Member States’ action or inaction can put at risk not only their own economies, but also that of the euro area or indeed the Union as a whole. For example, in November 2016 in the 2017 AMR, the Commission noted that investment rates remained stuck below pre-crisis levels in a manner consistent with a so-called “secular stagnation hypothesis”. It therefore made a call for coordinated action to mobilise resources for public and private investment and to support a demand recovery. Specifically, it advocated that surplus countries should support domestic demand more actively along with the creation, in particular in net debtor countries, of structural conditions favouring investment, productivity growth and competitiveness gains.

The European Semester is a surveillance process that concentrates on the economic and fiscal position of the individual Member States. However, the euro area as the totality of Member States using the single currency constitutes a region with even more intertwined structural and budgetary linkages between its participants. That singularity is recognised in practice by the Euro Area Recommendation (EAR) adopted every year by the Council on the basis of Article

⁹ Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (OJ L 306, 23.11.2011, p. 25).

136 TFEU in conjunction with Article 121(2) TFEU. The EAR is in some ways a functional equivalent to CSRs provided to individual Member States, albeit without the elements that flow exclusively from Article 148 TFEU in CSRs. The current practice is for the timetable for the adoption of the EAR to be distinct from that of the CSRs, with the Council making its recommendation in the spring of each year.

Just as CSRs reflect the principle of an open market economy with free competition, the same principle shapes the guidance given by the Council on the economic policy of the euro area. For instance, in the 2018 EAR the Council noted that, “[p]roduct market reforms that increase competition and reforms that improve the business environment and the quality of institutions (including an effective justice system that facilitates contract enforcements) foster economic resilience in Member States and the euro area as a whole”. Accordingly, it recommended that in 2018 and 2019 euro area Member States should take action within the Eurogroup, individually and collectively, to “make significant progress towards completing the Single Market, particularly in services, including financial, digital, energy and transport, by, inter alia, implementing relevant product market reforms at national level”. The previous year, the Council’s observations had again reflected that principle, when it explained in the 2017 EAR that “[s]tructural reform implementation, by creating efficient markets with responsive price mechanisms, would support monetary policy through facilitating its transmission to the real economy”.

5 Fiscal surveillance

It is not possible to understand the co-ordination of economic policy without reference to Article 126 TFEU that requires Member States to avoid excessive government deficits. Article 126 TFEU does not impose as narrow and restrictive a set of tasks as Article 127 TFEU does in the case of monetary policy, but together with that latter provision it is the foundation stone of EMU. Notwithstanding the relatively open-textured quality of its provisions, Article 126 TFEU sets the outer limits for the freedom of Member States in their economic policies, including matters that remain predominantly national competences such as public spending and taxation. Article 126 TFEU provides for a monitoring system and lays down possible sanctions for those euro area Member States that run excessive deficits.

Under the preventive arm of the SGP, euro area Member States transmit on an annual basis their stability programmes to the Council and the Commission, while Member States outside the euro area provide them with their convergence programmes. Those programmes set out the foreseen deficit and debt levels, as well as information about the economic policies and the general economic context of the Member State that allow an assessment of the plausibility of those forecasts. The subsequent review process based on the programmes tries to encourage the Member States, and (if necessary) for euro area Member States compels them by means of sanctions, to avoid excessive deficits.

In relation to stability and convergence programmes, the Commission and the Council monitor their implementation based on Article 121(3) TFEU, and under

Regulation (EC) No 1466/97 may open a so-called “significant deviation procedure” where a Member State’s budgetary position deviates or is expected to deviate from its medium-term budgetary objective. The Council initiated that procedure for the first time in 2017, as regards Romania, and opened it in 2018 for Hungary and again for Romania. However, for the purposes of teasing out the role of the principle of an open market economy with free competition, that aspect of fiscal surveillance reveals nothing of wider significance.

One might expect that under Article 126 TFEU, the decisions regarding the fiscal situation of Member States would be equally non-informative. That view is largely correct as regards the decisions to open or to close an excessive deficit procedure in respect of a Member State. There the Council’s evaluation is limited to assessing if the Member State fulfils the deficit and debt criteria laid down in the Treaty, without a detailed analysis of the factors leading to that situation.

By contrast, where a Member State that is under an excessive deficit procedure has not taken effective action to bring order to its government finances, Article 126(9) TFEU allows the Council to give it notice to take measures to remedy the situation of excessive deficit. In that setting, the principle of an open market economy with free competition finds some (limited) room for expression, as can be seen as regards the notices to Spain and to Portugal in 2016.

For Spain, the Council explained that it “should also pay due attention to the qualitative aspects of public finances, including its public procurement policy. [...] Spain stands out for a low publication rate of contract notices and a relatively high use of the negotiated procedure without prior publication compared with other Member States. This translates into limited competition from undertakings from other Member States and frequently, into direct awards, with implications in terms of higher general government expenditure”. Article 1(6) of the decision adopted by the Council on the basis of Article 126(9) TFEU provides: “Spain shall set up a consistent framework to ensure transparency and coordination of public procurement policy across all contracting authorities and entities with a view to guaranteeing economic efficiency and a high level of competition.” For Portugal, in a recital to the decision addressed to it on the basis of Article 126(9) TFEU, the Council stated: “Portugal should reinforce structural reforms to enhance competitiveness and long-term sustainable growth in line with the Council Recommendations addressed to Portugal in the context of the European Semester and in particular those related to the correction of its excessive macroeconomic imbalances.” The Portuguese example shows how economic policy guidance provided under Article 121 TFEU and under the MIP of Regulation (EU) No 1176/2011 ties back to the fiscal surveillance mechanisms. The notices to both Member States also place some reliance, albeit to a relatively limited extent, on the beneficial effects for the public finances of increased competition and of more open markets.

6 Other existing economic policy tools

Aside from the general regimes of multilateral surveillance of economic and fiscal policies seen in sections 4 and 5, the same Union institutions have a range of tools based directly or indirectly on the economic policy chapter. That set of instruments expanded during the sovereign debt crisis. A first step was the adoption under Article 122(2) TFEU of Regulation (EU) No 407/2010 establishing a European financial stabilisation mechanism¹⁰ (EFSM). The Union took a further step, under Article 136 TFEU, with Regulation (EU) No 472/2013¹¹ enacted as part of the “Two Pack”. The latter regulation creates a framework for treating euro area Member States that may need or that have to obtain financial assistance. Regulation (EU) No 472/2013 ensures inter alia that there is a Union law framework to shape any subsequent memorandum of understanding (MoU) between the Member State and the EFSM or the European Stability Mechanism (ESM).

On the basis of Regulation (EU) No 407/2010, the Council addressed an implementing decision to Portugal in 2011 setting out the general economic policy conditions measures that it would respect before receiving loan releases from the EUR 26 billion of financial assistance made available to it by the Union. Amongst the measures foreseen for adoption before 2012, set out in Article 3(5) of that decision, were the following:

“[...] (d) In the energy sector, Portugal shall take measures to facilitate entry, promote the establishment of the Iberian gas market and review the support and compensation schemes for the production of electricity. For other network industries, in particular transport, telecommunications and postal services, Portugal shall adopt additional measures to promote competition and flexibility.

(e) Portugal shall take urgently action to foster competition and the economy’s adjustment capacity. This includes the abolition of special rights of the State in companies, a revision of competition law to make it more effective, lighter requirements for establishment and cross-border provision in services sectors.

(f) Portugal shall improve practices and rules for public procurement contributing to a more competitive business environment and to more efficient public spending.”

Those measures articulate the principle of an open market economy with free competition, setting targets that translate the principle into specific steps that Portugal should take immediately. For the following year, the 2011 decision laid down further measures that Portugal was to adopt in the same vein, such as improving the competition framework, liberalising professional services and eliminating the regulated tariff in electricity and gas.

¹⁰ Council Regulation (EU) No 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism (OJ L 118, 12.5.2010, p. 1).

¹¹ Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability (OJ L 140, 27.5.2013, p. 1).

For macroeconomic financial assistance to euro area Member States, the EFSM has been replaced, in functional terms, by the ESM. Regulation (EU) No 472/2013 ensures that the actions taken by that intergovernmental body to support euro area Member States in difficulty are in line with Union law, by requiring the adoption of a Council implementing decision before the beneficiary State concludes or amends an MoU. Taking the example of Greece, the last modification of its ESM MoU was preceded in June 2017 by the adoption of such a decision where again the principle of open market economy with free competition was prominent. For example, amongst the legislative actions it envisaged Greece adopting were:

“Article 2

[...]

8. To promote growth, competitiveness and investment, the Greek authorities shall continue to design and implement a wide range of reforms in product markets. [...]. The reforms shall include: further implementation of OECD Toolkit recommendations to remove impediments to competition across a wide range of sectors; reforms to liberalise investment licensing and to reduce the administrative burden of starting a business; further steps to liberalise regulated professions;

[...].

10. The Greek authorities shall continue the implementation of wide-ranging reforms in the energy markets, to bring them in line with Union legislation and policies, to make them more modern and competitive, to reduce monopolistic rents and inefficiencies, to promote innovation, to favour the wider adoption of renewables and gas, and to ensure the transfer of benefits of all those changes to consumers. [...] The Greek authorities shall take further action to remove remaining obstacles to effective competition in the wholesale and retail gas markets, and to promote interconnections, as well as the diversification of the sources of supply.”

7 Manifestation of the principle in other provisions of the economic policy chapter

Having looked at Articles 121, 122 and 126 TFEU, this paper closes by looking at the remaining primary law provisions in the economic policy chapter to see if they express, amongst their various goals, the principle of an open market economy with free competition.

That reading is certainly possible for Articles 123(1) and 124 TFEU, which, respectively, prohibit the financing of the public sector¹² by the European Central Bank (ECB) or national central banks (NCBs) and measures establishing preferential financing of the public sector by other financial institutions.

¹² That is, Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States.

By prohibiting privileged access, Article 124 TFEU seeks to avoid the financing of the public sector on conditions that depart from the principle of a market economy with free competition laid down in Articles 119 and 120 TFEU, or which would depart from the latter's goal of "an efficient allocation of resources". Submitting the public sector in its financing operations to the discipline of the market helps to strengthen budgetary discipline. The corollary of the prohibition is, from the point of view of the financial services sector, a general freedom for banks to take decisions on creditworthiness (subject to prudential considerations, however) and a freedom of investment for other operators in that sector, such as insurance firms, pension funds and collective investment providers. As a result, financial institutions may not be forced to make loans to the public sector, or to invest on a non-commercial basis in debt instruments or other investment vehicles offered by it. Governments, public authorities and public firms must therefore compete on a level playing field with the private sector to access financing in the market.

Under its second alternative, the ban on monetary financing laid down in Article 123(1) TFEU bars the ECB and NCBs from purchasing debt instruments directly from the Member States. As for the purchase of government bonds on the secondary market, the Court of Justice examined the limits to such actions in *Gauweiler*¹³ The Court held that Article 123(1) TFEU does not preclude, generally, the possibility of the European System of Central Banks purchasing bonds previously issued by a Member State that are held by the creditors of the Member State, so long as it is done in such a manner that the ban on monetary financing is not circumvented. Amongst the relevant safeguards in the instance of the measure under examination in *Gauweiler* were the following:

- the purchases on the secondary market were not pre-announced;
- there was a minimum period between the issuance of the bond on the primary market and any purchase on the secondary market by the ECB or NCBs; and
- the ECB or NCBs were free to sell the bonds at any time.

Those safeguards also tend to ensure that the ECB and NCBs act in a way that is neutral as regards market operators, and in line with the principle of an open market economy with free competition. By ensuring that no particular operator has assurance as to when the bonds they hold may be purchased, or if the bonds will be purchased as all, or whether those bonds will be permanently "withdrawn" from the market, all sellers in the market have the same limitations as to knowledge and cannot derive an advantage vis-à-vis their competitors. Those outcomes are not the objective of Article 123(1) TFEU (namely, to encourage the Member States to follow a sound budgetary policy by subjecting the Member States to the discipline of the market) but the effect of safeguarding that objective has as a consequence ensuring that the principle of an economy market economy with free competition, too, is upheld.

¹³ Case C-62/14 *Gauweiler and Others*, ECLI:EU:C:2015:400.

The General Court has touched on Article 123 TFEU in its recent rulings in *Chrysostomides*¹⁴ and *Bourdouvali*,¹⁵ actions for damages against the ECB, the Council and Commission for losses suffered by shareholders, bondholders and uninsured depositors of two Cypriot banks that Cyprus had put into resolution in 2013. The applicants sought to support their claim by pointing to decisions regarding emergency liquidity assistance (ELA) for the two banks. The General Court made some remarks about ELA in its rulings:

- ELA does not come within the single monetary policy and is not part of the functions of the ESCB;
- one of the conditions to be met before ELA can be granted is the compatibility of the provision of ELA with Article 123 TFEU; and
- the rules governing ELA prohibit the grant thereof to insolvent credit institutions – according to the ECB, while the financing of solvent banks by means of ELA is compatible with Article 123 TFEU, any provision of ELA in case of underlying solvency problems would clearly infringe Article 123 TFEU.

Those considerations on ELA connect back to the Commission’s analysis of when providing ELA may constitute State aid for the purposes of Article 107(1) TFEU. In point 62 of the 2013 Banking Communication,¹⁶ the Commission explains:

“The ordinary activities of central banks related to monetary policy, such as open market operations and standing facilities, do not fall within the scope of the State aid rules. Dedicated support to a specific credit institution (commonly referred to as “emergency liquidity assistance”) may constitute aid unless the following cumulative conditions are met:

- (a) the credit institution is temporarily illiquid but solvent at the moment of the liquidity provision which occurs in exceptional circumstances and is not part of a larger aid package;
- (b) the facility is fully secured by collateral to which appropriate haircuts are applied, in function of its quality and market value;
- (c) the central bank charges a penal interest rate to the beneficiary;
- (d) the measure is taken at the central bank's own initiative, and in particular is not backed by any counter-guarantee of the State.”

The provision of State aid is, of course, the antithesis of ensuring free competition (even if there may be good grounds for accepting such measures as compatible with the internal market, such as market failures or the pursuit of other policy goals of common interest). It is clear that the first of the four negative cumulative conditions in

¹⁴ Case T-680/13 *Chrysostomides, K. & Co. and Others v Council and Others*, ECLI:EU:T:2018:486.

¹⁵ Case T-786/14 *Bourdouvali and Others v Council and Others*, ECLI:EU:T:2018:487.

¹⁶ 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 (OJ C 216, 30.7.2013, p. 11).

the 2013 Banking Communication (absence of insolvency) coincides with the remark of the General Court in *Chrysostomides* and *Bourdouvali* on the interplay of Article 123 TFEU with the provision of ELA. That shared outcome shows the congruence of the principle of the open market economy with free competition in the field of economy policy with the Treaty's more general regime on competition.

Finally, in the economic policy chapter, Article 125 TFEU lays down a “no bail out” rule. It ensures that the relative autonomy of Member States to pursue economic policy measures builds on their own ability to finance those policies, since they ultimately bear the consequences of the choices they make. In other words, responsibility for repaying public debt remains national. In that respect, Article 125 TFEU enshrines a vision of the Member States as sovereigns, each of which determines its own fiscal policy, controls its own tax base and makes its own spending decisions. The Court of Justice ruled in *Pringle*¹⁷ that Article 125 TFEU does not preclude one or more Member States offering financial assistance to another Member State, provided “the [recipient Member State] will remain responsible to its creditors for its financial commitments” and there are conditions attached to any assistance that incite that Member State to implement a sound budgetary policy. The above reference to the 2017 review of the Greek financial assistance programme shows how such conditions ensuring compliance with Article 125 TFEU intertwine with the principle of an open market with free competition to promote fiscally sound policies.

8 Conclusion

While the jurisprudence of the Court of Justice and the General Court offer us little guidance about the principle of an open market with freedom competition, the same is not true of the decisional practice of the Council and the Commission. The central role that the Treaty assigns to the two institutions in the coordination of economic policy means that they regularly have to put a concrete form on the principle. In the context of multilateral economic surveillance, one finds a repeated insistence on the roles of open markets and of free competition in enhancing long-term economic performance, thereby securing the resilience of economies of individual Member States and of the euro area. They translate into guidance that embraces the quality of public administration, the reliability of judicial systems and the substantive content of legislation. However, the principle does not provide a top-down approach or “unique right answer” as to how it should be implemented in a given Member State. An open market economy with free competition is compatible with a wide variety of institutional arrangements, and of visions of how the State and the market interact. At the same time, while the comparatively open texture of the principle means that there are no unique right answers, the decisional practice in the field of economic policy does indicate that some answers are wrong, and from those limits guidance can be taken for other fields of Union law, including monetary policy.

¹⁷ Case C-370/12 *Pringle*, ECLI:EU:C:2012:756, para. 137.

Panel 2

Delegation of tasks to external bodies,
internal delegation and assignments to
national competent authorities in the
preparation of ECB decisions



Introduction to the panel on delegation of tasks to external bodies, internal delegation and assignments to national competent authorities in the preparation of ECB decisions

By Eleni Koupepidou¹

The assumption of supervisory tasks by the ECB in 2014 marked another new chapter in the evolution of administrative law at Union level. The ECB took over the direct supervision of more than a hundred significant credit institutions and also assumed responsibility for common procedures relating to the entire population of credit institutions in the euro area. This meant that the ECB – a Union institution – would have to take individual supervisory decisions addressed directly to credit institutions on a day-to-day basis.

Because of the ECB's assumption of responsibility for this new task and the large number of decisions it had to adopt as a result, European Union administrative law witnessed a further development in the rules and principles governing administrative decision-making.

Precedents of Union institutions performing administrative competences vis-à-vis private parties are well known but still rather rare. In the financial services sector, in particular, the role of the European Securities and Markets Authority (ESMA) as supervisor of credit rating agencies and trade repositories enacted in 2009 and 2012 is a case in point. Another example concerns the direct responsibilities for resolution planning and resolution conferred on the Single Resolution Board (SRB) in 2014 – shortly after the supervisory tasks were conferred on the ECB.

These empowerments, of both the ESMA and the SRB, raised legal issues of an institutional nature as both these bodies comprised Commission agencies. This is because, as is well known, the conferral of decision-making powers, even of an administrative nature, and its limitations, are the subject of longstanding case-law of the Court of Justice of the European Union².

Turning to the ECB/Single Supervisory Mechanism (SSM) and the SRB, the exercise of supervisory tasks and resolution tasks respectively is to be carried out within frameworks which also include national authorities. Both the SSM Regulation and the Single Resolution Mechanism (SRM) Regulation prescribe a specific division of work between the ECB and SRB, on the one hand, and the national competent

¹ Head of the Supervisory Law Division, European Central Bank.

² Case C-9/56, *Meroni v High Authority*, ECLI:EU:C:1958:7, pp. 151-154.

authorities (NCAs) and national resolution authorities (NRAs) on the other. However, the ECB and the SRB retain overall responsibility for overseeing the effective and consistent functioning of the mechanisms³.

In the case of the SSM, the legislature decided to confer upon the ECB exclusive competence for carrying out the prudential supervisory tasks provided for in the SSM Regulation⁴. NCAs assist the ECB in the execution of those tasks⁵ and are entrusted to carry out, and hence remain responsible for, some of them in respect of less significant entities⁶.

However, the case for the SRM is somewhat different. The allocation of competences and powers was designed to ensure that the SRB was competent for drawing up resolution plans and adopting all decisions relating to resolution only in respect of certain entities⁷. This meant that NRAs were designated as competent and responsible for the resolution of all other entities⁸. However, when taking resolution action, the SRB involves the Council and the Commission in the decision-making process, and further involves the NRAs in implementing the adopted resolution scheme.

These two examples also show that these developments in the Union's administrative law are still recent and it is difficult to anticipate all the legal issues that they may raise. Some issues do however stand out, namely those relating to the decision-making processes and the potential involvement of national authorities in tasks conferred on the Union institutions.

In this light, this panel focused on closely-related issues of Union administrative law. The different issues have been selected for discussion as they have particular significance for the exercise of the ECB's supervisory tasks when it comes to rules and principles governing administrative decision-making.

1 Delegation of powers within the EU

First the panel discussed the delegation of powers in the EU. This is one of the first important legal issues that the Court of Justice had to deal with in the *Meroni* case,

³ Article 6(1) of Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013) and Article 7(1) of Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OJ L 225, 30.7.2014).

⁴ Article 4(1) of Council Regulation (EU) No 1024/2013.

⁵ Article 6(3) of Council Regulation (EU) No 1024/2013.

⁶ Article 6(6) in conjunction with Article 6(4) of Council Regulation (EU) No 1024/2013.

⁷ Article 7(2) of Regulation (EU) No 806/2014. Namely, (a) entities which are considered significant, (b) entities in relation to which the ECB has decided to exercise directly all of the relevant powers, and (c) cross-border groups. For all other entities, NRAs remain fully competent and responsible, although the SRB is granted significant powers to ensure cooperation within the SRM by Article 31 of Regulation (EU) No 806/2014.

⁸ Article 7(3) of Regulation (EU) No 806/2014.

where the Court considered the limits for the delegation of powers by Union institutions to other bodies.

This judgment was delivered exactly 60 years ago in June 1958, and the fact that the *Meroni* doctrine still applies proves that it is one of the pillars on which the Union legal system has been built.

The mechanism through which the *Meroni* judgment has become relevant for banking lawyers was the reform proposed by the de Larosière group, which led to the creation of the three European supervisory authorities (ESAs): the European Banking Authority (EBA), ESMA and the European Insurance and Occupational Pensions Authority (EIOPA). The doctrine on the delegation of powers has defined the design of these authorities and the mechanisms for their intervention in the supervision of the financial sector.

Some of the powers of the ESAs were already tested in the Court (the short selling judgment of 2014 brought by the United Kingdom⁹) with the Court supporting the Union legislator's approach on that occasion.

Delegation has also been instrumental in the creation of another Union agency, the SRB, which has been conferred with an important task in overseeing the financial sector. The jurisprudence on delegation was a key consideration in the design of the decision-making procedures in bank resolution.

2 Internal delegation

The jurisprudence on the delegation of powers within the Union has a broader impact than the mere setting-up of new agencies and bodies to assist the Commission. The *Meroni* case-law and the principles established concerning external delegation also provided the inspiration for the principles of internal delegation. Taking into account the considerable number of decisions that an institution may be required to adopt, the Court has given the green light to the internal delegation of decision-making powers by Union institutions in order to enable them to perform their duties¹⁰.

In this light, and owing to the high number of supervisory decisions, the ECB has sought to utilise such delegation to alleviate the workload of the Supervisory Board

⁹ A Union Regulation on short selling was adopted in 2012. The Regulation granted ESMA certain intervention powers, notably to temporarily ban short selling. Under the Regulation, there is no requirement for the Commission to "rubber stamp" ESMA's decisions, i.e. these decisions are taken autonomously by ESMA. The United Kingdom challenged the empowering provision, arguing that ESMA had been given a very large measure of political discretion, which is at odds with Union principles relating to the delegation of powers. The Court dismissed the action as it found that the Regulation on short selling did not confer any autonomous powers on ESMA that go beyond the powers granted to that authority when it was created (all three ESA Regulations contain a latent empowering provision, which then has to be supplemented in sectoral legislation, as was done with the Regulation on short selling or the Regulation on credit rating agencies). The Court also pointed out that the exercise of the ESMA powers in question was circumscribed by various conditions and criteria which limited ESMA's discretion.

¹⁰ Case C-5/85, *AKZO Chemie v Commission*, ECLI:EU:C:1986:328.

and the Governing Council. This in turn should allow the decision-makers to focus on the important strategic and policy decisions in the supervisory realm¹¹.

The framework for the delegation of certain supervisory tasks was adopted in late 2016, providing for the delegation (to Senior Management of the SSM) of relatively straightforward supervisory decisions (for example in the context of the determination of significance, fit and proper assessment and classification of own funds instruments).

3 Assignments to NCAs

Apart from delegation, the ECB has for some time been exploring the possibility of assigning the preparation of certain ECB decisions to NCAs, i.e. the adoption of ECB decisions based on NCA assessments. In this regard, the SSM framework already envisages that the ECB may ask the NCAs to prepare complete draft decisions for the ECB's consideration for more than just the common procedures¹². Such a possibility is justified as the NCAs participate in the day-to-day supervision of significant institutions and, moreover, are now well aware of the ECB's supervisory policies.

The ECB is therefore seeking to leverage the expertise of the NCAs and their close involvement in day-to-day supervision by assigning certain supervisory assessments to them. The NCAs have, in particular, a duty to assist the ECB under the SSM Regulation. Of course, there are limits to such assignments and there are also a number of legal issues which we will have to consider in order to make such assignments work and to limit the legal risks. Such assignments, in the context of the NCAs' role of assisting the ECB, should be done within the limits set by the SSM Regulation and in compliance with the allocation of responsibilities between the ECB and NCAs under that Regulation.

4 Conclusion

In conclusion, the common thread of this panel is the implementation of the Union institutions' tasks, in particular with the assistance of other bodies, including national authorities. The panel discusses how the ECB, the SRB, the Commission, the EBA,

¹¹ Concerns about the efficiency of the decision-making process for the adoption of supervisory decisions by the ECB were raised by the 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, published on 11 October 2017), the European Court of Auditors (ECA Special Report No 29/2016, *Single Supervisory Mechanism – Good start but further improvements needed*) and the IMF (IMF Country Report No 16/196, *Germany: Financial Sector Assessment Program – Detailed Assessment of Observance on the Basel Core Principles for Effective Banking Supervision*, 29 June 2016).

¹² Articles 14 and 15 of Council Regulation (EU) No 1024/2013 and Part V of the Regulation ECB/2014/17 of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the ECB and national competent authorities and with national designated authorities (OJ L 141, 14.5.2014); Articles 90 and 91 Regulation ECB/2014/17 provide for the possibility for NCAs to prepare and submit draft decisions to the ECB, either at the request of the ECB or at the NCAs' own initiative.

NCA and NRA divide the work in the exercise of their tasks conferred on them by Union legislation.

This division of work is extremely useful for prioritising decision-making in terms of the most important issues and decisions and thus leads to more efficient decision-making. In that sense, it also enables the best use to be made of the technical expertise of the authorities closest to the financial sector, thus also allowing the decision-makers to focus on the really important strategic and policy decisions in the supervisory realm.

On the other hand, such sharing of responsibility creates various legal issues, which the panellists will at least try to touch upon. Setting out some of the detail of these issues is important to the ECB both in its role as a supervisor of the banks' day-to-day work, but also in the broader context of banking regulation and supervision in the Union.

Audronė Steiblytė discusses the delegation of tasks within the Union institutions, mentioning in particular the *Meroni* case-law and its significance. Willem Bovenschen guides us through the delegation of decision-making by the ECB. Finally, Carmen Hernández Saseta explores the assignments to the NCAs relating to the preparation of the ECB's decisions and elaborates on the boundaries of the mechanism of assistance by NCAs in the context of the SSM Regulation.

Delegation of tasks within Union institutions: scope for action for agencies in the light of the *Meroni* judgement

By Audronė Steiblytė¹

1 Introduction

Union agencies represent an important part of the European Union's institutional machinery. The so-called "agencification" of the Union legal order especially intensified in early 1990s.

While Union agencies enjoy a certain degree of functional autonomy, they are not allowed to challenge the Commission's overall power in implementing Union law and policies.

The European Supervisory Agencies (hereinafter "ESAs")² and the Single Resolution Board (hereinafter the "SRB")³ are among the agencies which enjoy the most extensive executive powers that may sometimes even appear to come quite close to the edge of legality. So what are those powers delegated to the Union agencies acting within the remit of the Banking Union?

It was in particular the *Meroni* judgement of 1958⁴ that shaped for years the relationship between agencies and Union institutions. In that judgement, the Court of Justice of the European Union (hereinafter the "Court of Justice") recognised the

¹ Member of the Legal Service, European Commission.

² The European Banking Authority was established by Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12) (hereinafter the "EBA Regulation"); the European Insurance and Occupational Pensions Authority was founded by Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (OJ L 331, 15.12.2010, p. 48) and the European Securities and Markets Authority was founded by Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84) (hereinafter together referred to as the "ESAs Regulations").

³ The Single Resolution Board was established by Article 42 of Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OJ L 225, 30.7.2014, p. 1).

⁴ Judgment of the Court of 13 June 1958, *Meroni v High Authority*, C-9/56, ECLI:EU:C:1958:7.

possibility for Union institutions to delegate certain powers to independent executive bodies.

The “*Meroni* powers” permit the ESAs to be more than just a network of national authorities. The quasi-regulatory⁵ and supervisory functions of the ESAs⁶ are, in fact, framed by limitations directly or indirectly imposed by the Treaties and the institutional balance imbedded therein.

In other words, the delegation of powers to the agencies may not breach the principle of institutional balance that is at the core of the *Meroni* judgment in which the Court underlined that “the balance of powers which is characteristic of the institutional structure of the Community [is] a fundamental guarantee granted by the Treaty in particular to the undertakings and associations of undertakings to which it applies”⁷.

Currently Article 13(2) of the Treaty of the European Union (hereinafter the “TEU”) provides that “[e]ach institution shall act within the limits of the powers conferred on it in the Treaties, and in conformity with the procedures, conditions and objectives set out in them.” According to the principle of conferral of powers set out in Article 13(2) of the TEU the Union institutions may not change the competences attributed to them by the Treaties by adopting secondary law to that effect.

The delegation of powers is permitted as long as it relates to clearly defined executive competences. Therefore no power for making policy choices may be given away by Union institutions. In other words, the delegation of powers to the agencies may not breach the principle of institutional balance that is at the core of the *Meroni* judgement.

It is rather widely accepted in academic circles⁸ as well as among Union institutions that the *Meroni* jurisprudence, as confirmed in the *Short Selling* judgement of 2014⁹, continues to be valid in a post-Lisbon context as well. That is essentially because Articles 290 and 291 of the Treaty on the Functioning of the European Union (hereinafter the “TFEU”) ¹⁰ impose limitations on the delegation of powers. As Member States entrusted Union institutions with certain powers under the Treaties, the delegation of those powers must also take place within the limits allowed by the Treaties. If executive powers with wide discretion were granted to Union agencies and not the Commission, the secondary legislation would illegally amend the institutional system established by the Treaties. Some scholars¹¹, however, take a

⁵ Usually regulatory functions refer to the adoption of rules.

⁶ Supervisory functions concern the application of those rules to individual cases when carrying out monitoring of activities and enforcement.

⁷ *Meroni*, op cit.

⁸ Craig, P., *EU Administrative Law*, (2012), Oxford, Oxford University Press, p. 154 and Hofmann, H. and Morini, A., “The Pluralisation of EU Executive – Constitutional Aspects of Agencification”, *European Law Review* 37 (2012), p. 442.

⁹ Judgment of the Court of 22 January 2014, *United Kingdom of Great Britain and Northern Ireland v European Parliament and Council*, C-270/12, ECLI:EU:C:2014:18.

¹⁰ Treaty on the Functioning of the European Union (OJ C 326, 26.10.2012, p. 47).

¹¹ Geradin, D., “The Development of European Regulatory Agencies: What the EU Should Learn from American Experience”, 11 *Columbia Journal of European Law* (2005), p. 10.

view that in the case of the ESAs, the delegation of powers is made by relevant national authorities and not by the Commission and therefore the *Meroni* doctrine would not be applicable.

Therefore, agencies could only be granted more prominent executive powers following Treaty amendment.

In accordance with the Treaties the real regulatory powers may only be exercised by the Unions institutions, while certain executive functions may be entrusted to Union agencies even if the Commission and the Member State maintain primary responsibility for applying Union law.

More specifically, the *Meroni* case-law provides that a delegation involving “discretionary power implying a wide margin of discretion which may, according to the use which is made of it, make possible the execution of actual economic policy” would be illegal.

In view of the *Meroni* and the *Short selling* case-law there is therefore a common understanding among Union institutions that a legislative measure may grant to an agency the power to adopt binding decisions of individual scope of application (individual decisions) provided that the power to be delegated is (i) executive in its nature, (ii) precisely described, (iii) amenable to judicial review¹², and (iv) does not imply a wide margin of discretion.

It is not, however, unlawful to grant to a Union body, office or agency a certain power of assessment concerning how to apply rules to specific factual situations, as that does not usually amount to a wide margin of discretion to make policy choices. As long as the policy choices and the respective setting of horizontally applicable rules remain with Union institutions, Union agencies may, within the limits of powers delegated to them, analyse facts and circumstances in accordance with applicable rules.

Some examples are worth mentioning in order to illustrate the *Meroni*-compliant competences of ESAs and the SRB.

2 The European Supervisory Authorities (ESAs): a variety of executive tasks

The most widely known individual binding decisions of the ESAs concern four *micro-prudential* situations: (i) ensuring consistent application of Union law, (ii) addressing emergency situations, (iii) carrying out binding mediation and (iv) intervening directly for the purpose of consumer protection. In practise, the ESAs do not frequently use those powers.

¹² After the Lisbon Treaty, new Articles 263 and 267 TFEU inter alia refer to acts of agencies, therefore the acts adopted by means of the delegation of powers may clearly be challenged in court.

2.1 Ensuring consistent application of Union law

In order to ensure consistent application of Union rules, the ESA may adopt an individual decision addressed to a financial institution requiring the necessary action to comply with its obligations under Union law when a breach of Union law, including regulatory and implementing standards, has been identified¹³. The individual decision addressed to a financial institution must be preceded by a formal opinion of an ESA requiring the respective competent authority to take the action necessary to comply with Union law¹⁴. Why do the ESAs Regulations require only a formal ESA's opinion (in the form of a recommendation) addressed to the competent authority and not a binding ESA's decision? The Treaties established a system for addressing infringements of Union law by the Member States. The procedure set out in Articles 258, 259 and 260 of the TFEU ensures that the Commission plays a key role in such infringement proceedings. The Court of Justice has also established that the rights and duties of Member States may only be determined and their conduct appraised only by a judgement of the Court of Justice¹⁵. Under the TFEU the Council and the European Parliament do not have the power to bring an infringement action against a Member State or the power to establish by means of a decision having direct legal effects that a Member State has infringed Union law. To the extent that the Council and the European Parliament do not have such powers, they cannot delegate them either. It should be noted that the European Banking Authority (hereinafter the "EBA")¹⁶ has so far never used the power to adopt an individual binding decision for a breach of Union law addressed to a financial institution to comply with its obligations under Union law. However, following formal investigations, the EBA has adopted two recommendations with respect to Bulgarian¹⁷ and Maltese authorities¹⁸.

¹³ Article 17(6) of the ESAs Regulations, op cit.

¹⁴ Article 17(4) of the ESAs Regulations, op cit.

¹⁵ Judgment of the Court of 22 February 2001 *Gomes Valente*, C-393/98, ECLI:EU:C:2001:109, paragraph 18 and Judgment of the Court of 27 May 1981 *Essevi and Salengo*, C-142 and 143/80, ECLI:EU:C:1981:121, paragraph 16.

¹⁶ The article focuses on the activities of the EBA as the functions of other two ESAs strictly speaking fall outside the remit of the Banking Union.

¹⁷ In October 2014, the EBA adopted a formal recommendation addressed to the Bulgarian National Bank and the Bulgarian Deposit Insurance Fund notifying that they were breaching Article 1(3)(i) and Article 10 of Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes. The EBA also informed the two national authorities of the actions that they need to follow in order to comply with their obligations under Union legislation.

¹⁸ In July 2018, the EBA issued recommendation to the Maltese Financial Intelligence Analysis Unit (FIAU) in relation to its supervision of Pilatus Bank. The EBA Recommendation aimed at remedying the particular failings identified by the EBA by encouraging the FIAU to take all the necessary actions to comply with the Anti-Money Laundering and Countering Terrorism Financing Directive. The EBA Recommendation aimed at remedying the particular failings identified by the EBA by encouraging the FIAU to take all the necessary actions to comply with Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (OJ L 309, 25.11.2005, p. 15).

2.2 Addressing emergency situations

The EBA may adopt individual decisions addressed to competent authorities¹⁹ and to financial institutions²⁰ in emergency situations. The Council must, however, first establish the existence of an emergency situation for the purpose of the EBA Regulation²¹. On that basis, the EBA may adopt a decision addressed to competent authorities to take the necessary action and, if the competent authorities do not comply with the EBA's decision, the EBA may address individual decisions to specific financial institution requiring it to take the necessary action. Both of those decisions of the EBA are of individual and executive nature. In this case the scope of the agency's action is well-defined and there is no policy choice left to it. It is important to recall that the EBA may only act if the Council determined the existence of an emergency situation. The EBA may only require the application of legal requirements which are already directly applicable to financial institutions.

The EBA can adopt an individual binding decision addressed to a market participant or participants after a lengthy process. According to certain authors²², that lengthy process is incompatible with the timing of emergency situations seriously affecting one or more key market participants. So far the Council has never declared the emergency situation referred to in Article 18 of the EBA Regulation.

2.3 Binding mediation

The third situation in which individual binding decisions addressed to competent authorities may be adopted by the EBA concerns the settlement of disputes between competent authorities in cross-border situations, where provisions of a legislative act so provide²³. If the competent authority does not take the required action, the EBA may address an individual decision to a financial institution²⁴. The mediation procedure is essentially available²⁵ where the applicable legislation already creates an obligation of coordination, cooperation and joint action by home and host authorities. When acting as a mediator, the EBA is, of course, required to examine the relevant facts and to identify a solution to be applied by the competent authorities – solution to which not all the relevant authorities necessarily adhere. However, the EBA's margin of discretion when acting as a mediator may not be "wide" in terms of the *Meroni* jurisprudence²⁶. In principle, the EBA would rather apply its capacity of assessment rather than exercise a power of wide discretion by determining policy

¹⁹ Articles 18(3) of the EBA Regulation, op cit.

²⁰ Article 18(4) of the EBA Regulation, op cit.

²¹ Article 18(2) of the EBA Regulation, op cit.

²² Di Noia, C. and Gargantini, M., "Unleashing the European Securities and Markets Authority: Governance and Accountability for the ECJ Decision on the Short Selling Regulation (Case C-270/12)", *European Business Organisation Law Review* 15 (2014), p. 27.

²³ Article 19(1) of the EBA Regulation, op cit.

²⁴ Article 19(4) of the EBA Regulation, op cit.

²⁵ Article 31(c) of the EBA Regulation, op cit. required the EBA to promote a coordinated Union response by also carry out non-binding mediation, without prejudice of Article 19 of the EBA Regulation, upon a request from the competent authorities or on its own initiative.

²⁶ *Meroni*, op cit.

choices. Differently from the breach of law and emergency situation procedures, the mediation procedure does not involve a Union institution at any step. Some scholars²⁷, however, argue that the mediation procedure might possibly need to involve the use of wider discretion and, furthermore, divergent views of authorities often reveal a breach of Union law by a disputant. In April 2018, the EBA issued the first ever binding mediation decisions²⁸ which are in fact also the first “*Meroni* type” decision by the EBA.

2.4 Direct intervention for the purpose of consumer protection and financial services

Finally, the ESAs may adopt direct intervention measures for the purpose of consumer protection and financial services²⁹. The ESAs may temporarily prohibit or restrict certain financial activities that threaten the orderly functioning and integrity of financial markets or the stability of the financial system in the Union: (i) in cases specified and under the conditions laid down in the legislative acts within whose scope the Agency may act³⁰ or (ii) in case of an emergency situation determined by the Council³¹.

In May 2018, European Securities and Markets Authority (hereinafter the “ESMA”) used for the first time its powers to prohibit the marketing, distribution or sale of binary options to retail clients and to restrict the marketing, distribution or sale of contracts for differences³² to retail clients. Those *Meroni* type measures aiming at ensuring greater investor protection in the Union are meant to remain in force for three months from the date of application.

2.5 ESMA's powers of direct supervision

Of the three ESAs, only the ESMA so far possesses direct supervisory powers as a single supervisor as their exercise does not necessitate the involvement of relevant national authorities. Its powers as a single supervisor are also framed by the *Meroni* case-law. In respect of credit rating agencies³³ and trade repositories³⁴, direct

²⁷ Shammo, P., *EU Prospectus Law*, Cambridge, Cambridge University Press, (2011) pp. 235 et seq.

²⁸ The decisions concern two resolution authorities – the Single Resolution Board (SRB) and the National Bank of Romania (NBR). The decisions were issued following a request from the NBR for the EBA to assist in settling a dispute with the SRB concerning the resolution planning for two banking groups.

²⁹ Article 9(5) of the ESAs Regulations, op cit.

³⁰ Those acts are specified in Article 1(2) of the ESAs Regulations, op cit.

³¹ In accordance with Article 18 of the ESAs Regulations, op cit.

³² In accordance with Article 1(a) of the ESMA decision „contract for differences“ means a derivative other than an option, future, swap or forward rate agreement, the purpose of which is to give the holder a long or short exposure to fluctuations in the price, level or value of an underlying, irrespective of whether it is traded on a trading venue, and that must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event.

³³ Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (OJ L 302, 17.11.2009, p. 1). Although ESMA registers and supervises CRAs, the Member States remain competent for the use of ratings.

supervision by ESMA is not confined to the granting and withdrawal of authorisations. It also extends to continuous supervision, which may involve the imposition, by ESMA, of cease-and-desist orders, fines and periodic penalty payments on undertakings³⁵.

The imposition of fines and penalties is a very sensitive matter from the perspective of the *Meroni* jurisprudence, which is why the relevant Union Regulations provide for a full list of breaches³⁶ and the criteria for selecting the supervisory measure and for setting the level of pecuniary sanction³⁷. As a consequence, also in case of fines and penalties, the ESMA can assess the facts but has little discretion in choosing the sanction to be imposed³⁸.

In September 2017, the Commission adopted a proposal to amend the ESAs Regulations³⁹ which, if adopted, would further increase the ESMA's competence, by making it the single direct supervisor with regard to certain types of prospectuses⁴⁰, administration of critical benchmarks⁴¹ as well as specific types of funds (for European venture capital funds and European social entrepreneurship funds⁴² – it is proposed to confer upon the ESMA the registration and supervision of the managers of those funds⁴³ and for investment funds managed by a fully-fledged alternative investment fund manager⁴⁴ and European long-term investment funds⁴⁵ – it is

³⁴ Article 55-74 of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (OJ L 201, 27.7.2012, p. 1) provide ESMA with supervisory powers with respect to trade repositories.

³⁵ Articles 24(1)(c), 36a and 36b(1)(a) of Regulation (EC) No 1060/2009 and Articles 66 and 73(1)(a) and (b) of Regulation (EU) No 648/2012.

³⁶ Annex III to Regulation (EC) No 1060/2009 and Annex I to Regulation (EU) No 648/2012.

³⁷ Annex IV to (EC) No 1060/2009 and Annex II to Regulation (EU) No 648/2012.

³⁸ Di Noia, C. and Gargantini, M, op cit, page 31.

³⁹ Proposal COM(2017) 536 final of 20 September 2017 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); Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority); Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority); Regulation (EU) No 345/2013 on European venture capital funds; Regulation (EU) No 346/2013 on European social entrepreneurship funds; Regulation (EU) No 600/2014 on markets in financial instruments; Regulation (EU) 2015/760 on European long-term investment funds; Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds; and Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market.

⁴⁰ Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC (OJ L 168, 30.6.2017, p. 12).

⁴¹ Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 (OJ L 171, 29.6.2016, p. 1).

⁴² Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds (OJ L 115, 25.4.2013, p.1) and Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds (OJ L 115, 25.4.2013, p. 18).

⁴³ When below the threshold of the Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (OJ L 174, 1.7.2011, p. 1) (hereinafter the "AIFMD Directive").

⁴⁴ I.e. managers above the threshold of the AIFM Directive.

⁴⁵ Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds (OJ L 123, 19.5.2015, p. 98).

proposed that the ESMA conducts the authorisation and supervision of the funds). The proposal was drafted by the Commission taking full consideration of the limits imposed by *Meroni*. The proposal, however, incited a debate in the Council on whether the empowerments must be circumscribed already in the legislative act or delegated acts could validly frame the Agency's discretion.

2.6 Adoption of non-binding acts and drafting of technical standards

The limits of the quasi-regulatory functions of the ESAs in adopting non-binding acts and drafting technical standards are also determined by the *Meroni* case-law.

Agencies may, with fewer constraints, adopt legally non-binding acts since those are not considered to determine the policy of the Union. Guidelines and recommendations of the ESAs, despite being subject to the "comply or explain" mechanism, are considered legally non-binding. They are therefore not subject to the *Meroni* requirements which apply to binding decisions. Of course, legally non-binding acts must remain genuinely non-binding and may not have a policy-shaping purpose.

So in case of guidelines and recommendations, the margin of discretion to implement Union legislation is touched upon by the agencies.

Similarly, the draft technical standards prepared by the ESAs are adopted by the Commission as its own delegated acts or implementing acts. As a result, it is the Commission that bears full responsibility and legal accountability for the content of the legal acts which set out those technical standards including, in particular, the policy choices that they cover.

Nevertheless the influence of the ESAs on the content of technical standards remains very significant because in principle the Commission may only reject or amend the proposed technical standards "in very restricted and extraordinary circumstances"⁴⁶.

The Commission's tacit approval of technical standards was originally suggested in the 2009 Communication on European Financial Supervision⁴⁷. The Communication suggested that the Commission would, however, retain a veto power. It is rather evident that such a system would have marginalised the Commission but widened the powers of the ESAs, despite the veto power. The non-opposition could, however, have taken the delegation of powers too far and in practise would have deprived the Commission of the powers conferred upon it by Articles 290 and 291 of the TFEU. From a more conservative perspective, one might even ask whether the bargaining mechanism laid down in Articles 10 and 15 of the ESAs Regulation, in case of the non-endorsement of a draft technical standard and the Commission's possibility to question draft standards only in exceptional circumstances and for limited reasons, indeed reduces the Commission's prerogatives legally.

⁴⁶ Recital 23 of the ESAs Regulations.

⁴⁷ Commission Communication COM(2009) 252 final of 27 May 2009 on European financial supervision.

3 The Single Resolution Board (SRB): a complex multi-stage decision adoption procedure

It might be interesting to look into the delegation of powers to one of the most recently created Union agencies – the Single Resolution Board (hereinafter the “SRB”).

The Union co-legislators were aware that the field of resolution is prone to high volumes of litigation and sought to avoid any risk that Regulation (EU) No 806/2014 (hereinafter the “SRM Regulation”)⁴⁸ and bank resolution decisions adopted pursuant to it, are declared invalid in view of the *Meroni* jurisprudence.

In its initial proposal, the Commission⁴⁹ did not envisage the creation of a Union agency which would handle technical aspects of resolution and it considered itself to be fit for the task of placing entities into resolution. The Union co-legislators, however, thought that an agency would better ensure a swift and effective decision-making process in resolution and, as a consequence, entrusted to the SRB the task of drawing up and adopting resolution schemes⁵⁰.

Nevertheless, given that it was not possible to frame the scope of discretionary assessment inherent in a resolution decision by means of detailed instructions laid down in advance, the Union co-legislators did not intend to and could not delegate to the SRB the exercise of discretionary powers for the adoption of the binding decision endorsing the resolution scheme. Therefore, SRM Regulation established a mechanism so as to give the power of decision to an institution of the Union – the Commission and, in certain cases, the Council⁵¹.

On 7 June 2017, the first resolution in accordance with the rules set out in the SRM Regulation took place⁵². Following the resolution of Banco Popular, the adoption of the resolution scheme by the SRB and the required subsequent endorsement by the Commission is questioned in more than hundred court cases which among other matters also challenge the legality of the complex multi-stage decision adoption procedure for resolution schemes. In those actions, almost certainly, all possible avenues for challenging the validity of the resolution scheme, including claims based on *Meroni* jurisprudence, have been explored by the applicants. Roughly two-thirds of the applicants brought actions against the SRB alone, while the remaining one-third of applications is against the Commission and the SRB as co-defendants. One

⁴⁸ Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OJ L 225, 30.7.2014, p. 1) (hereinafter – the “SRM Regulation”).

⁴⁹ Proposal COM(2013) 520 final of 10 July 2013 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.

⁵⁰ Article 18(6) of the SRM Regulation, op cit.

⁵¹ Recital 120 and Article 18(7) and (8) of the SRM Regulation, op cit.

⁵² Commission Decision (EU) 2017/1246 of 7 June 2017 endorsing the resolution scheme for Banco Popular Español S.A. (OJ L 178, 11.7.2017, p. 15).

application is brought against the Commission alone. The General Court will therefore not be able to avoid assessing the competence of the SRB in the light of *Meroni* jurisprudence in those cases.

In particular, due to the *Meroni* doctrine, the decision-making procedure leading to the adoption of a final resolution scheme with binding effects vis-à-vis third parties, as set out in Article 18 of the SRM Regulation, is a complex multi-stage procedure.

Where the resolution conditions are fulfilled⁵³, the SRB prepares and adopts a resolution scheme that will eventually govern the resolution of the respective entity. In particular, the SRB envisages the application of the appropriate resolution tools⁵⁴: the sale of business tool, the bridge bank tool, the asset separation tool or the bail-in tool, as well as whether to apply the power to write down and convert certain regulatory capital instruments⁵⁵. The choice of the resolution tool(s) and resolution power(s) is to be made in view of which one(s) of them would best achieve the resolution objectives in the specific case.

Once the SRB has adopted the resolution scheme, it must immediately transmit it to the Commission. The second subparagraph of Article 18(7) of the SRM Regulation requires the Commission to either endorse the resolution scheme or to object to it with regard to its discretionary aspects. The Commission is required to take a decision within 24 hours of receiving the scheme from the SRB.

In accordance with the SRM Regulation, the final endorsement of the resolution scheme falls to the Commission, apart from situations indicated in points (a) and (b) of the third subparagraph of Article 18(7) where the Commission submits a proposal to the Council. Where the Commission is of the view that the public interest condition⁵⁶ to resolve the relevant entity is not fulfilled – and thus takes a contrary view to that of the SRB – or where the Commission would like to propose a material modification to the amount of Fund aid proposed by the SRB, the Commission must involve the Council. The latter has to decide whether to object to the resolution scheme on the basis of a lack of public interest or whether to approve or reject the Commission's proposal for a material modification of the amount of Fund aid to be used.

By means of its endorsement decision, the Commission makes the resolution scheme, which is formally annexed to the Commission decision, its own. Only that Commission's decision provides the resolution scheme with binding effects that are capable of affecting the legal situation of third parties (the entity to be placed under resolution, its shareholder and creditors).

Even from the limited practical experience, it seems it would definitely be easier from the perspective of the *Meroni* jurisprudence if the Commission alone were in charge

⁵³ Article 18(1) to (5) of the SRM Regulation, op cit.

⁵⁴ Article 18(6) of the SRM Regulation, op cit.

⁵⁵ Article 21 of the SRM Regulation, op cit.

⁵⁶ Article 18(1)(c) of the SRM Regulation, op cit.

of the preparation and adoption of the resolution scheme, as the original Commission's proposal for the SRM Regulation envisaged.

4 Conclusions

The functioning of the Banking Union relies heavily on Union agencies – the ESAs as well as the SRB. However, neither greater powers nor more independence could be granted to the agencies, as no conferral of policy choices could legally take place unless Member States decide to amend the Treaties.

Therefore, in conclusion, the post-Lisbon version of the Treaties, as interpreted in the *Short Selling* judgment which relies on *Meroni*, allows direct attribution of executive powers by the Union legislator to an agency. However, the Treaties continue to impose the requirement of institutional balance and do not envisage that Union agencies may take policy decisions. Therefore in practice, a distinction is being kept, between on one hand, policymaking decisions that are based on the exercise of wide discretion and, on the other hand, decisions based on technical assessment, with limited exercise of discretion. The former is a taboo for the agencies, while the latter is their daily bread and butter.

Delegation in ECB's decisions. Scope and limits. Recent experiences.

By Willem Bovenschen¹

1 Introduction

The start of the Single Supervisory Mechanism (hereinafter the “SSM”) in 2014 brought two fundamental changes for the European Central Bank (hereinafter the “ECB”): (i) a more complex decision-making process regarding supervisory decisions, involving not only the Governing Council but also a newly created Supervisory Board; and (ii) a significant increase in the amount of decisions to be made by the ECB in respect of its new supervisory task.

Given the fact that the ECB takes thousands of supervisory decisions each year, it is not surprising that the exercise of the new ECB supervisory task led to the discussions on delegation and subsequently – to a framework for delegation of decision-making powers regarding banking supervision. Since the SSM Regulation² does not foresee in delegation of decision-making powers, the creation of the delegation framework had to take into account the limits set by the case-law of the Court of Justice of the European Union (hereinafter the “Court of Justice”) as well as the particular ECB institutional context. This contribution will address the existing framework for delegation in the Statute of the European System of Central Banks (hereinafter the “Statute of the ESCB”)³ and the SSM Regulation as well as the delegation framework which has been created within the ECB. Furthermore, specific ECB delegation decisions concerning supervision will be discussed.

2 Legal setting for delegation

The ECB's governance structure is set out in the Treaty on the Functioning of the European Union (hereinafter the “TFEU”)⁴, the Statute of the ESCB and the SSM Regulation.

Article 12.1 of the Statute of the ESCB states that the Governing Council may delegate powers to the Executive Board. However, Article 25(2) of the SSM

¹ Senior Legal Counsel, De Nederlandsche Bank. The views expressed in this article are those of the author and cannot be attributed to De Nederlandsche Bank.

² Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

³ Protocol (No 4) on the Statute of the European System of Central Banks and of the European Central Bank (OJ C 202, 7.6.2016, p. 230).

⁴ Treaty on the Functioning of the European Union (OJ C 326, 26.10.2012, p. 47).

Regulation requires the ECB to carry out its supervisory tasks without prejudice to and separately from its tasks relating to monetary policy and any other tasks. Consequently, the involvement of the Executive Board with regard to supervisory decisions is to be avoided.

Article 8 of the Rules of Procedure of the Supervisory Board⁵ enables the Supervisory Board to authorise the Chair or the Vice-Chair to take defined management or administrative measures and certain final decisions if such measures are limited and clearly defined.

The delegation of decision-making powers in relation to supervisory decisions has however not been catered for in the ECB's governance. Consequently, the limits set by the case-law of the Court of Justice come into play.

According to the Court of Justice, the powers conferred on a Union institution include the right (to the extent they comply with the requirements of the Treaty) to delegate certain powers⁶. Regarding delegation, the case-law of the Court of Justice differentiates between delegation of decision-making powers to external and internal subjects. These two types of delegation are assessed by the Court of Justice in two landmark cases, the so-called AKZO case (regarding delegation to internal bodies of an institution)⁷ and the Meroni case (regarding delegation to bodies that are external to an institution)⁸.

As regards the internal delegation to ECB staff the AKZO case is particularly relevant. In this case the Court of Justice held that a system of delegations of authority could even be considered indispensable in order to enable an institution to perform its duties, given the considerable number of decisions which it is required to adopt. When it comes to the adoption of acts addressed to third parties such a system is however to be limited to specific categories of measures of management or administration. Hence, decisions of principle remain outside the scope of delegation⁹. Measures that merely implement such a decision of principle are deemed measures of management or administration and as such are suitable for delegation¹⁰.

It follows from the jurisprudence of the Court of Justice that the internal delegation to ECB staff is feasible as long as it is subject to limits and conditions. The conditions are the following:

- the decision-making authority operates in name of the delegating body;

⁵ Rules of Procedure of the Supervisory Board of the European Central Bank (OJ L 182, 21.6.2014, p. 56).

⁶ Judgment of the Court of 26 May 2005, *Carmino Salvatore Tralli v ECB*, C-301/02 P, ECLI:EU:C:2005:306, paragraphs 41-42.

⁷ Judgment of the Court of 23 September 1986, *AKZO Chemie BV and AKZO Chemie UK Ltd v Commission*, 5/85, ECLI:EU: C:1986:328.

⁸ Judgment of the Court of 13 June 1958, *Meroni v High Authority*, C-9-10/56, ECLI:EU:C:1958:7.

⁹ Judgment of the Court of 23 September 1986, *AKZO Chemie BV and AKZO Chemie UK Ltd v Commission*, 5/85, ECLI:EU: C:1986:328, paragraph 37.

¹⁰ Judgment of the Court of 14 July 1995, *Groupement des cartes bancaires "CB" v Commission*, T-275/94, ECLI:EU:T:1995:141, paragraph 70.

- the delegating body remains responsible and has the right to reconsider the delegation;
- those to whom powers have been delegated do not act in their own right;
- the delegation excludes decisions of principle;
- the measures to implement a decision of principle are suitable for delegation;
- there is a general decision laying down the framework as to how delegating decisions can be adopted.

3 ECB framework for delegation of decision-making powers regarding ECB supervisory tasks

In 2015, the ESCB Legal Committee (LEGCO) was mandated by the ECB's governing bodies to devise a regime for delegation of decision-making powers regarding the ECB supervisory tasks. This resulted in a framework that consists of three different layers that ultimately lead to a supervisory decision that is addressed to a supervised entity.

(i) General Framework Decision

The General Framework Decision¹¹ provides the institutional framework for the delegation of the decision-making competences of the Governing Council. This Decision has been adopted by the Governing Council on a proposal of the Executive Board under the standard ECB decision-making procedure. It states that the Governing Council may delegate decision-making powers in relation to supervisory legal instruments to heads of work units of the ECB by adopting a delegation decision in accordance with the procedure laid down in Article 26(8) of the SSM Regulation. The delegation decision is to set out in detail the scope of the matter to be delegated and the conditions on the basis of which such powers may be exercised¹². The latter is a clear codification of the jurisprudence of the Court of Justice on delegation.

Furthermore, a nomination decision by the Executive Board is required for the delegation to become effective¹³.

(ii) Delegation decision

The Governing Council adopts a specific delegation decision (for each type of delegated matter, e.g. significance decisions), thereby delegating particular supervisory powers and providing the supervisory framework for the substance of

¹¹ Decision (EU) 2017/933 of the European Central Bank of 16 November 2016 on a general framework for delegating decision-making powers for legal instruments related to supervisory tasks (ECB/2016/40) (OJ L 141, 1.6.2017, p. 14).

¹² Article 4 of the General Framework Decision.

¹³ Article 5 of the General Framework Decision.

these delegated powers. Such a delegation decision is to be adopted on a proposal from the Supervisory Board. Up until now three specific matters have been delegated¹⁴.

(iii) Nomination decision(s)

Within the ECB, the Executive Board is responsible for the current business of the ECB¹⁵ and the internal structure and the staff of the ECB¹⁶. Therefore, the decisions to nominate ECB heads of work units and entrust them with decision-making powers, are taken by the Executive Board.

4 Implementation of the delegation of decision-making powers regarding ECB supervisory tasks

Currently there are three areas in which the Governing Council, on the basis of the General Framework for Decision has transferred its decision-making capacity.

(i) Significance decisions

The division of work between the ECB and the national competent authorities (hereinafter “NCAs”) regarding day-to-day supervision depends on the significance status of the respective supervised entities. As a rule the ECB supervises directly significant credit institutions and the NCAs supervise directly less significant credit institutions. While the significance status may be a potentially sensitive matter, the determination of the significance status is a rule-based process and as such particularly suitable for delegation. The elements which have to be taken into account in this rule-based process are¹⁷:

1. size;
2. importance for the economy of the Union or any participating Member State;
3. significance of cross-border activities;
4. significant relevance with regard to the domestic economy;
5. whether public financial assistance has been requested or received directly from the European Financial Stability Facility or the European Stability Mechanism;
6. particular circumstances which lead to the conclusion that make a classification as a significant credit institution inappropriate.

¹⁴ See below.

¹⁵ Article 11.6 of the Statute of the ESCB.

¹⁶ Article 13m.1 of Decision of the ECB of 19 February 2004 adopting the Rules of Procedure of the ECB (ECB/2004/2) (OJ L 80, 18.3.2004, p. 33).

¹⁷ See Article 6 of the SSM Regulation.

There is not much discretion involved in the assessment of these criteria, with the exception of the last one. Hence it may be concluded that the significance determination is a topic that is appropriate for delegation and has therefore been the subject to an ECB delegation decision¹⁸. Nevertheless where the criteria for determination as a significant credit institution are met but the institution will not be considered as such in view of the particular circumstances or where the significance determination is contested, the final ECB decision will not be taken by means of delegation.

(ii) Fit and proper decisions

The ECB assesses and determines the suitability of potential members of management bodies (and key function holders) of supervised credit institutions in so-called fit and proper decisions¹⁹. These decisions are made in accordance with applicable national law against criteria such as experience, reputation, potential conflicts of interest and independence, time commitment and collective suitability. These fit and proper rules have the objective to contribute to the financial soundness of the institutions and the public trust in those institutions.

Article 3 of the ECB Delegation Decision regarding fit and proper decisions²⁰ limits the scope of the delegation by carving out several situations wherein a fit and proper decision cannot be taken by a delegated decision when:

1. the assessed person does not meet the criteria (i.e. negative decisions) or if conditions are imposed by the ECB (unless the latter have been agreed upon in writing);
2. there is insufficient information or the assessment has additional complexity;
3. there are reputational issues (i.e. if the person assessed is subject to criminal proceedings or convicted or subject to proceedings in respect of non-compliance with financial regulations); and last but not least
4. the decision concerns members of the management bodies at the highest level of a significant supervised group or a stand-alone significant credit institution.

Therefore even if there were discretion involved in the decisions that have been delegated to a staff member, the above limitations to the scope of delegation ensure that in practice the risk of a potential legal challenge is limited.

(iii) Own fund decisions

As a competent authority, the ECB is required to decide whether to grant prior permissions regarding own funds, namely (i) for the classification of instruments as

¹⁸ Decision (EU) 2017/934 of the European Central Bank of 16 November 2016 on the delegation of decisions on the significance of supervised entities (ECB/2016/41) (OJ L 141, 1.6.2017, p. 18).

¹⁹ See Article 4(1)(e) of the SSM Regulation.

²⁰ Decision (EU) 2017/935 of the European Central Bank of 16 November 2016 on delegation of the power to adopt fit and proper decisions and the assessment of fit and proper requirements (ECB/2016/42) (OJ L 141, 1.6.2017, p. 21).

Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments and (ii) for the reduction, repurchase, call or redemption of Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments. The category of own fund decisions ranks very high in volume of supervisory decisions to be taken by the ECB. These decisions entail a certain level of discretion.

In the ECB Delegation Decision²¹ certain own funds decisions have been carved out from delegation: negative decisions, complex and controversial decisions, decisions that impose conditions or obligations (unless the institution has agreed in writing or such conditions merely restating of obligations stemming from Union law.

5 Food for thought

Both the jurisprudence of the Court of Justice on delegation and Article 4 of the ECB General Framework Decision, require that delegation decisions set out in detail the scope of the matter to be delegated and the conditions on the basis of which such powers may be exercised. The aim is to ensure that the persons to which the ECB decision-making powers are delegated are aware how to apply the ECB's discretionary powers. One could however wonder whether such criteria are indeed laid down in the three current ECB delegation decisions. The three current delegation decisions delineate the circumstances under which a decision can, or cannot, be made by delegation. However the delegation decisions do not contain detailed criteria on how to take such decisions. The person to which the power is delegated has to exercise it in accordance with the applicable law. In this respect this person may apply the ECB discretion without being bound by pre-set detailed criteria. Whether this is in line with Article 4 of the General Framework Decision and the jurisprudence of the Court of Justice is open for debate.

By carving out (i) negative decisions, (ii) decisions that are very complex and (iii) decisions that come with conditions and or obligations, the risk that decisions that are taken by delegation will be legally challenged is substantially reduced.

Another interesting question is whether the balance of power within the ECB institutional structure is altered. The particular SSM set-up which foresaw a role for both the Supervisory Board and the Governing Council seems somewhat sidestepped. As delegating body the Governing Council always has the right to reconsider decisions made by the persons to which the decision-making power has been delegated. Does the same apply to the Supervisory Board? I would be tempted to say it does not apply because the Supervisory Board is not a delegating body. Consequently, the Supervisory Board²² is somewhat side-lined which triggers the question of altering the balance of power determined by the Union legislator.

²¹ Decision (EU) 2018/546 of the European Central Bank of 15 March 2018 on delegation of the power to adopt own funds decisions (ECB/2018/10) (OJ L 90, 6.4.2018, p. 105).

²² And therewith the NCA representatives.

6 Concluding remarks

It is fair to say that the ECB General Decision Framework has turned out to be rather successful, by substantially reducing the amount of (routine) supervisory decisions to be prepared by the Supervisory Board and to be taken by the Governing Council, thereby allowing both the Supervisory Board and the Governing Council to focus on strategic and policy decisions.

Assignments to the national competent authorities in the preparation of the ECB's decisions: legal challenges

By Carmen Hernández Saseta¹

1 Introduction

The ECB has to adopt a large number of individual decisions addressed to credit institutions in order to carry out its prudential supervision tasks. This number has grown continuously since the beginning of the Single Supervisory Mechanism (SSM), amounting to 2,308 decisions taken in 2017.²

Supervisory decisions are adopted using the non-objection procedure. Under this procedure, complete draft decisions are submitted first to the Supervisory Board and then to the Governing Council for final adoption³. This two-step procedure is necessary to ensure that ECB decision-making bodies⁴ take final responsibility for ECB decisions. At the same time, the non-objection procedure reflects the specific features of supervisory tasks and its separation from the ECB's monetary policy tasks in order to avoid conflicts of interest.⁵

Given the large number of supervisory decisions and the variety of tasks they cover, the involvement of the Supervisory Board and the Governing Council in every decision has raised concerns about the efficiency of the supervisory decision-making process. The European Commission,⁶ the European Court of Auditors⁷ and the International Monetary Fund (IMF)⁸ have echoed these concerns.

¹ Adviser, Supervisory Law Division, European Central Bank.

² See [ECB Annual Report on supervisory activities 2017](#), p. 84.

³ Article 26(8) of Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013).

⁴ According to the Treaties, the ECB's decision-making bodies are the Governing Council and the Executive Board.

⁵ Recital 65 of Council Regulation (EU) No 1024/2013.

⁶ Report from the Commission to the European Parliament and the Council on the Single Supervisory Mechanism established pursuant to Regulation (EU) No 1024/2013, published on 11 October 2017.

⁷ ECA Special Report No 29/2016, *Single Supervisory Mechanism – Good start but further improvements needed*, 18 November 2016.

⁸ IMF Country Report No 16/196, *Germany: Financial Sector Assessment Program – Detailed Assessment of Observance on the Basel Core Principles for Effective Banking Supervision*, 29 June 2016.

The ECB, well aware of this situation since the beginning of the SSM, has made significant efforts to streamline the decision-making process.⁹ A big step was taken with the adoption of the legal framework for delegation in 2017¹⁰ under which certain types of supervisory decisions are adopted by ECB senior managers instead of the Supervisory Board and Governing Council.

Delegation has certainly helped to reduce the number of decisions that the Supervisory Board and Governing Council had to adopt¹¹. However, the workload of the ECB and the national competent authorities' (NCAs) intermediate structures has not been reduced. They have to prepare the same large number of decisions for final adoption either by the Governing Council under non-objection or by a senior manager under delegation.

These operational difficulties are prominent in the field of fit and proper assessment of board members of significant institutions, given the high number of decisions to be adopted (1,057 decisions in 2017) and the fact that the ECB applies a non-fully-harmonised legal framework.¹² Moreover fit and proper procedures have to be handled within tight deadlines and often involve complex assessments. The challenges are therefore manifold in this field.

For this reason, the ECB continues to explore other measures that may help to streamline the decision-making process. In this regard, the ECB has implemented in 2018 an "alternative fit and proper process", which allows, under certain conditions, ECB decisions addressed to significant institutions to be taken based solely on NCAs' assessments.¹³

The alternative fit and proper process is built upon intensified NCA assistance to the ECB. Although the applicable legal framework clearly provides for a general responsibility of NCAs to assist the ECB within the SSM, the legal provisions leave certain questions unanswered about the nature, scope and limits of this assistance.

⁹ During the first few years of the SSM, the ECB developed common methodologies, policy stances, templates and other horizontal initiatives that facilitated the work of the internal structures of the ECB and the NCAs. Despite these efforts and the increased use of written procedures, the burden on the decision-making bodies was still too high.

¹⁰ Decision ECB/2016/40 of 16 November 2016 on a general framework for delegating decision-making powers for legal instruments related to supervisory tasks (OJ L 141, 1.6.2017, p. 14). Decision ECB/2016/41 of 16 November 2016 on the delegation of decisions on the significance of supervised entities (OJ L 141, 1.6.2017, p. 18). Decision ECB/2018/42 of 16 November 2016 on delegation of the power to adopt fit and proper decisions and the assessment of fit and proper requirements (OJ L 141, 1.6.2017, p. 21). In 2018, delegation was extended to the field of own funds: Decision ECB/2018/10 of 15 March 2018 on delegation of the power to adopt own funds decisions (OJ L 90, 6.4.2018, p. 105).

¹¹ Between June, when the delegation framework was implemented, and December 2017, 51% of the ECB's fit and proper decisions were adopted by means of delegation. Between June and December 2017, 52% of the ECB's decisions on significance were adopted by means of delegation (according to the ECB Annual Report on supervisory activities 2017).

¹² According to Article 4(3) of Council Regulation (EU) No 1024/2013, the ECB "shall apply all relevant Union law, and where this Union law is composed of Directives, the national legislation transposing those Directives." Fit and proper requirements are established in Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013) (CRD IV). Therefore, for all fit and proper decisions, the assessment is conducted on the basis of criteria which stem from the national laws that transpose the CRD IV.

¹³ See [ECB Annual Report on supervisory activities 2017](#), p. 86.

The present article briefly explores the general responsibility of NCAs to assist the ECB in the exercise of its supervisory tasks and to what extent the ECB may rely on this assistance, with particular regard to the supervision of significant credit institutions.

2 A new form of assistance: the “alternative fit and proper process”

According to Article 4(1)(e) SSM Regulation¹⁴, the ECB is responsible for ensuring that persons responsible for the management of credit institutions comply with the fit and proper requirements established in the relevant applicable law. In practice, this means that, since 4 November 2014, the ECB has been responsible for assessing whether members of the management bodies of significant credit institutions are fit and proper to hold those positions and to adopt individual decisions approving or rejecting the appointment of those members.¹⁵

In order to carry out its fit and proper tasks with regard to significant credit institutions, the ECB has relied to a large extent on the assistance of the NCAs. Thus, NCAs are the entry point for applications¹⁶ and normally contribute to the assessment by preparing a draft decision that is subsequently submitted to the relevant ECB business areas (i.e. horizontal functions and joint supervisory teams) for their consideration.¹⁷ Despite this successful assistance, the high number of decisions taken and the operational difficulties inherent in the supervisory decision-making process have made it necessary for the ECB to explore new ways of streamlining the supervisory decision-making process.

Against this background, the ECB has taken the assistance provided by the NCAs a step further and has developed the “alternative fit and proper process”. Within this process, under certain circumstances, only the NCAs (without the involvement of the ECB business units) conduct the assessment of individual cases and prepare a proposed decision that is submitted to the ECB for final adoption.

In this way, the ECB expects to free up its resources from straightforward cases and allow them to focus on assessments concerning institutions that have a greater

¹⁴ Council Regulation (EU) No 1024/2013 p. 63.

¹⁵ According to Article 91 of the CRD IV, members of the management body shall at all times be of sufficiently good repute and possess sufficient knowledge, skills and experience to perform their duties.

¹⁶ Article 93 Regulation ECB/2014/17 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 (OJ L 141 14.5.2014).

¹⁷ As explained in the [Supervisory Manual](#), part 4.4 “[...] Appointments are declared by the credit institutions (or exceptionally by the appointee) to the relevant NCA, using national notification forms. The NCA then informs the ECB. Together they collect the necessary information, carry out the assessment and present a detailed proposal for a decision. A formal ECB decision is taken after every fit and proper assessment within the deadline provided for by national law, if applicable. An appointee is either considered fit and proper or not. However, the ECB has the power to include recommendations, conditions or obligations in positive decisions. Where concerns cannot be adequately addressed by means of these tools, a negative decision will need to be taken. The ECB has the power to remove at any time members from the management body of a significant supervised entity who do not fulfil the suitability requirements. [...]”.

impact on the financial system or on potentially problematic cases.¹⁸ The ECB also aims to improve efficiency and timeliness. On average, the ECB expects that the alternative fit and proper process could apply to approximately 20% of the fit and proper assessments.

The “alternative fit and proper process” applies to smaller significant credit institutions with total assets below a defined threshold. Moreover, the scope of application coincides with that of delegation.¹⁹ Therefore negative decisions, decisions with conditions not agreed with applicants, and decisions involving the assessment of certain issues related to reputation will continue to be prepared by the ECB business units in cooperation with the NCAs, irrespective of the size of the credit institution.

Under the “alternative fit and proper process”, the NCAs will continue to be the entry point for applications.²⁰ Subsequently, the NCAs will assess whether a case fulfils the conditions to be handled under the alternative fit and proper process. For this purpose, the NCAs will also assess whether certain obligations or conditions are needed to address identified shortcomings and liaise with the applicants in order to seek agreement on such conditions or obligations. Finally, the NCAs will also prepare a draft decision to be submitted for adoption by the ECB. The relevant ECB business units will not be involved in the substance of those draft decisions although consistency and quality checks will still be conducted by the ECB. When preparing the draft decisions, the NCAs take into account the policy stances and common supervisory practices agreed at the Supervisory Board.²¹

The following sections examine the general responsibility of NCAs to assist the ECB in relation to significant supervised entities, and the extent to which this assistance can be extended in order to cover forms as far-reaching as the alternative fit and proper process.

3 NCAs’ responsibility for assisting the ECB in the SSM Regulation

Article 6 SSM Regulation deals with cooperation within the SSM. In particular, paragraph 3 establishes the general responsibility of NCAs for assisting the ECB in relation to the tasks conferred on it by Article 4 SSM Regulation.²² This legal

¹⁸ See IMF Country Report No. 18/233. [Detailed Assessment of Observance of Basel Core Principles for Effective Banking Supervision](#), 19 July 2018.

¹⁹ Decision ECB/2018/42 p. 21.

²⁰ Article 93 Regulation ECB/2014/17.

²¹ These policy stances and supervisory practices are to a large extent reflected in the ECB’s [Guide to fit and proper assessments](#).

²² Article 6(3) of Council Regulation (EU) No 1024/2013 establishes: “where appropriate and without prejudice to the responsibility and accountability of the ECB for the tasks conferred on it by this Regulation, national competent authorities shall be responsible for assisting the ECB, under the conditions set out in the framework mentioned in paragraph 7 of this Article, with the preparation and implementation of any acts relating to the tasks referred to in Article 4 related to all credit institutions, including assistance in verification activities.”

provision does not examine the scope and limits of this assistance but provides some indications. According to Article 6(3) SSM Regulation, the assistance of NCAs: (i) is without prejudice to the responsibility and accountability of the ECB for the tasks conferred on it by the SSM Regulation; (ii) should be provided under the conditions set up in the SSM Framework Regulation;²³ (iii) concerns the preparation and implementation of any acts relating to the tasks conferred on the ECB under Article 4(1) SSM Regulation, including assistance in verification activities and; (iv) when providing such assistance NCAs should follow the ECB's instructions.

The rationale behind the assistance of NCAs is provided in Recital 37 SSM Regulation. This provision refers to the long-established expertise of NCAs in supervising credit institutions within their territory and their economic, organisational and cultural specificities. Recital 37 also refers to the large body of dedicated and highly qualified staff established by NCAs for those purposes. On this basis, in accordance with Recital 37 SSM Regulation, the assistance of NCAs to the ECB would ensure high quality and European Union-wide supervision.

The assistance of NCAs was already contained in the initial proposal of SSM Regulation presented by the European Commission in September 2012. That proposal intended to confer on the ECB the direct supervision of all credit institutions established in the euro area, irrespective of their significance. Owing to the magnitude of this task, and the short timeframe for its implementation, the assistance of the NCAs was conceived as a basic pillar of the SSM considering, in particular, the NCAs' significant existing resources and expertise.

In addition to the general principle of assistance set out in Article 6(3) SSM Regulation, specific forms of assistance are provided for in the SSM Regulation.

- Recital 37 refers to assistance in the ongoing day-to-day assessment of a credit institution's situation and related on-site verification.
- Article 7 provides for assistance in terms of close cooperation with the competent authorities of participating Member States whose currency is not the euro. In this regard, the NCAs should follow the instructions given by the ECB.
- Article 9 establishes that the ECB may require, by way of instructions, the NCAs to make use of their supervisory powers where the SSM Framework Regulation (SSMR) does not confer those powers on the ECB.
- Article 12 stipulates assistance in relation to on-site inspections by way of participation of NCAs' staff in the inspection teams, as well as assistance in overcoming the potential opposition of the investigated entity.
- NCAs' assistance is also contained in Articles 14 and 15 in relation to "common procedures" (granting and withdrawal of authorisations and the assessment of acquisitions of qualifying holdings). Within these common procedures, the NCAs should submit draft decisions or proposals for the ECB's consideration.

²³ Regulation ECB/2014/17.

- According to Article 32, the NCAs should also assist in the provision of staff and staff exchanges with the ECB.
- Article 33(4) provides for the assistance of the NCAs in the comprehensive assessment conducted during the SSM transitional phase.

This is not a complete list of actions. In addition to these specific forms of assistance, the ECB may request the NCAs' assistance via other types of action and, in accordance with Article 6(3) SSM Regulation, under the conditions set out in the SSM Framework Regulation.

4 Further developing the concept of assistance: the SSM Framework Regulation

The SSM Framework Regulation establishes the practical arrangements for implementing Article 6 SSM Regulation and develops procedures applying to the cooperation of the ECB and the NCAs.

The SSM Framework Regulation identifies specific forms of NCAs' assistance and also establishes general conditions concerning the assistance with regard to the supervision of significant and less significant credit institutions and common procedures. In particular, the following forms of assistance from NCAs are found in the SSM Framework Regulation.

- The participation of staff from the NCAs on the joint supervisory teams²⁴ and the on-site inspection teams²⁵ is a prominent form of assistance in the ongoing supervision of significant credit institutions.
- Assistance is provided in relation to passporting procedures where NCAs act as the entry point and exchange information with the ECB²⁶.
- The SSM Framework Regulation further develops the assistance provided in the context of common procedures, where NCAs are the entry point for applications and conduct preliminary assessments, which are reflected in the proposals submitted to the ECB for its assessment.²⁷
- The SSM Framework Regulation also provides for NCAs' assistance in relation to fit and proper procedures where they act as the entry point and exchange information with the ECB.²⁸

²⁴ Article 3 Regulation ECB/2014/17.

²⁵ Article 144 Regulation ECB/2014/17.

²⁶ Articles 13-17 Regulation ECB/2014/17.

²⁷ Part V Regulation ECB/2014/17.

²⁸ Articles 93 and 94 Regulation ECB/2014/17.

- In relation to supervisory reporting and access to information, NCAs assist the ECB in receiving information from credit institutions and conducting initial data checks.²⁹

The role of NCAs in assisting the ECB with the supervision of significant credit institutions is specifically dealt with in Articles 90 and 91 of the SSM Framework Regulation. According to Article 90, NCAs should assist the ECB, in particular, by performing the following activities: (i) submit draft decisions to the ECB in respect of significant supervised entities; (ii) assist the ECB in preparing and implementing any acts relating to the exercise of the tasks conferred on the ECB by the SSM Regulation, including assisting in verification activities and the day-to-day assessment of the situation of significant banks; and (iii) assist the ECB in enforcing its decisions, using, when necessary, the powers referred to in the third subparagraph of Article 9(1) and 11(2) SSM Regulation.

Article 91 SSM Framework Regulation states that NCAs may prepare draft decisions either at the request of the ECB (paragraph 1) or at its own initiative (paragraph 2).

The scope and limits of this last type of assistance, provided in the context of individual decisions addressed to significant supervised entities, should be further explored in order to better understand its scope and limits. The next section examines this in more detail.

5 Assistance in the preparation of individual supervisory decisions addressed to significant credit institutions

Assistance by NCAs in the preparation of individual decisions is certainly covered by the general principle provided in Article 6(3) SSM Regulation when it refers to *assistance with the preparation of acts* relating to the ECB's supervisory tasks.

As seen in previous sections, the SSM Regulation and the SSM Framework Regulation have stipulated many ways through which NCAs can assist the ECB in the preparation of individual supervisory decisions. For example, conducting interactions with and verifications at the supervised entities, using investigatory powers when necessary; exchanging with the ECB all relevant information in their possession; maintaining day-to-day contact with ECB's staff members on the individual circumstances of a specific case; and, in general, sharing the NCAs' knowledge and expertise of the credit institutions, the local banking sector and national regulations.

²⁹ Part XI Regulation ECB/2014/17.

It is quite clear that the assistance of NCAs in the preparation of individual decisions may also cover the assessment of individual cases.³⁰ As a corollary of this assessment, NCAs may propose draft decisions for the ECB's consideration.³¹ Actually, it is precisely through the preparation of draft decisions that NCAs have mostly assisted the ECB in the fit and proper field. These draft decisions were taken into account by the relevant ECB business areas in the preparation of the final assessment submitted for adoption.

It is less clear whether the assistance provided by NCAs on individual decisions addressed to significant credit institutions may fully replace the ECB's technical assessment.

The wording of Article 91(2) SSM Framework Regulation seems to suggest the opposite. According to this provision, draft decisions submitted by NCAs at their own initiative should reach the decision-making bodies through the corresponding joint supervisory team. This seems to be an indication that following the submission of draft decisions by NCAs, ECB's intermediate structures should still conduct a technical assessment within which those draft decisions will be considered.

Moreover, in common procedures where the legislator has foreseen a prominent role for the NCAs, the ECB's own assessment is still mandatory.³² A fortiori, this should also be the case for the ECB's exclusive tasks where the involvement of NCAs is not required by the legislator.

A form of assistance that fully replaces the ECB's technical assessment should normally have been expressly defined in the legal provisions. It is difficult to admit that such far-reaching assistance might be implicit in the rather vague reference of *assisting with the preparation of acts* of Article 6(3) SSM Regulation.

- Thus, the delegation of assessments and decisions by the European Securities and Markets Authority (ESMA) to national authorities in the context of the supervision of credit agencies is expressly dealt with in Article 30 CRA.³³ According to paragraph 4 of this provision, "Supervisory responsibilities under

³⁰ This possibility has to be understood within the intention of the EU legislator. The Explanatory memorandum of the European Commission on the initial proposal for the Council Regulation (EU) No 1024/2013 (Document COM(2012) 511 final), envisages, as an example of assistance, the case of a "request from a bank to use an internal risk model" where "the national supervisor could assess the request and its compliance with EU law and any guidance issued by the ECB and could propose to the ECB whether and under which conditions the model could be validated. [After validation the national supervisor could oversee the application of the model and monitor its ongoing use]".

³¹ Article 91 Regulation ECB/2014/17.

³² Within common procedures, NCAs should submit a proposal to the ECB (see in this regard Articles 14(2), 14(5) and 15(2) of Council Regulation (EU) No 1024/2013 and Articles 76, 80 and 86(2) of the Framework Regulation). The ECB, responsible for adopting the final decision, should take into account the analysis put forward by the NCA in those proposals or draft decisions when conducting its own assessment (see Article 77(1) Regulation ECB/2014/17 in relation to authorisations, Article 83(2) Regulation ECB/2014/17 in relation to a withdrawal at the national competent authority's initiative, and Article 87 Framework Regulation in relation to the acquisition of qualifying holdings. Common procedures are therefore a type of complex or composite procedure where the NCAs' functions are clearly defined under the legal provisions and the final decision is the ECB's responsibility (Opinion of the Advocate General Campos Sánchez-Bordona in case C-219/17, ECLI:EU:C:2018:502, para. 94).

³³ Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (OJ L 302, 17.11.2009, p. 1).

this Regulation, including registration decisions, final assessments and follow-up decisions concerning infringements, shall not be delegated”.

- A similar provision is found in Article 80 EMIR³⁴ which also stipulates that ESMA may not delegate to NCAs.
- Delegation of tasks from the European Commission to national authorities and courts, including conducting assessments and even taking decisions, also exists in the field of competition law. In the same vein, this delegation is extensively regulated in Council Regulation 1/2003 on the implementation of the rules on competition.³⁵

Unlike the above situations and despite the prominent role of the NCAs within the SSM, there are no aspects of the SSM Regulation that indicate that the legislator wanted to allow assistance from national authorities that might fully replace the ECB technical assessment on individual decisions addressed to significant credit institutions.

Nor could such a conclusion be drawn from recent interpretations of the General Court on the allocation of responsibilities under the SSM Regulation.³⁶ The Court of Justice has recognised the direct prudential supervision exercised by NCAs over less significant credit institutions as a *mechanism of assistance*.³⁷ The Court refers to this *mechanism of assistance* in the context of the decentralised implementation of competences exclusively conferred on the ECB in respect of less significant institutions and for specific tasks, namely those listed in Article 4(1)(b) and (d) to (i) SSMR³⁸. This *mechanism of assistance* clearly covers final assessments and the adoption of decisions by NCAs relating to less significant credit institutions. However, a similar *mechanism of assistance* does not apply in the case of significant credit institutions. The *mechanism of assistance* referred to by the General Court therefore differs from the assistance provided under Article 6(3) SSMR in relation to significant credit institutions.

The General Court also notes that tasks explicitly entrusted to the ECB fall outside the competence of the Member States. On this basis, the Court concludes that the Council has delegated exclusive competence to the ECB for the tasks laid down in Article 4(1) SSMR and the sole purpose of Article 6 (on cooperation with NCAs) is to enable, under the SSM, decentralised implementation of that competence by national authorities, under the control of the ECB, in respect of the less significant entities and for the tasks listed in Article 4(1)(b) and (d) to (i) SSM Regulation.³⁹

³⁴ Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (OJ L 201, 27.7.2012, p. 1).

³⁵ Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (OJ L 1, 4.1.2003, p. 1).

³⁶ Case T-122/15 *Landeskreditbank Baden-Württemberg – Förderbank (L-Bank) v ECB*, ECLI:EU:T:2017:337 (*L-Bank*).

³⁷ Case T-122/15 *L-Bank*, para. 58.

³⁸ Case T-122/15 *L-Bank* para. 63.

³⁹ Case T-122/15 *L-Bank* para. 63.

Last, assistance by national authorities that is as far-reaching as that provided by Regulation 1/2003 on the implementation of the rules on competition does not seem to fit with the SSM. Article 105 TFEU directly confers on the European Commission exclusive regulatory, legislative and enforcement tasks related to the competition rules set out in Articles 101 and 102 of the Treaty. After 40 years of the application of competition policy, Regulation 1/2003 was adopted with the aim of simplifying administration as much as possible and meeting the challenges of an integrated internal market and successive enlargements of the EU while ensuring compliance with competition law.

The case of the SSM is different. The conferral of prudential supervisory tasks on the ECB has not been directly laid down by the Treaties but, by the European legislator at a later stage in order to ensure the uniform and effective application of the prudential rules. According to the legislator, this objective could not be adequately met by the Member States and can therefore be better achieved by the Union.⁴⁰ Against this background, and unlike competition law, it does not seem possible for the ECB to delegate certain tasks back to the NCAs, such as performing final assessments or taking certain decisions. Considering the recent allocation of tasks to the ECB, and the objectives pursued by the legislator by conferring said tasks, the SSM is closer to the above-mentioned case of ESMA where delegation to national authorities relates to the assistance on investigations and the exchange of information and expressly excludes the delegation of final assessments and the adoption of decisions.

Based on the above considerations, it is difficult to conclude that the legislator intended to provide for a type of assistance by national authorities that might supersede the ECB's technical assessment inherent in individual supervisory decisions concerning significant credit institutions. In particular, it is unlikely that a vague, general reference to *assistance on the preparation of acts* would be sufficient to delegate final assessments or the adoption of decisions, even if purely executive, back to NCAs.

That said, the next section reflects on the conditions under which an enhanced level of assistance by the NCAs might be explored in order to find a balance between effective supervision and efficient administration, on the one hand, while respecting the boundaries of the legal framework on the other.

6 Exploring new forms of enhanced assistance by national authorities

When exploring new forms of enhanced assistance by NCAs, the ECB should bear in mind the risks involved in overly far-reaching assignments to NCAs. In particular, the ECB should avoid arrangements that may disrupt the allocation of tasks under the SSM Regulation or jeopardise the objectives it pursues.

⁴⁰ Recital 87 of Council Regulation (EU) No 1024/2013.

In this regard, it is worth noting that the European legislator has conferred specific supervisory tasks on the ECB because “the objectives of the SSM Regulation, namely setting up an efficient and effective framework for the exercise of specific supervisory tasks over credit institutions and ensuring the consistent application of the single rulebook to credit institutions cannot be adequately met at Member State level and can, therefore, by the pan-Union structure of the banking market and the impact of failures of credit institutions on other Member States, be better achieved at Union level”.⁴¹

When exploring new forms of enhanced assistance, the ECB should always maintain a uniform application of the single rulebook and supervisory practices and ensure equal treatment among supervised entities. As stated in Article 6(1) SSM Regulation, the ECB is responsible for the effective and consistent functioning of the SSM. Moreover, according to Article 1(1) SSM Regulation, equal treatment of credit institutions should be ensured in order to prevent regulatory arbitrage.

The ECB should provide precise guidelines on the way NCAs should make far-reaching assignments in relation to significant credit institutions. The application of discretion should be reduced to a minimum. Such guidelines should ideally be binding for NCAs to ensure they act in accordance with the ECB’s instructions, as required by Article 6(3) SSM Regulation. The ECB should always oversee the way NCAs perform those assignments and it should retain the possibility to intervene in individual cases, at any point in time, if required. A mechanism that would easily allow assignments conferred on NCAs to be called back should be provided. The ECB should also define timelines and practical methods via which assignments to NCAs would be made.

Considering Article 6(7) SSM Regulation, it may also be necessary to publicise the conditions under which this type of enhanced assistance would be carried out. Moreover, for legal certainty reasons, it may be advisable to include those conditions in the SSM Framework Regulation.

7 Conclusions

NCAs play an important role within the SSM. Owing to their long-established expertise in the supervision of credit institutions and their significant existing resources, they are mandated to provide substantial assistance to the ECB even for the tasks concerning significant supervised entities. However, this assistance cannot be unlimited. Assignments to NCAs should not distort the allocation of responsibilities between ECB and the NCAs under the SSM Regulation or the objectives pursued by the European legislator with this allocation of tasks.

While it is clear that NCAs may assist with the preparation of individual decisions addressed to significant credit institutions, it is less clear whether, in this context, assessments conducted by NCAs will fully replace the ECB’s technical assessment.

⁴¹ Recital 87 of Council Regulation (EU) No 1024/2013.

Even if the final decision were still to be adopted by the ECB, such far-reaching assistance, unprecedented in the SSM legal provisions, would entail risks. It goes without saying that the ECB would still be responsible and accountable for decisions taken based on those national assessments.

Although the SSM Regulation enables the ECB to rely on NCAs to a significant extent, it seems very unlikely that it is intended to allow for assignments that fully replace the ECB's technical analysis for tasks exclusively conferred on the ECB by the SSM Regulation. A joint assessment, at least, would be required.

Bearing these considerations in mind, the ECB may continue to explore new forms of enhanced assistance by NCAs in order to find a balance between effective supervision on the one hand and efficient administration on the other.

Presentation



Search engines don't understand lawyers, but smart technologies can improve access to legal information

By Marc van Opijnen¹

1 Introduction

Notwithstanding the sometimes incredible progress being made by Google and various brands of enterprise search engines, lawyers often still have to spend hours searching because systems for information retrieval are not designed to cover their specific needs. A lawyer (a term used here for anybody with a legal education or profession) doing research on e.g. the national implementation and judicial interpretation of the Revised Payment Services Directive² can easily spend hours on gathering the relevant documents before she can start with her legal analysis.

This article aims to describe some of the reasons why the legal community does not seem to be able to take full advantage of the dazzling developments in information retrieval, including those related to artificial intelligence and data science. To demonstrate how progress can be made, a project from the Netherlands is showcased which aims to link legal documents from different sources with the aim to improve effectiveness and quality of legal search.

With a legal audience in mind, this article presents a general overview of various topics that have been described in more (technical) detail elsewhere. It should be noted that the scope of this article is limited to legal information retrieval, which is defined as the activity of finding relevant documents in repositories with legal resources. Hence, the article does not discuss information discovery in documents like reports, e-mails or balance sheets that might be relevant for a specific legal case (e-discovery), or the dematerialisation of decision making (legal expert or decision support systems).

Section 2 discusses why search engines do not understand lawyers; although informaticians prefer to formulate it the other way around. This problem is rooted in the specificities and the uniqueness of the legal domain and, inter-related, a fundamental paradigm gap between lawyers and informaticians.

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² Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC.

In Section 3 the Dutch project “Linked Legal Data” will be discussed. This project aims to improve the accessibility and searchability of legal resources (like national and European legislation, court decisions and parliamentary documents) by using the references in the text. An important role is played by the “LinkeXtractor” that intelligently recognises a great variety of legal citations. By using the output of this application, a question like: “give me all national court decisions that refer to the Saunders/UK decision of the European Court of Human Rights” can be answered in seconds instead of hours.

With the growing importance of the European legal order and the broadening and deepening of the internal market, lawyers not only need access to their own national and European legal resources, but also to those of other Member States. Section 4 describes some developments at the European level to cater for these needs. By way of conclusion, in Section 5 some remarks will be made regarding the possible role of artificial intelligence within legal search.

2 The troublesome relation between search engines and the legal domain

The legal domain has some characteristics that make it distinct from other knowledge domains with regard to computerisation, digitalisation and information retrieval. Some of these aspects are discussed in this section.

2.1 The paradigm gap

Many professional domains root in the natural sciences (like medicine and engineering) or in social sciences (like sociology and economics). All of them are based on universal theories and are empirically falsifiable.

Because of their common background in natural sciences, informaticians on the one hand, and physicians, engineers, economists and sociologists, [on the other], share a way of thinking and reasoning which creates a common approach on the applicability of information technologies to their respective domains. An informatician is not a doctor, but she will understand the deterministic way of thinking and the well-defined terminology with meticulously described facts.

Over the centuries though, law has developed as a universe on its own. A universe with its own language, routines, logic and systems of proof. Unlike e.g. sociologists, psychologists and geographers, many lawyers left their secondary education with as little as math and physics as possible and did not receive any academic training in statistics or other scientific methodology.

Lawyers are digital laymen, and this is equally true for the younger generation. Nowadays, many know the basic functions of their laptop, use e-mail and instant messaging, but have no clue how it works or how to put technology to their use. As a

result, the legal sector has always been a late follower in technological developments and never a front-runner.

The isolated position of the legal domain is further reinforced by the closed shop character of the legal profession. While in many organisations people with different backgrounds co-operate, the judiciary, the bar, the notary and the legislature are run by lawyers only, notwithstanding the presence of staff with other backgrounds. As a result, lawyers live in splendid isolation.

For informaticians on the other hand, as well as for most other non-lawyers, the legal domain is a black box as well. They have no clue about the nature and structure of legal resources, they cannot make sense of legal reasoning, and hence they cannot be helpful in formulating objectives or practical use cases for computer applications.

As a result, in many IT projects one can witness two sides of the table, although both thinking in rules and exceptions, not understanding each other, and often not even aware of the immense paradigm gap.

In the daily work of lawyers, “search” (or “information retrieval”) is one of the tasks where much is to be gained in time-savings and quality of work. At the same time, it is one of the most problematic, overlooked and underestimated realms, not only because it is only regarded as a supporting task and not as core business, but also because the paradigm gap might be broadest here.

2.2 The problematic notion of relevance

In the science of information retrieval, the basic concept is “relevance”: how to retrieve the most relevant (sections of) documents from huge repositories? Before any methodology or retrieval system can be discussed or developed, the concept of “relevance” has to be examined further. At first sight, this seems to be a trivial undertaking since the term “relevance” tends to be immediately understood by everybody. A thorough understanding though is of the utmost importance for the effectiveness of information retrieval systems. In precise terms, relevance can be defined as: “A cognitive notion involving an interactive, dynamic establishment of a relation by inference, with intentions toward a context.”³ From this definition it follows that relevance is measured in comparison with something, that it may change over time and that it involves some kind of selection. Following its comparative character, information objects can be ranked as to their relevance, but ranking is just one function derived from “relevance”.

Closer inspection demonstrates that relevance has different dimensions, which behave differently in different domains. Tailoring it to the legal domain, a framework has been developed, in which six “dimensions” of relevance are distinguished.⁴ All of them should be taken into consideration when developing legal search solutions;

³ (Saracevic 1996).

⁴ (van Opijnen and Santos 2017).

design decisions should motivate how they are applied or why one or more dimensions are left out. The six dimensions can be briefly summarised as follows.

This first dimension, algorithmic or system relevance, pertains to the computational relationship between a query and information objects, based on matching or a similarity between them. Traditionally, this has been the domain of full-text search, which has evolved from Boolean search to probabilistic, vector-space and other algorithms. Within system relevance, the search algorithm does not have any notion of the contents or semantics of the information objects, and the relevance performance is merely dependent upon the quality of the algorithms of the search engine. This “relevance performance” – not only in algorithmic relevance but also in the other dimensions – is measured by a combination of recall and precision. “Recall” measures which percentage of documents is retrieved as compared to those that should have been retrieved; “precision” measures how much of the actually retrieved documents should have been retrieved indeed. The challenge is to build systems that have a high score on both recall and precision.

The second dimension, topical relevance, concerns the relationship between the “topic” (concept, subject) of a request and the information objects retrieved. A topical relation is assumed to be an objective property, independent of any particular user. “Aboutness” is the traditional distinctive criterion. The topics of the information objects might be hand-coded or computed, e.g. by machine learning or other types of classification algorithms.

Bibliographic relevance is the third dimension; it relates to the relationship between a request and the bibliographic closeness of the information objects. Where “aboutness” is the distinctive criterion for topical relevance, “isness” is the distinctive criterion for bibliographic relevance. If searching for a European act, does one retrieve the authentic version as promulgated or a consolidated version? And in which language and file format? And if one searches for “RFSD” does the search engine understand she is actually looking for Directive (EU) 2015/2366?

Dimension number four, cognitive relevance (or “pertinence”) concerns the relation between the information needs of a user and the information objects. Unlike algorithmic, bibliographic and topical relevance, cognitive relevance is user-dependent, with criteria like informativeness, preferences and novelty as measuring elements. Recommender systems, as used nowadays on many commercial sites, are focused on improving cognitive relevance: based on previous choices or belonging to a specific peer group, suggestions are presented to the user.

Situational relevance (or “utility”) is the fifth dimension and can be defined as the relationship between the actual problem or work task of the user and the information objects in the system. This dimension of relevance is dependent on the specific user as well, but unlike the cognitive relevance – which focuses on the request as formulated – it relates to the underlying motivation for starting the information retrieval process. Criteria for performance on situational relevance are the usefulness for decision-making, appropriateness in problem solving and reduction of uncertainty.

Domain relevance is the final dimension. It pertains to the relation between information objects *inter se*, measured in legal importance, as viewed by the legal community as a whole, independent from any specific information system, search query or user. Domain relevance can be used to add a legally relevant hierarchical order to groups of information objects – e.g. giving preference to treaties over national legal acts, over by-laws, over ministerial decrees – but domain relevance can also be used to measure the legal importance of individual objects, e.g. to indicate which court decisions should be viewed upon as landmark cases and which are only relevant for the parties to the case. In small databases such classification can be done manually, but for huge repositories algorithms are needed.⁵

These six dimensions of the concept of relevance are closely related to the specific features of legal information. These characteristics impede the out-of-the-box use of search engines in a way that fits the legal mindset.

2.3 Language

Legal resources are textual documents; their meaning is in the natural language of the text. Legal language though is extremely complex: it's very precise, while at the same time verbose with many vague terms with changing definitions over time, always having ifs, ands or buts. Legal terminology also differs as to its context: criminal versus civil law, national law versus European law versus the vocabulary used by the European Court of Human rights.

Legal search is complicated by the absence of a global terminology. While in biology species are globally identified by Latin names and in chemistry elements and substances have a global notation, the law lacks such a *lingua franca*. And to make it even worse, there are no globally agreed-upon definitions of legal concepts, since every state (or even state within a federation) has its own legal order, with its own language and its own terminology.

2.4 Lack of structure and standardisation

Practising lawyers have a case-based orientation: e.g. a judge having a legal dispute to solve. She reads the documents submitted by parties, organises a hearing, maybe asks for an expert opinion, and finally drafts a verdict. This core document has many requirements, but most of them are legal: it has to be properly motivated, list the arguments and cite legal resources in a way understood by peers.

With the public pronouncement of the judgment and/or handing down the judgment to the parties, the case is closed and the document is published on the internet or filed in an archive. From this moment on though, the document becomes a possible legal resource for her colleagues, scholars, students and maybe even herself. For optimal accessibility and contextualisation, they need a well-structured, identifiable,

⁵ (van Opijnen 2013), (van Opijnen 2016).

keyword tagged and layered document, but it is not up to the judge to do this structuring, identifying, tagging and layering herself: it takes time, it requires technical and bibliographical skills and it might even limit her freedom to express herself in a way she deems necessary from a judicial perspective.

Such enrichment of legal resources has for long been the task of commercial publishers: they gathered, selected, annotated, summarised, tagged, structured and contextualised legal acts, court decisions and other legal materials. For organisational and commercial reasons all these publishers developed their own identification systems, document structures, thesauri and linking methods; common standards were not in the interest of these oligopolistic companies.

At the turn of the century the producers of legal information – from all pillars of the *trias politica* – started to use the internet to publish their documents for free. In the beginning ad hoc and unstructured, offering only basic search functions, but gradually awareness grew that proper accessibility is more than bare access. Better search engines flooded the market, but it soon turned out that the problem is not only in the search algorithms but also in the data. Documents, and parts thereof, must have a machine-readable structure, with persistent and unequivocal identification and the knowledge contained in the documents should be as computer understandable as possible.

Awareness has now surfaced that common and open standards are an indispensable prerequisite for improved accessibility of legal resources. Within the European Union the European Case Law Identifier⁶ and the European Legislation Identifier⁷ have been developed. On a global scale, the OASIS Legal DocML standard, also known as “Akoma Ntoso”,⁸ is gaining adoption.

2.5 Legal references

“Legal communication has two principal components: words and citations.”⁹ These citations define the way how legal documents and the propositions, facts and arguments contained therein relate to the whole framework of legislation, jurisprudence and legal doctrine. In the legal domain the interconnection between concepts and resources is much stronger and more important than in other domains. Therefore, it is extremely important one is able to search by citation and to navigate through the whole network of references.

Given their role as cement between the building blocks of legal knowledge, one would expect that references would be one of the core pillars in legal information retrieval. Unfortunately, this is not the case; only recently interest has shifted into this

⁶ Council of the European Union, 'Council conclusions inviting the introduction of the European Case Law Identifier (ECLI) and a minimum set of uniform metadata for case law', CELEX:52011XG0429(01). See also: (van Opijnen 2017).

⁷ Council of the European Union, 'Council conclusions inviting the introduction of the European Legislation Identifier (ELI)', CELEX:52012XG1026(01). See also: [EUR-Lex](#).

⁸ [OASIS Legal DocML standard](#).

⁹ (Shapiro 1991).

direction. Also here, the paradigm gap between lawyers and informaticians is probably one of the reasons: informaticians do not understand the nature and importance of legal references; lawyers have not been able to explain their problem in a way useful to informaticians. A second reason is in the complexity of the problem and the number of stakeholders needed to solve it.

First, common and open standards, like ECLI, ELI and Akoma Ntoso, have to be developed. Secondly, those standards have to be implemented by legal authorities within their huge repositories and complex IT systems. Also, legacy content has to be adapted, new search methods have to be developed and lawyers have to change their citation habits. In the next section we discuss a project in the Netherlands that focused on the question how to improve reference-based search by developing software to detect, understand and harmonise the many, many different citation styles lawyers use for referencing.

3 Linked legal data in the Netherlands

3.1 Project objectives

As happened in many other countries over the last two decades, the Netherlands witnessed the emergence of vast internet repositories with official journals, consolidated legislation, parliamentary documents, court decisions, policy guidelines and other official legal information. Given the variety of publishing organisations and document types, a number of repositories exists, different in structure, ownership, metadata and search functionalities.

Public bodies publishing their materials for free helped to reduce cost of access for citizens, legal professionals and the government itself, but the disparity of sources left the end-user with a lot of problems. Hence, various (often commercial) initiatives for “content integration” emerged, catering a single search interface for all the different databases. But although there are advantages of being able to search in five million documents at once instead of having to search in five databases with one million documents each, it does not solve the problem of lacking semantic interconnections between the documents themselves. In other words: having access to national court decisions and EUR-Lex in one search portal does not help in finding those court decisions that cite a specific directive. The reasons have been discussed in the previous section: if you build a bigger search engine it still does not understand the contents of the documents.

Not aimed to serve the public in general, but primarily to improve the accessibility of legal information for people working in the public sector itself, the Linked Government Data Project (LiDO, after the Dutch name: “Linked Data Overheid”), was initiated in 2012.

3.2 Infrastructure

The LiDO project started by developing a technical infrastructure for the storage of linked data, for importing and cleansing of legal resources and for making the linked data available for end-user applications. Also, a “link tool” was created: a user-friendly web application to construct uniform and persistent (hyper)links.

By the use of a national technical identification standard, in the database with consolidated legislation cross-references were already available – they are created as part of the consolidation process – but references to and from other sources, like court decisions, parliamentary documents and policy guidelines were absent. It was assumed that by demonstrating the tools and stressing their advantages, knowledge workers would start linking their documents themselves, but this assumption was too optimistic. Proper linking requires specific knowledge and a lot of time, both of which were not available.

To solve this problem, first and foremost for the public case law database of the judiciary, it was decided to develop the LinkeXtractor.

3.3 The LinkeXtractor

3.3.1 A short history

A first version of the LinkeXtractor was developed in a PhD research project¹⁰ aimed to develop a computer algorithm (dubbed “Model for Automated Rating of Case law”) that would rate court decisions as to their legal importance. The number of outgoing and incoming references was considered to be an indispensable variable in calculating this importance. Because those links were not available in computer readable format, software had to be developed to detect them. After two years of development, the software performed with a satisfactory level of recognition, but it could only be used for populating the one-off database used for further statistical research. The code was not developed to be maintainable, adaptable or extensible and the performance was far too poor to serve multiple users.

Within the LiDO project it was recognised that the LinkeXtractor could be used to solve its problem of missing links. All the knowledge about reference detection, reference repositories and linking logic was reused from the original version, but technically the LinkeXtractor was rebuilt from scratch, to meet the requirements of maintainability, adaptability, extensibility, security and performance. With co-financing from the Council for the Judiciary and the Ministry of Finance, it went live in October 2017, together with a new version of the LiDO website.

¹⁰ (van Opijnen 2014).

3.3.2 Basic architecture

In this section the functioning of the LinkeXtractor is outlined; a more technical explanation can be found elsewhere.¹¹ Other programmes with comparable functionalities have comparable architectures, but differ in technical frameworks.¹²

In this section, the “intelligent core” of the LinkeXtractor is described. Since it cannot function without reference repositories, these will be discussed first. At the end of this section, the architectural embedding and some maintenance issues are discussed.

Reference repositories

The LinkeXtractor must have knowledge about what has to be recognized as legal reference, e.g. titles of acts, document numbers of European acts or the names of parties used to refer to decisions of the European Court of Human Rights. Hence, all these (meta) data have to be collected, converted and often cleansed or adapted. Although these data sources are available as open data, this is not a trivial task. The number of records run in the millions and they often contain technical or substantive errors.

Currently, in the LinkeXtractor six reference repositories are used:

- The database with consolidated legislation of the Netherlands, containing titles, abbreviations and aliases of Dutch acts, by-laws, ministerial decrees and other secondary legislation that was in force on 1 May 2003 or enacted after that date. The database also contains all international treaties to which the Netherlands have acceded.
- The ECLI register of the judiciary. This register contains more than two million European Case Law Identifiers and accompanying metadata of Dutch court decisions: all cases published on the website of the judiciary, nearly all decisions published by commercial publishers (since 1913) and those stored in internal databases of the courts. Apart from the ECLI, the register contains case numbers and the publication numbers assigned by legal magazines; both are often used within citations.
- A database with all official promulgations of the – nowadays – seven official journals. It also contains all parliamentary documents since 1995.¹³
- All decisions from the European Court of Human Rights, as stored in its HUDOC database.
- Some sections of the EUR-Lex database of the European Union: sector 2 (international agreements), sector 3 (legal acts, like directive and regulations),

¹¹ (van Opijnen, Verwer and Meijer 2015).

¹² Like the BO-ECLI parser discussed in Section 4. Compare also: (Boella and Kostantinov 2014).

¹³ A database with parliamentary history dating back to 1814 will be added in the near future.

sector 4 (complementary legislation) and sector 6 (decisions of the Court of Justice).

- A repository especially developed for the LinkeXtractor. On the one hand it contains a collection of global aliases (i.e. abbreviations and common names) for national and European acts and court decisions which are not in the original repositories but are often used by lawyers.

Intelligent core

The intelligent core is the heart of the LinkeXtractor. It can be viewed as a pipeline that processes the documents in which legal references should be detected. Within this pipeline, there are four basic groups of functional processes, which are described here more or less in chronological order. Although the LinkeXtractor is configured for the Dutch language only, most examples have been translated into English.

Named entity recognition

The first step – “named entity recognition” – steps through each word (or series of words) of the document to discover whether it could be a “named entity”, i.e. a sequence of characters that exists as a title, alias or abbreviation in one of the reference repositories. Since the number of named entities exceeds more than 200.000 entries, this looks like a tedious process, but due to an optimised data-structure, this is actually the fastest step in the whole pipeline. All recognised entities (words or series of words) are tagged with the code that identifies the source in the reference repository (e.g. an ECLI for a court decision that has been cited by a common name or a CELEX number for a European regulation that has been cited by the full title).

Examples of named entities that are recognised (for one and the same resource):

- Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC.
- Revised Payment Services Directive.
- PSD2.
- PSD-2.

After tagging all the strings recognised as named entities, the document is ready for the next step.

Pattern matching

The second step is “pattern matching”. This function recognises patterns of digits, letters and punctuation marks that might reference (part of) a legal resource. In a short hand notation, the abovementioned directive might be referred to in tens of different ways, e.g.:

- Dir. (EU) 2015-2366.
- Direct. 2015/2366.
- EC-directive 2015.2366.

Although they do not obey the formal citation rules or are even blatantly wrong from a legal perspective (like the last one), lawyers are able to recognise all of them immediately and interpret them correctly, but search engines do not. Hence, the pattern matcher tries to recognise strings that might refer to an EU directive, court decision or any other resource.

Simplified, in the examples from above the pattern matcher searches for:

- The word “Directive” or some defined abbreviation for it;
- Optionally, the abbreviation “EU”, “EC”, “EEC” or “ECSC” before or after this “Directive” and optionally with some interpunction like hyphens or brackets;
- A year (between 1951 and the current year), written in two or four digits until 1999,¹⁴ and in four digits from 2000 onwards;
- A slash, hyphen or dot, optionally encapsulated by white space;
- A string of one to four digits.

The pattern matcher also searches ECLIs, parallel case law citations, case numbers, dates and names of courts (the latter three together can also be used to identify a court decision), publication numbers in official journals and many ways in which parliamentary documents can be cited. It also searches for article references that follow or proceed an act that has been found either by named entity recognition or the pattern matcher itself.

The variety of patterns to be recognised is quite huge, but on the other hand there is a lot of overlap: e.g. EU regulations look a lot like directives, although they have (until 2015) the year and document number in reverse order. To keep the code maintainable and extensible, a computer grammar has been used: a language in which the patterns are formulated in very small reusable parts that can be assembled to find specific types of references.

¹⁴ Although officially acts from 1999 have to be written with the year in four digits, they are often referred to with the year in two digits.

Logic and special functions

Since many situations exist that deviate from the basic process described above, special routines have been built to cater for them. Only some examples are mentioned here.

A special routine has been developed to handle “local aliases”. In legal texts often short-hand notations are used to refer to a legal resource repeatedly. One might write: “Applicant is referring to Directive (EU) 2015/2366 (hereinafter: “the Directive”) [...]” And three pages later: “The rules on initial capital as laid down in article 7 of the Directive [...]” If somebody else searches for documents referring to article 7 of Directive (EU) 2015/2366, this citing document will only be found if the search system somehow knows what is meant by “the Directive” in the reference to article 7. Therefore, the LinkeXtractor is able to detect these local aliases.

Another routine has been implemented to reduce the number of false positives for abbreviations of legal acts. In the full title or a nickname of a legal act casing differences might occur, but they are not relevant. On the other hand, “BOOM” should be recognised as the abbreviation of a Dutch act, while the word “boom” should not, since it is the Dutch word for “tree”. But if “RTL” is recognised (the abbreviation for a Dutch aviation decree), we run the risk of unintentionally mistaking the broadcasting company for a legal act. Optimal performance is realised by recognising all strings of six characters or less case-sensitive, and only if accompanied by the reference of a specific article or paragraph, unless the abbreviation is also declared in the document itself as a local alias, in which case it will also be recognised without accompanying article reference.

A third, comparable, example comes from the recognition of court decisions. For such references often aliases are used, sometimes named after the parties to the case. Examples are *Cilfit*¹⁵ and *United Brands*.¹⁶ When a reference is made to “Cilfit”, chances are more than 100 to 1 that the CJEU decision is actually being referred to here. But when “United Brands” appears in a text, even in court decisions, it might be a reference to the company and not necessarily to the CJEU case. As a solution for optimal balance between false positives and false negatives, the LinkeXtractor can make a distinction between global aliases that have to appear in combination with words like “decision”, “case”, “verdict”, and global aliases that can appear without such additional terms. In which category a specific alias belongs still has to be done by a human editor.

A lot of logic is also involved for the preparation for the next step, verification. A pattern that is recognised as – possibly – a European directive, has to be tagged with a constructed CELEX number, the identification code that is used by the EUR-Lex database. In the example of “EC-directive 2015.2366” this CELEX number is 32015L2366. For case law references much more preparatory work has to be

¹⁵ Case C-283/81, *Cilfit*, ECLI:EU:C:1982:335.

¹⁶ Case 27/76, *United Brands*, ECLI:EU:C:1978:22.

done: dates, court names, case numbers and parallel citations have to be standardised before they can be verified.

Verification and error handling

References that have been found by named entity only do not have to be verified, since the process guarantees that they do exist. But if an accompanying article has been recognised, or if a reference has been recognised with pattern matching, a look-up is necessary to check if the resource that has been recognised actually exists.

If the reference can be identified without any technical doubt, the text is labelled accordingly, otherwise it is tagged as an error. Error codes can be used to improve the citation or to inform end-users.

The LinkeXtractor has a very high recognition rate, but given the infinite complexity and error-proneness of legal citations, errors are unavoidable. These errors come in various types:

- False negative: a string that should have been recognised as a reference has not been recognised;
- False positive: a string has been recognised as a legal reference while actually it is not;
- Mapping error: a legal reference has been detected, but the incorrect legal resource has been mapped to it;
- Ambiguity: a textual legal reference might have two or more legal resources that could be identified by it. E.g., without the date of the decision, the names of the parties might refer to two or three decisions or opinions in the same court case.
- Incomplete or erroneous reference: the LinkeXtractor has recognised something that looks like a legal reference, but it cannot be resolved. This can e.g. occur if a typo is made in the number of an EU regulation: the reference is detected as a possibly valid identifier, but it does not exist in EUR-Lex.

False negatives, false positives and mapping errors can only be detected by humans, while ambiguities and incomplete or erroneous references are detected and explicitly tagged by the LinkeXtractor. If there would be enough human resources available, these errors could be corrected by editors. In the current situation such errors are ignored in the hyperlinked documents – i.e. no links are shown – but translated into user-friendly messages if they occur in the request that has been submitted by the user of the LiDO website (below, Section 3.4).

Architectural embedding and maintenance

To suit all different types of purposes and to support all types of applications, the “intelligent core” described in the previous section does not have a predefined output. Links found can be stored in a database, sent to another application or shown in the text of the document itself. Within the LiDO architecture various components are used for storage and search, but for optimal flexibility and maintenance, they might be replaced without having consequences for the functioning of the LinkeXtractor.

Of course, the LinkeXtractor requires maintenance. Apart from pure technical maintenance, adjustments have to be made if reference repositories change their connectors or content structure, or if identification systems or citation rules change.¹⁷ Also the list of aliases and exceptions has to be updated continuously.

3.4 Linked data website

The LiDO website¹⁸ has been developed as an entry point for those who want to do research on the relations between legal documents, while it is also meant to serve as an aid for those looking for legal sources without knowing the exact name.

On the LiDO website, one can find a quick answer to questions like:

- In which Dutch court decisions has the Saunders/UK case of the European Court of Human Rights been cited?
- In which Dutch legal sources is the Revised Payment Services Directive being referred to?

The search interface has just one search box, in which any title, document number, ECLI, abbreviation, common name or article number of a legal act can be keyed in. This request is then sent to the LinkeXtractor, which returns the legal resource(s) the LinkeXtractor has recognised.

By clicking one of the resources found (in most cases just one), five options are presented:

- *Relations*: This shows all outgoing or incoming relations of the resource, as discovered from the metadata of the resource, manually added metadata and references discovered by the LinkeXtractor;
- *Original resource*: A link to the original resource, like EUR-Lex, HUDOC or the national legislation database;
- *Document with links*: If the document has been parsed by the LinkeXtractor (currently all published court decisions), this shows the document with all legal

¹⁷ As happened with the numbering of EU legal acts in 2015: [EUR-Lex](#).

¹⁸ [LiDO website](#).

references being hyperlinked. Clicking such a hyperlink performs a LiDO search on the linked resource. This way, the user can navigate through a web of references.

- *Metadata*: Additional metadata about the resource;
- *Link tool*: with this tool the user can create a stable and persistent link to the resource. Various options are offered, like adding a manually edited label, choosing formats tailored for Word or web pages, and in some case also different technical standards.

3.5 Integration with other websites

Although the LiDO website itself offers useful functionality, the linked data cloud has even more added value when used in combination with other data sources or search engines.

An important connection is made with the public database of court decisions, maintained by the Council for the Judiciary. As mentioned above, the half a million documents in this database are all processed by the LinkeXtractor. Since October 2017 every record in this database now has a link “enriched version” that leads to the hyperlinked version on the LiDO website.

It has been discussed whether this hyperlinked version with all the incoming and outgoing links should be shown on the website of the judiciary itself, since for all professional users this added information is extremely relevant. However, it was decided not to implement this option, since a clear distinction should be made between the original (though pseudonymised) judgment as published by the court and the version that has been parsed by the LinkeXtractor. Although textually there is no difference, the impression might arise that the links have been added by the court itself and are part of the authentic decision. And since errors do occur (see Section 3.3.2), it has been decided only to offer a direct link to the enriched version on the LiDO website.

From the consolidated legislation database of the Netherlands a direct connection is made to the LiDO website as well. Each (article of a) treaty, act, regulation or decree in this database has a linked data icon indicating the availability of related information and the number of links available. By providing this link, a user of the legislation database can receive an aggregated overview of all related parliamentary documents, relevant by-laws and citing court decisions in one click.

Finally, because of its open architecture, the LinkeXtractor is being used for various projects where legacy databases are converted into modern systems for legal data management. Many of such old repositories contain collections of legal references that are structured but not compatible with current standards. With the help of the LinkeXtractor they can be converted within seconds, instead of the many days that would be required for manual editing.

3.6 The Law Pocket app

The highly structured contents of the legislation database and the availability of millions of links inspired the development of the “Law Pocket”, an app to cater for the needs of legal professionals and other employees working in the public domain.¹⁹ In their daily work – at the office, at home, in meeting and conference rooms, on mission – lawyers need access to all legislation relevant for their, often very specialised, task. This information is often printed, highlighted and annotated manually and carried around. But there is the problem of not being able to share a specific collection with colleagues, not being able to search it efficiently and often wondering whether the most up-to-date version is at hand.

The Law Pocket App has been developed to alleviate these information concerns. The app can be downloaded on a tablet or smartphone and can be populated with “law bundles”, “treaty bundles” and “law pockets” which can be downloaded for offline use from a growing library.

The first type, “law bundles”, are computer-generated collections either of families of law as they have been defined in the legislation database, or of all legislation of any municipality, province or water board (in the Netherlands, these three types of regional government have an obligation to publish their legislation electronically in a central database managed by the Publications Office of the Netherlands). Every time an act or regulation in a law bundle changes, a new version is generated and an alert is visible for the user. Within the app, all acts can be navigated in the same way as in the database itself: they have a table of contents, a search function and in-text links to other legislation. Additionally, users can highlight text sections, place bookmarks and add their own notes; all these personal additions are kept on the device and are not shared with others.

The second type of content in the Law Pocket App, the treaty bundles, do not contain national acts but treaties, with additional information from a treaty database maintained by the Ministry of Foreign Affairs.

The third type, “law pockets”, are collections on very specific legal topics, edited by specialists in the field. The editor can make any selection from national or regional legislation. She can select full documents, but also specific chapters or articles. She can add annotations (visible for all users), include additional (pdf) documents and external hyperlinks to sites or documents of relevance. If any act or regulation in her law pocket changes, she receives an e-mail alert, so updates can be made immediately.

By using law pockets, knowledge can easily be shared between co-workers; they can have access to all relevant information at all times, even off-line. The only exception is the linked data from LiDO. Information about the number of related number of links, and accessing them on the LiDO website from within the Law Pocket App is only possible if the device is connected to the internet.

¹⁹ An earlier, but functionally nearly equivalent version of the Law Pocket has been described in: (van Opijnen, Schreijer, Andreas and Kroon 2016).

The Law Pocket App can be downloaded for free, as well as all law bundles, treaty bundles and law pockets. For reasons of competition law though, only civil servants are allowed to create law pockets.

3.7 Future extensions

The LiDO project is running for six years now. A lot of progress has been made, but still we consider it to be in an early stage of development. The algorithms of the LinkeXtractor can still be improved and extended with modules for recognising other types of references (e.g. legal doctrine). Currently, references are recognised in publicly published court decisions only; although this is a substantive collection, more collections should be added, like parliamentary documents. Also, due to new insights and technological developments, the architecture of the LiDO framework needs reconsideration.

Alongside the textual interface currently available, work is in progress to visualise the relations between documents in a network graph. Other future developments include statistical analysis modules and integrating the LiDO search with a full text search engine. The LinkeXtractor could also be used to improve the quality of data at an earlier stage in the production process, e.g. by using it in word processors or editorial applications for quality control of legal references before documents are published.

4 European developments

The deepening and broadening of the internal market and the European legal order amplifies the need for EU wide accessibility of national legal resources. In its *Cilfit* decision,²⁰ the Court of Justice stressed already in 1982 that the national judge has to take the jurisprudence of the national courts of other Member States into account when deciding on questions related to the application of the doctrine on *acte clair* and *acte éclairé*. Various initiatives have tried to meet the needs,²¹ but also here it was proven that search engines cannot solve the problem of insufficient data quality.

The development of the European Case Law Identifier, already mentioned in Section 2.4, is an important building block for solving the problems. The ECLI search engine²² is an essential element within the ECLI framework. In this portal – part of the European e-Justice portal, developed and maintained by the European Commission – all court decisions from all publishers and websites can be indexed, as long as they have an ECLI assigned. Currently, nearly 10 million court decisions

²⁰ Case C-283/81, *Cilfit*, ECLI:EU:C:1982:335.

²¹ (van Opijnen 2008).

²² [ECLI search engine](#).

from fourteen Member States and two European courts are indexed.²³ Additional metadata, translations and summaries can be published by others than the rendering courts as well.²⁴

Apart from the problem of translations, which is being addressed in other European projects,²⁵ the ECLI search engine faces the same issues as national repositories: how to find national decisions that cite a specific EU regulation if the references in all those court decisions are not computer readable?

To tackle this problem, an important step has been taken within the project “Building on the European Case Law Identifier” (BO-ECLI), an EU co-funded project that ran from October 2015 until October 2017 by a consortium of sixteen organisations from ten EU Member States, co-ordinated by the Publications Office of the Netherlands.²⁶ BO-ECLI, described elsewhere in more detail,²⁷ had five main objectives: the initial or extended implementation of ECLI in eight Member States, promotion of ECLI for use in databases and legal citations; comparative research on the publication of court decisions within the EU;²⁸ technological evaluation of the standard and making proposals for an updated version²⁹ and finally, developing software for linking data.

This BO-ECLI parser has been designed with the specific aim of being usable in a variety of jurisdictions. The software, available under an open licence,³⁰ consists of a “common core” and an unlimited number of “plug-ins”. The common core performs the functions that are equal to all jurisdictions, while a plug-in contains the computer readable citation rules for a specific jurisdiction, links to national repositories of legal resources and other jurisdiction-specific functions.³¹ Within BO-ECLI, plug-ins for the Italian and the Spanish jurisdiction have been developed, but anyone who so wishes can download the software and develop its own plug-in. By not having to worry about the common core, a lot of time, money and development efforts can be saved.

By making the discovered references available within the metadata of the court decisions that are indexed by the ECLI Search Engine, the accessibility of this rapidly growing knowledge base will be improved substantially.

²³ As of 1 October 2018: Belgium, Bulgaria, Czech Republic, Germany, Estonia, Greece, Spain, France, Croatia, Italy, Latvia, Netherlands, Slovenia, Finland, Court of Justice of the European Union, Boards of Appeal of the European Patent Office. Also Portugal, Slovakia, Austria and the European Court of Human Rights assign ECLI to their decisions, but they are not yet connected to the ECLI Search Engine. Denmark, Cyprus and Romania are working on the introduction of ECLI as well.

²⁴ Currently, the Jurifast database of the Association of the Councils of State and Supreme Administrative Jurisdictions of the European Union is connected.

²⁵ [eTranslation](#).

²⁶ [BO-ECLI](#).

²⁷ (van Opijnen 2017).

²⁸ (van Opijnen, Peruginelli, Kefali and Palmirani 2017a), summarised in: (van Opijnen, Peruginelli, Kefali and Palmirani 2017b).

²⁹ (van Opijnen, Palmirani, Vitali, van den Oever and Agnoloni 2017).

³⁰ [Gitlab](#).

³¹ For a more detailed description: (Agnoloni, Bacci, Peruginelli, van Opijnen, van den Oever, Palmirani, Cervone, Bujor, Lecuona, García, di Caro and Siragusa 2017).

5 Some words on AI & Law

Long before artificial intelligence (AI) was the hype it is today, a scientific community “artificial intelligence and law” (“AI & Law”) had emerged. Most people active in this field though were trained in artificial intelligence – attracted by the scientific challenge to have a computer rendering judicial decisions – and not by lawyers looking for ways to use AI for easing and improving their daily work. For many years, the focus within AI & Law was on developing models for legal argumentation and reasoning. Given the “unscientific” nature of the legal domain, this has been, and still is, a mission impossible. On the other hand, questions many lawyers would like to have answered were ignored as not being academically interesting, one of the most pressing questions being: how to find reliable, fast and correct answers to my information needs in huge, unstructured and scattered repositories.

Thanks to the recent availability of huge databases with legislation, court decisions and other resources, the interest of the AI & Law community – as within AI in general – gradually has shifted from developing argumentation schemes and prescriptive models for aping legal reasoning, to extracting knowledge from solidified human knowledge in millions of documents. Natural language processing, machine learning and data science are directions that might offer the legal profession more direct use than the endeavours to force the law in a matrix that is fundamentally unfit for the purpose.

Still, “modern” AI is not capable of truly understanding human – left alone legal – language without humans telling it something about structure and meaning. And this is where the paradigm gap between lawyers and informaticians still looms. In this article I have described how the specificities of the legal domain impede the development of effective information retrieval systems that fit the legal mindset.

Probably due to the paradigm gap, the importance of legal references as a building block for legal information retrieval has long been misunderstood or underestimated. In the description of the LinkeXtractor the complexity of the problem is highlighted and the importance of interdisciplinary co-operation demonstrated.

However, improving data quality is a *condicio sine qua non* for effective application of AI to the legal domain. Documents must to better structured to be readable and understandable by computers; all relevant information objects and entities, like concepts, facts, actors, references and arguments should be structured, identified and labelled in a persistent and uniform way. Preferably this should be done during drafting stage as far as possible, according to open standards and without as little human intervention as possible.

Only with well-structured, properly identified and semantically enriched data, we are able to develop search engines and other applications that really meet the needs of the legal community.

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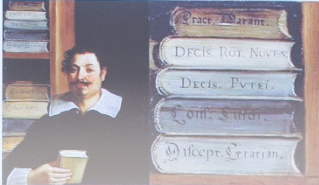


Panel 3

Efficient use of technology to support
the legislative process

1. Why is today's technology so important for lawyers?

Lawyers are knowledge workers
Their capital is their knowledge



Knowledge and information management at the ECB: the role of technology

By Fabienne Allegret-Maret¹

1 Introduction

This paper aims to explain the current activities in knowledge and information management at the European Central Bank (ECB) and, more specifically, how these activities can support ECB lawyers in adopting new technologies, thereby improving their work processes, to enable them to respond to today's customer and organisational demands.

The first part of this paper will provide a general overview of some technological developments and their impact on lawyers and their work. It will show that lawyers have not fundamentally changed the way they perform their work. The new wave of technological developments (machine learning and intelligent technologies, etc.) will, however, offer lawyers opportunities to develop and change their practices to enable them to meet the challenges of the digital age.

The second part will present the activities the ECB is planning to perform to create the ECB Digital Workspace. The concept of the Digital Workspace and the strategy to support its creation will be explained.

Finally, the third part will aim to show how the ECB Digital Workspace activities and outcomes will support ECB lawyers in their quest to adopt and use new technologies to enhance their contributions towards the ECB's mission and objectives.

2 The importance of technology for lawyers as knowledge workers

The legal profession is perhaps more associated with paper files, complex procedures and tradition than with technological innovation. However, information technology has already changed the way lawyers work: the internet, for example, has substantially changed the way lawyers perform legal research; and the introduction of personal computers and office applications has significantly altered the administration of law firms and departments.

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I would, however, argue that these IT solutions have not yet fundamentally disrupted the way lawyers manage and use their knowledge to perform their work.

2.1 Definition of knowledge workers

The term “knowledge worker” seems to have been coined when Peter Drucker first presented it in his book² in 1959. Drucker defined knowledge workers as high-level workers who apply theoretical and analytical knowledge. In 2005, Thomas Davenport offered this description: “knowledge workers have high degrees of expertise, education or experience, and the primary purpose of their jobs involves the creation, distribution or application of knowledge.”³

The literature characterises knowledge workers based on the following aspects:

- knowledge workers undergo several years of formal training to gain and master the information needed to perform their roles and must continue learning even when employed;
- they must know how to find and identify relevant information from a large database of information. They should be able to discard less important information and focus on essential information that will help them solve problems, answer questions and generate ideas;
- they use analytical reasoning and relevant judgement to solve customer issues and tackle new situations; and
- their work involves frequent communication to customers, colleagues and other stakeholders. They must be able to speak, read and write, and deliver a presentation when needed.

Given the importance of information and knowledge in the definition of knowledge workers, it is not surprising that any technological developments in this field will impact the tasks and processes entrusted to such workers.

2.2 Today's technology is different as it is more powerful and intelligent

Thomas Davenport suggests that there are three eras of technological innovation or automation, which have fundamentally changed people's work.⁴ Applying these three eras to the field of legal work reveals that the latest technological changes will fundamentally change not only the way lawyers work, but also the tasks they perform.

² Drucker, P. (1959), *The Landmarks of tomorrow [On economic and social progress in the twentieth-century]*.

³ Davenport, T. (2005), *Thinking for a living: How to get better performance and results from knowledge workers*, Boston, Mass., Harvard Business School Press.

⁴ Davenport, T., & Kirby, J. (2016), *Only humans need apply: Winners and losers in the age of smart machines*, New York, Harper Business.

In the first era, machines relieved people “of work that was manually exhausting and mentally enervating”.⁵ These developments are still ongoing to a certain extent, with the introduction of new machines and robots in factory lines, for example. Tasks that can be taken over by such machines are repetitive, relatively simple and limited in scope. These technologies have not directly impacted the work performed by lawyers.

The second era of technological innovation affected more specifically office and service workers. These technologies aim to support workers in accomplishing transactional, routine and procedural tasks more effectively. Because these tasks follow definite rules and procedures, they can be codified and performed consistently via a machine interface, with limited human intervention. System applications will guide customers through a series of pre-defined steps or options but will stop short of making a decision. Some of the current technological developments are still being deployed and worked on, especially in cases when these applications can be enriched with the next generation of technology.

The third era brings in systems that are capable of making decisions, something which was thought to be the prime capability of humans. These technologies will more directly impact knowledge workers, who relied on their knowledge and powers of analysis to make decisions as part of their tasks. The consultancy firms Gartner⁶ and McKinsey⁷ have both predicted that these technologies will be very disruptive as they will “transform life, business and the global economy” over the next two decades. These technological developments were also enabled by the IT industry’s ability to continuously innovate and multiply the computational power of machines while reducing the size of devices. This “intelligent” technology has already transformed, and will continue to transform, the work of lawyers.

The main functionalities of such technology can be summarised as below:

- analysis of numbers and words: applications can now understand the meaning of numbers and words – they can count, find patterns, classify, interpret and predict with tools such as machine learning, natural language processing, deep learning and more;
- execution of digitally-based actions and decision-making based on their analysis: systems are increasingly capable of taking autonomous action based on their analysis of words and numbers. Complex structured information-based tasks with defined rules can already be performed by machines;
- execution of actions in the physical world: robots are becoming more and more sophisticated and, in some fields, such as medicine, they can already execute tasks that require greater strength or finer precision of movement than a person has. Human beings are currently still supervising these machines either directly

⁵ See footnote 4.

⁶ Gartner Identifies the Top 10 Strategic Technology Trends for 2014 (last accessed on 23 October 2018).

⁷ Disruptive technologies: Advances that will transform life, business and the global economy.

(medical machinery) or remotely (military), but Thomas Davenport predicts that autonomous machines will be available in the next decade.⁸

2.3 Impact of technological developments on legal work

These technological developments have, or will have, several consequences for lawyers:

- There are now an almost infinite number of legal information sources.

Technology has enabled legislators, regulators, judges, legal practitioners and academics to adopt and comment fully on legislation and judicial decisions.

Technology has also allowed access to laws from other jurisdictions and facilitated communication and exchanges between countries, therefore multiplying the amount of potentially relevant information a lawyer will have to consider for any given task.

Even with the best training and intentions, it is doubtful that lawyers will ever be able to deal with this increasingly vast number of legal information sources, and there is therefore a risk that they will miss important information relevant for their tasks and customers.

- These technologies and the related increase in potentially relevant information will also negatively impact lawyers' efficiency: lawyers need to spend more time on legal research, on keeping up to date with new legal developments and on learning new skills, such as how to use legal databases efficiently or how to verify the authenticity and reliability of the vast amount of information now easily available.
- With the advent of new smarter technologies, customers' expectations are changing too: faster, simpler and cost-effective communication and advice are now expected. This will also apply to the recruitment field: new lawyers will be attracted to firms that can show they are adopting new technologies and promoting innovative ways of working.⁹
- The traditional business model of legal services provision is being re-evaluated. New opportunities are being created with lower costs and improved efficiencies, and start-ups and technological companies are starting to offer some legal services, something that only law firms were traditionally able to provide. For example, some of these companies offer online solutions to review, and sometimes even draft, a standard legal document for customers.

For lawyers, it is only the beginning. Some sectors, such as medical treatment or financial markets, are already relying heavily on technology to perform core tasks. It

⁸ See footnote 4.

⁹ See 2016 Microsoft survey results summary (last accessed on 21 October 2018).

will not be long before legal services are affected too: systems, such as IBM Watson, have already demonstrated that they can analyse and understand more content than a human being would be able to do (additionally, machines have the advantage of being more consistent than human beings); some IT companies have already developed software to create content or stories, for example in journalism or wealth management.

While creating these pressures for lawyers, technology is also providing some solutions and answers and it is widely agreed that today's lawyers must embrace new technology not only to face these challenges, but also to remain relevant.

To respond to these challenges and provide solutions for its workers, lawyers and others, the ECB has recently decided to adopt the concept of the Digital Workspace.

3 The Digital Workspace at the European Central Bank

3.1 Information management at the ECB so far

Since 2009, the ECB has had an Enterprise Content Management system, which is the central repository for ECB text-based information, as well as the main document-centric collaboration platform. Network drives have been abolished and ECB staff are highly aware of information policies developed on the basis of European Union regulations, local legislation and international standards. ECB information is managed on the basis of an Information Management Framework and dedicated policies and procedures.

To enhance these achievements, the ECB's Executive Board recently approved an Enterprise Information Management (EIM) Strategy 2020. The EIM Strategy contributes to the creation of the ECB Digital Workspace together with other strategies and initiatives such as the Data Management Strategy, the End-User Computing and User Experience Strategy.

The ECB Digital Workspace will complement the ECB's physical workspaces and enable staff to better create, manage, share and reuse information and knowledge assets in a virtual environment. New tools, policies and processes will be introduced to enable ECB staff to collaborate better and to perform their work more efficiently in carrying out the ECB's mission.

Although the EIM Strategy 2020 does not directly address the challenges faced by ECB lawyers, it will provide the ECB with several innovative solutions to enhance the way its staff manage and use information for their work. These will benefit all ECB staff, including lawyers.

The following sections provide an overview of the EIM Strategy and its activities.

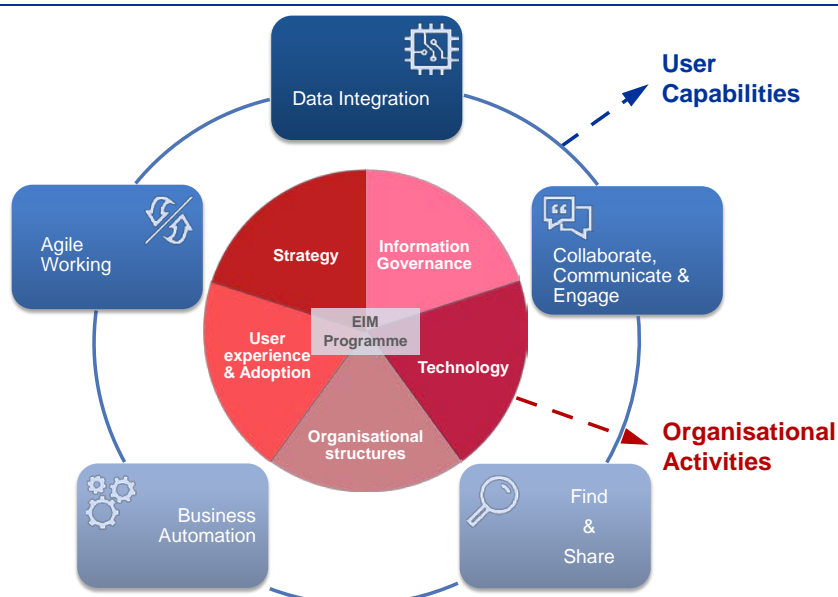
3.2 EIM Strategy – purpose and strategic direction

This EIM Strategy 2020 aims to accelerate the ECB's digital transformation by developing the right user capabilities to co-create the ECB Digital Workspace. It outlines the strategic direction, objectives and challenges of information management at the ECB and lists the key activities related to appropriate policies, behaviours, technology and processes required to meet specific short-term goals by 2020. The successful completion of these goals will create the necessary technological and organisational conditions to accomplish the ultimate aim of developing a working environment for secure, highly effective and agile business processes and enable data-driven decision-making.

The EIM Strategy addresses the ECB Business Strategy's 2018-2020 information-critical objectives, in particular those related to "being a world-class institution" i.e. improving business processes via technology, integrating information/data to better support decision-making and strengthening knowledge management.

The ECB Digital Workspace provides five capabilities to end users, to support them overcome the challenges of the modern working environment. These capabilities are facilitated by seven organisational activities that provide the appropriate organisational governance structures and culture, as well as financial, human and technology resources.

Figure 1
The ECB Digital Workspace



The EIM Strategy and the associate projects/activities described below, together with other institutional strategies around data and IT infrastructure, will create the user capabilities and support the organisational activities of the Digital Workspace. By 2020, once these goals are completed, the ECB will have in place a secure, agile and reliable infrastructure, which will enable staff to gain increased insight from

information and reuse information assets with due respect for protection and confidentiality.

3.3 The main goals, themes and components of the EIM

The current overall high level of Information Governance and Management maturity provides the ECB with a solid basis for developing the ECB's Digital Workspace. There is, however, a need to further develop specific capabilities such as data management and knowledge management as well as to build reliable, high-performing and available technology to facilitate a holistic approach to managing the ECB's information and knowledge assets. The following EIM goals reflect these considerations:

1. Improve access to, and the protection of, ECB information
2. Strengthen staff engagement through Knowledge Management
3. Increase insight from information
4. Enhance the efficiency of business processes
5. Manage all information assets in a compliant and optimised manner

These goals are further broken down into a series of activities/projects, which are described in the sections below. These activities aim to create the capabilities required to develop a highly creative and performing ECB Digital Workspace, supported by the necessary infrastructure.

3.4 EIM short-term goals and activities

The ECB already has considerable strengths in the domain of Enterprise Information Management, which place it in a leading position among international organisations and Union institutions. The completion of the EIM goals builds on the use and enhancement of these strengths.

3.4.1 Goal 1: Improve access to, and the protection of, ECB information

To enable the ECB to unlock the full potential of its information, it needs to ensure it can be efficiently accessed and retrieved. Much of the information created by the ECB is sensitive and needs to be adequately protected. The organisation needs to strike a balance between these two competing requirements.

Changes in staff working preferences and the increased need for remote access and collaboration with external third parties require tools that better facilitate virtual/mobile working and provide more efficient ways of collaborating securely.

Furthermore, the ECB needs to provide secure external protection and facilitate a more open internal environment. The following activities are planned to better address these gaps:

1. Improve availability of ECB information for staff
2. Enhance access to ECB information
3. Introduce integrated secure external collaboration
4. Foster a culture of information sharing at the ECB
5. Protect information from internal and external threats
6. Manage new and emerging ECB information assets

3.4.2 Goal 2: Enhance engagement through knowledge management

Knowledge management has been identified as one of the ECB's strategic priorities for 2018-2020 as it is expected to provide considerable benefits to the organisation, i.e.:

1. Increase and better facilitate collaboration among staff (i.e. better identify, connect and share expertise and skills to make the best use of existing knowledge and to improve innovation, efficiency and the overall quality of work)
2. Improve productivity by avoiding duplication and reusing existing information assets
3. Enhance on-boarding for new staff and access to knowledge for all staff
4. Improve succession planning and reduce the loss of know-how by capturing explicit and tacit knowledge

The ECB, however, still has further steps that must be taken to successfully and systematically embed knowledge management across the organisation and to further support external accountability and transparency. The following activities are planned to help achieve this:

1. Design ECB Knowledge Management principles and framework
2. Support staff engagement via technologically robust and user-friendly platforms
3. Promote external transparency
4. Enhance accountability and good governance

3.4.3 Goal 3: Increase insights from information

ECB information comes from a variety of sources and in a variety of formats. It comprises any information that exists in unstructured formats (such as documents, pictures, sounds and video recordings) as well as in structured databases. Currently, ECB structured and unstructured information is not systematically integrated and considerable time and effort is therefore needed to consult multiple information sources and formats in order to gain the necessary knowledge and establish the full picture. To address this, the following activities are planned:

1. Integrate economic data and provide semantic tools and an IT platform
2. Integrate administrative data
3. Increase analytical capabilities and provide tools and services (e.g. data mining, text mining, machine learning and network analysis) and methodological training to foster the autonomous or semi-autonomous examination of data and content
4. Improve insights and sentiment analysis of the impact of digital communication
5. Improve the provision of relevant external information
6. Build an Enterprise Search facility to allow users to locate relevant data and information across ECB systems in a timely and accurate manner

3.4.4 Goal 4: Enhance efficiency of business processes

To enable information to be efficiently reused when needed, it is important to ensure that business units share their work and associated information more systematically within the ECB. This can be achieved by a series of well-defined and integrated business processes. The following activities are, therefore, planned:

1. Automate document-centric business processes
2. Provide business automation for non-document-centric processes
3. Improve website publication processes

3.4.5 Goal 5: Manage all information assets in a compliant and optimised manner

ECB information needs to be authentic, reliable, easy to find and identify and should be well-ordered, organised, labelled and maintained. It is, therefore, important that there is a clear set of rules to enable all ECB information to be consistently created and managed throughout its lifecycle.

The ever-increasing volume of information warrants the implementation of ECB information governance across the ECB information landscape to ensure that, regardless of its format or storage medium, ECB information is consistently created, described and maintained. Thus, the following activities are planned:

1. Identify ECB information assets and create an inventory of ECB information holding systems in order to identify what information the ECB holds
2. Standardise, unify and integrate metadata
3. Ensure ECB information is retained correctly

4 EIM capabilities and their application to ECB legal work

Although the ECB's EIM Strategy is not specifically intended to provide new technological tools or solutions for ECB lawyers, it offers an excellent opportunity for ECB lawyers to use some of these activities to adopt and integrate new technologies into their work.

The following section will consider a selection of EIM activities and show how ECB lawyers could take advantage of these activities.

4.1 Integrated secure external collaboration

As part of the activities under Goal 1, the ECB will introduce an integrated secure collaboration platform. This will provide a more seamless and integrated approach to document-centric collaboration with third parties.

ECB lawyers could take advantage of this new platform, for example by streamlining the exchange and distribution of legal documents with other EU institutions and bodies. At the moment, documents are mainly exchanged via email, or by manually uploading them onto third-party applications. The new solution to be provided will allow ECB experts to share and distribute documents in a secure manner. This new cloud-based solution will certainly reduce some of the administrative tasks required for the sharing and distribution of ECB documents.

4.2 New collaboration tools

The ECB has recently introduced new tools to facilitate virtual meetings. Recognising the importance of collaboration for the ECB, and the benefits it could provide to the organisation, the ECB has decided to look further into implementing new tools to support ECB staff members in multiple collaborative settings.

This element of the EIM Strategy could be of great interest to ECB lawyers. Collaboration is key not only for the drafting of legal advice or legal acts, but also for the continuous learning essential for lawyers as knowledge workers. Lawyers

acquire their legal training via formal education, and their continuous learning can take several formats, but collaboration with more experienced colleagues is one of the most important aspects of learning for lawyers. Any tools that support and enhance collaboration at the ECB would benefit ECB lawyers.

4.3 Knowledge management (KM)

In the ECB's Legal Services, a specific KM function was established in 2015 with a KM Team responsible for steering and contributing to KM activities. Apart from a number of KM toolboxes and information management tools, the KM Team has been instrumental in strengthening the KM culture in the Legal Services department, inter alia, by creating networks, welcome and succession planning initiatives and identifying and communicating commonalities across all Divisions to reduce the "silo" mentality. This initiative (and its successes) has now triggered more interest in KM across the ECB, which has ultimately resulted in KM being identified as one of the ECB's key strategic objectives. KM is assessed as crucial for the institution, given the need to identify and disseminate expertise and know-how across the organisation.

The ECB-wide KM initiative could provide additional benefits to ECB lawyers by adding new innovative tools and solutions that could not have been introduced within the Legal Services department only. Ensuring that the ECB's Legal Services is collaborating in the ECB-wide KM initiative will put them in the best position to identify, promote and use the opportunities afforded by the ECB-wide activity.

4.4 Content analytics tools

According to Gartner¹⁰, "content analytics defines a family of technologies that processes digital content and user behavior in consuming and engaging with content, such as documents, news sites, customer conversations (both audio and text), and social network discussions, to answer specific questions."

While data analytics, i.e. the processing and analysing of structured data, has been ongoing at the ECB for a couple of years, content or text analytics is still in its infancy. The EIM Strategy plans to develop and introduce new tools to support the processing of documents and in-depth analysis of large volumes of information. It is clear that ECB lawyers could gain many benefits from such tools.

Law firms are already using content analytics to read and review contracts and some use advanced language analysis tools to examine the legal content of the documents, identifying, for example, key clauses that may be not be in line with a company's standards.

¹⁰ Gartner IT Glossary: Content analytics (last accessed on 22 October 2018).

Content analytics tools could also help with the ever-increasing volume of legal information sources. Such tools have already been introduced by companies in the legal research area for several decades, but, with content analytics tools and natural language processing technology, the new tools will be able to read, interpret and summarise a written document, sketch out a legal strategy, or assess the merits of a case.

For ECB lawyers to benefit from content analytics developments at the ECB, it is important that they are, and continue to be, involved in this activity. Their participation is necessary to ensure that their needs, and the legal terminology, which is specialised and highly context-sensitive, are captured and that new insights can be mined efficiently. By efficiently processing a large and varied volume of information, lawyers will be able to increase the quality and delivery of legal services and create solutions that were not previously known or thought of.

4.5 Monitoring external information

Monitoring information developments is a key task for many ECB staff. With the multiplication of information sources, it is becoming increasingly difficult to follow all relevant sources and to distinguish between what is relevant and what is not. Relevant information is often included in an email with less relevant information, there is very often a large overlap between sources, and it is becoming more complicated to identify accurate facts and information. This situation contributes to the general information overload for ECB staff members, increases the time staff members spend on scanning the information sources, rather than on analysis, and increases document and email traffic. The EIM Strategy plans to address these challenges by introducing a tool to streamline, consolidate and filter the flow of information to the ECB.

The main expected benefits of this tool will be to help ECB staff overcome information overload by automating the monitoring and filtering of information sources in one place.

Given the importance to lawyers of keeping up-to-date with new legal developments, this activity could provide substantial benefits for ECB lawyers. It would not only save them time in performing their monitoring tasks but also ensure that they do not miss out on particularly important developments.

4.6 Business processes

In order to support the ECB's efforts to become more efficient, more collaborative and more innovative, the EIM Strategy will introduce an activity to review and improve business process management tools at the ECB. In law firms, such tools

have enhanced operational efficiency¹¹ by providing a clear understanding of workflows and identifying inefficiencies and ways to improve processes. These tools can also assess the impact that policy or procedural changes may have on their business processes.

The ECB's Legal Services have already introduced several processes and workflows to manage the increased demands from stakeholders. This EIM Strategy activity may provide them with an opportunity to review and optimise these processes and introduce new tools to make them more efficient. As the demands from stakeholders continue to grow and change, it is important to ensure that these processes are continuously reviewed to ensure they are adequate for ECB lawyers' work.

4.7 Enriched metadata and enterprise search

The aim of one of the activities in the EIM Strategy is to provide an intuitive enterprise search capability that will allow users to locate relevant data and information across ECB systems in a timely and accurate manner. This activity will address the fact that ECB information may be scattered throughout different systems and that, in order to perform their tasks, ECB staff will need to spend an increasing amount of time searching in multiple applications to find relevant information.

Automating the capture of, and enriching the metadata on ECB documents will enhance the retrieval of ECB information and facilitate the creation (and successful implementation) of an enterprise search tool. This activity will, therefore, increase the time ECB staff spend on their core tasks, while reducing the time spent on searching and switching between systems.

An enterprise search tool will also provide insights from new sources, as information will be more easily discoverable. This will in turn improve decision-making at the ECB.

For the ECB's Legal Services, this activity could provide several benefits: lawyers will spend less time searching for information as they will be able to use a single interface for multiple systems, and the relevance of the results will improve due to the enriched metadata. It will also ensure that ECB lawyers can be confident that they have consulted all the necessary documents before taking their decisions.

5 Conclusion

Technology and lawyers are now inextricably linked. Not only do lawyers need to adopt new technology but they should also be involved in the shaping of this new technology to ensure that their information needs are met.

¹¹ See, for example, Clifford Chance White Paper, *Applying Continuous Improvement to high-end legal services*, 2014 (last accessed on 23 October 2018).

ECB lawyers are not alone. Recognising that its staff members face these challenges, the ECB is planning to carry out a set of new activities to introduce new technologies and the related governance framework supporting the use of these technologies. ECB lawyers have a unique opportunity to leverage these activities for their own benefits. Together with relevant colleagues, they will be in a position not only to follow the changes, but to lead and contribute to the transformation of their whole profession.

Discussion

Failing or likely to fail but no resolution

Introduction to the discussion

By Alexander Karpf¹

When the BRRD and SRMR were adopted, the hope might have been that the first cases concerning the resolution of, in particular, larger banks would not materialise for some time. However, since then the resolution scheme has already been tested in a number of cases. In those instances, shortcomings were identified, one of them being that banks are declared failing but do not enter into resolution, which leads to unsatisfactory legal and practical consequences, in particular as regards different outcomes in different jurisdictions, as has been demonstrated by the ABLV case.

The following two speakers bring not only their involvement in the legislative process of the BRRD and the SRMR, but also first-hand experience in actual resolution cases. They will give their views on the legal framework both at EU and national level and the ways perceived shortcomings in the process could be overcome. Without going into too much detail given the limited time frame of this session, let me stress the following aspects that I would consider of main importance:

Harmonisation: With the EU resolution framework the conditions for triggering the resolution of a bank have been harmonised. Therefore, it would appear reasonable to consider harmonisation of the triggers for insolvency proceedings of banks that are declared failing, but where resolution measures are not in the public interest.

Effectiveness: The resolution regime was introduced in order to address the shortcomings of normal insolvency proceedings in case of banks to prevent risks for the financial stability and to limit the use of taxpayers' money. The safeguarding of the effectiveness of the legal framework for failing banks that cannot enter into resolution should thus be paramount.

No "Zombie" banks: a bank that has failed should not operate in a legal twilight zone, which could bring about risks to stakeholders involved, and in particular to depositors, especially when the banking licence cannot be withdrawn (yet).

With this in mind, one should not be too dogmatic whether the best way to approach this unsatisfactory situation is legislative, regulatory or supervisory initiatives or a combination thereof, but to come to a solution that can be swiftly implemented and reduces the legal complexity, so that all authorities involved can deal with failing banks in an appropriate manner without running the risk of being embroiled in endless court procedures at national and EU level.

I am confident that the following two presenters will make valuable contributions to this important discussion that will have to take place at the relevant fora as soon as possible.

¹ Head of the SSM Law Section, European Central Bank.

Failing or likely to fail but no resolution – what then?

By Emilie Yoo¹

1 Introduction

Banks are subject to normal insolvency proceedings in most countries. Yet the special nature of banks often makes it difficult to wind down a troubled bank in the same way as any other failing business in normal insolvency proceedings. The failure of – in particular systemically important – banks can cause severe disruptions to the financial system and even the functioning of an entire economy. Indeed, during the previous financial crisis European Union Member States had to bail out a number of banks with public funds² to prevent widespread disruption to the financial markets and the real economy in the absence of adequate tools for dealing efficiently with the failure of banks.

Among the lessons learned from the crisis, an effective resolution regime for banks was seen as a necessary alternative to normal insolvency proceedings which normally involve a less orderly process.³ To ensure that banks could fail in an orderly manner without endangering the financial system and requiring public sector support, therefore, the Union legislator established a framework for the resolution of banks by adopting two main pieces of legislation in 2014, namely Directive 2014/59/EU (the “BRRD”)⁴ and Regulation (EU) No 806/2014 (the “SRM Regulation”)⁵.

The Union resolution framework was applied in two recent cases, with the consequence that a bank was determined as “failing or likely to fail”, but the resolution authority in fact determined that there was no need for resolution actions because public interests were not at stake. As resolution is understood as an alternative to normal insolvency proceedings and should only take place if necessary

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² Between October 2008 and December 2012, Member States provided more than €590 billion of government support to the financial sector, see European Commission press release of 20 December 2013, [IP/13/1301](#).

³ See the legislative proposal of the European Commission regarding the BRRD, COM (2012) 280 final, 6.6.2012, p. 5.

⁴ Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190).

⁵ Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OJ L 225, 30.7.2014, p. 1).

to safeguard public interests such as the stability of the financial system, a bank in the aforementioned situation would normally go into normal insolvency proceedings.

In practice, however, it became clear that the consequence for a bank in such a situation can vary from Member State to Member State depending on the applicable national framework. More specifically, in one of the two cases the bank, which was determined as failing or likely to fail and for which the resolution authority determined that there was no public interest in taking resolution actions, could not enter winding-up proceedings at national level because the conditions for this were not considered to be fulfilled under national law.

In view of the above, this article primarily aims to raise awareness of the possibility that a bank which has been determined as failing or likely to fail might neither be resolved nor put into insolvency proceedings, and consider whether this situation was envisioned when the possibility of bank resolution was introduced at Union level as an alternative to normal insolvency proceedings. The following part first describes the issue at stake based on a more detailed look at the two cases in question (Section 2). The relevant legal framework at both Union and national level will then be examined (Section 3). Finally, the article will provide a conclusion (Section 4).

2 Issue at stake

In general, bank resolution occurs when a failing bank cannot go through normal insolvency proceedings without harming public interests, in particular causing financial instability.⁶ This would mean that if the failure of the bank would not endanger public interests, it should usually enter normal insolvency proceedings like any other corporate entity.

Two recent cases have demonstrated, however, that such an understanding of the interrelationship between resolution and normal insolvency proceedings may not be fully supported by the applicable legal framework.

The first case concerns Italian banks. In June 2017, the European Central Bank (ECB) as the competent supervisory authority determined that Banca Popolare di Vicenza S.p.A. (BPVi) and Veneto Banca S.p.A. (VB) were failing or likely to fail in accordance with Article 18(1)(a) and Article 18(4)(a) of the SRM Regulation, as the two banks repeatedly breached supervisory capital requirements.⁷ On the same day, the Single Resolution Board (SRB) as the competent resolution authority determined that resolution action with respect to these banks was not necessary in the public interest in accordance with Article 18(1)(c) and Article 18(5) of the SRM Regulation. The SRB considered in particular that the failure of these banks was not likely to result in significant adverse effects on financial stability, and that normal Italian insolvency proceedings would achieve the resolution objectives to the same extent

⁶ See [European Commission](#).

⁷ See [ECB press release](#) of 23 June 2017.

as resolution.⁸ The SRB concluded that as a consequence, the winding up of these banks will take place under Italian insolvency proceedings.⁹ Subsequently, it was announced on 26 June 2017 that the Italian Ministry of Economy and Finance, acting on the proposal of the Banca d'Italia, put the two banks into compulsory administrative liquidation in accordance with the Italian Decree Law of 25 June 2017.¹⁰

In the second case, which occurred in 2018, the ECB as the competent supervisory authority determined that ABLV Bank Luxembourg S.A. (ABLV Luxembourg), a Luxembourgish credit institution, was failing or likely to fail in accordance with Article 18(1)(a) and Article 18(4)(c) of the SRM Regulation as the bank was likely unable to pay its debts or other liabilities as they fall due.¹¹ On the same day, the SRB decided that resolution action was not necessary in the public interest in accordance with Article 18(1)(c) and Article 18(5) of the SRM Regulation. The SRB assessed that the functions performed by ABLV Luxembourg were not critical and the failure of the bank was not likely to result in significant adverse effects on financial stability in Luxembourg or in other Member States.¹² The SRB concluded that as a consequence, the winding up of this bank will take place under the law of Luxembourg.¹³ On 9 March 2018, however, the Luxembourg District Court rejected the request to put ABLV Luxembourg into national winding-up proceedings¹⁴ and instead imposed a suspension of payments in accordance with the applicable national framework¹⁵.

Although the situation of the Italian banks and ABLV Luxembourg were comparable in that all the banks were determined as failing or likely to fail while resolution action was deemed not necessary in the public interest in accordance with the Union resolution framework, the outcomes of these two cases were substantially different. The Italian banks were liquidated in accordance with the applicable national insolvency law, while in Luxembourg the competent national court rejected the initiation of winding-up proceedings in respect of ABLV Luxembourg and instead imposed a suspension of payments, which prohibits payments by the bank and is only temporary in nature by virtue of law¹⁶.

Overall, these two cases highlight that the outcome of a bank that has been determined as failing or likely to fail but for which there is no public interest can vary from Member State to Member State and may not necessarily lead to such a bank being placed into normal insolvency proceedings.

⁸ See in particular the [summaries of the SRB's decision](#) in relation to BPVi and VB.

⁹ *ibid.*

¹⁰ See [Banca d'Italia press release](#) of 26 June 2017.

¹¹ See [ECB press release](#) of 24 February 2018.

¹² See the [summary of the SRB's decision](#) in relation to ABLV Luxembourg.

¹³ See [SRB press release](#) of 24 February 2018.

¹⁴ See [ABLV press release](#) of 9 March 2018; Baltic News Network, 25 June 2018, "Potential investors want ABLV Bank's owned bank in Luxembourg".

¹⁵ See [CSSF press release](#) (18/09) of 9 March 2018.

¹⁶ See Article 122 of the Luxembourgish Law of 18 December 2015 on the resolution, reorganisation and winding up measures of credit institutions and certain investment firms and on deposit guarantee and investor compensation schemes.

3 Legal framework

This part examines the relevant legal framework, both the Union resolution framework (Section 3.1) and the national insolvency triggers in a selected number of Member States (Section 3.2), to see how the aforementioned bank situation should be treated.

3.1 Union resolution framework

3.1.1 Conditions to enter resolution

Before examining what the Union legislator intended for the treatment of a failing bank in the absence of public interest, it seems useful to briefly recall the general conditions for resolution under the Union resolution framework.

According to the BRRD and the SRM Regulation, the resolution authority shall take a resolution action in respect of an entity if the authority considers that all resolution conditions are met. The resolution conditions, as laid down in Article 32(1) of the BRRD and Article 18(1) of the SRM Regulation, are threefold and need to be met cumulatively:

1. the entity is failing or likely to fail;
2. having regard to the timing and other relevant circumstances, there is no reasonable prospect that any alternative private sector measures or supervisory action would prevent the failure of the entity within a reasonable timeframe; and
3. a resolution action is necessary in the public interest (“public interest test”).

For the purpose of determining “failing or likely to fail” under the first condition above, Article 32(4) of the BRRD and Article 18(4) of the SRM Regulation stipulate that an entity shall be deemed to be failing or likely to fail if it meets any one of the following circumstances:

- the entity infringes or there are objective elements to support a determination that the entity will, in the near future, infringe the requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation;
- the assets of the entity are or there are objective elements to support a determination that the assets of the entity will, in the near future, be less than its liabilities ((likely) over-indebtedness);
- the entity is or there are objective elements to support a determination that the entity will, in the near future, be unable to pay its debts or other liabilities as they fall due ((likely) illiquidity); or

- extraordinary public financial support¹⁷ is required subject to certain exceptions.

For the purpose of carrying out the public interest test under the third condition above, Article 32(5) of the BRRD and Article 18(5) of the SRM Regulation provide that a resolution action shall be treated as in the public interest if (i) it is necessary for the achievement of and is proportionate to one or more of the “resolution objectives” and (ii) winding up of the entity under “normal insolvency proceedings” would not meet those resolution objectives to the same extent.

In this context, resolution objectives are further specified in Article 31(2) of the BRRD and Article 14(2) of the SRM Regulation as follows: “(a) to ensure the continuity of critical functions; (b) to avoid a significant adverse effect on the financial system, in particular by preventing contagion, including to market infrastructures, and by maintaining market discipline; (c) to protect public funds by minimising reliance on extraordinary public financial support; (d) to protect depositors covered by Directive 2014/49/EU and investors covered by Directive 97/9/EC; (e) to protect client funds and client assets”. According to Article 31(3) of the BRRD and Article 14(3) of the SRM Regulation, the resolution objectives are of equal significance, and shall be balanced as appropriate to the nature and circumstances of each case.

In addition, normal insolvency proceedings are defined in the BRRD as “collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator or an administrator normally applicable to institutions under national law and either specific to those institutions or generally applicable to any natural or legal person”.¹⁸ Normal insolvency proceedings thus involve some type of divestment of a bank under administrative or judicial control for the purpose of collective satisfaction of creditors.

A bank will only enter resolution if the resolution authority assesses that all three aforementioned resolution conditions are met.

3.1.2 Resolution – “an alternative to normal insolvency procedures”

According to the legislative proposal for the BRRD, “resolution” is considered as “a special insolvency regime for institutions” and “an alternative to normal insolvency procedures” which is introduced in order to substitute normal insolvency proceedings where the latter cannot appropriately consider the need to avoid disruptions to financial stability, maintain essential services or protect depositors.¹⁹

In addition to the legislative proposal, the fact that resolution is considered as a “true” alternative to normal insolvency proceedings under the Union resolution framework

¹⁷ According to Article 2(1)(28) of the BRRD, “extraordinary public financial support” means State aid within the meaning of Article 107(1) TFEU, or any other public financial support at supra-national level, which, if provided for at national level, would constitute State aid, that is provided in order to preserve or restore the viability, liquidity or solvency of an institution [...]”.

¹⁸ Article 2(1)(47) BRRD.

¹⁹ See the legislative proposal of the European Commission regarding the BRRD, COM (2012) 280 final, 6.6.2012, page 5.

is evident from a number of recitals of the BRRD/SRM Regulation as well as the public interest test that constitutes the third condition for resolution.

According to recital (45) of the BRRD, “[a] failing institution should in principle be liquidated under normal insolvency proceedings. However, liquidation under normal insolvency proceedings might jeopardise financial stability, interrupt the provision of critical functions, and affect the protection of depositors. In such a case it is highly likely that there would be a public interest in placing the institution under resolution and applying resolution tools rather than resorting to normal insolvency proceedings. The objectives of resolution should therefore be to ensure the continuity of critical functions, to avoid adverse effects on financial stability, to protect public funds by minimising reliance on extraordinary public financial support to failing institutions and to protect covered depositors, investors, client funds and client assets.”

According to recital (46) of the BRRD, “[t]he winding up of a failing institution through normal insolvency proceedings should always be considered before resolution tools are applied”.

In addition, according to the public interest test a resolution action may only be applied if resolution is necessary for the achievement of one or more resolution objectives and if the winding up of an institution under normal insolvency proceedings would not achieve the resolution objectives to the same extent.

By implication, if resolution action is “not” deemed necessary in the public interest for a bank that otherwise meets the other conditions for resolution, the Union legislator’s view is that such bank should be wound up in normal insolvency proceedings.

This understanding has been clearly laid down in Article 18(8) of the SRM Regulation, which stipulates that if an entity is not placed under resolution on the ground that the public interest criterion is not fulfilled, “the relevant entity shall be wound up in an orderly manner in accordance with the applicable national law”. As the provision refers to winding up “in accordance with the applicable national law”, it is also clear that the Union legislator’s intention is to rely on the applicable national law to ensure that the relevant entity will indeed be wound up in an orderly manner.

3.2 Examples of national insolvency triggers

As seen above, the fate of a bank which has been determined as failing or likely to fail but for which resolution action is not considered necessary in the public interest is determined by the applicable national (insolvency) law.

Whether such a bank will become subject to insolvency proceedings depends primarily on whether the conditions for initiating normal insolvency proceedings under the applicable national law (national insolvency triggers) are met in respect of a bank which has been determined as failing or likely to fail in accordance with the Union resolution framework (resolution triggers). In other words, are the national insolvency triggers and the resolution triggers aligned?

With this question in mind, the following part examines the national insolvency triggers of a selected number of Member States, namely Italy and Luxembourg in consideration of the two recent cases, as well as Germany and Spain (see the summary of these national insolvency triggers in Table 1 below).

In Italy, winding-up proceedings for banks take the form of compulsory administrative liquidation initiated by public authorities. Article 80 of the Italian Consolidated Banking Law in conjunction with Articles 17 and 20 of the Legislative Decree 180/2015 transposing the BRRD provide that where the conditions for entering resolution (as defined in the BRRD) are met but resolution action is not ordered because there is no public interest, compulsory administrative liquidation is initiated. Initiation is ordered by the Ministry of Economy and Finance acting on a proposal from the Banca d'Italia.

In Luxembourg, only the Commission de Surveillance du Secteur Financier (the Financial Sector Supervisory Commission – CSSF) or the State Prosecutor may apply to the court to order the dissolution and winding up of an institution. The conditions for initiating winding up proceedings are laid down in Article 129 of the Law of 18 December 2015²⁰, which provides that the dissolution and winding up may take place where:

- (i) it is apparent that the suspension of payments scheme, as previously decided upon by the court, is not able to rectify the situation which caused it;
- (ii) the financial situation of the institution is shaken to such an extent that the institution will no longer be able to comply with the commitments with respect to the rights to claim or participate;
- (iii) the authorisation of the institution was withdrawn and this decision became final.

In Germany, insolvency proceedings for credit institutions may only be initiated by the submission of an application to the court by the Bundesanstalt für Finanzdienstleistungsaufsicht (the Federal Financial Supervisory Authority – BaFin) in accordance with Section 46b of the German Banking Act. Such application can be based on three grounds for insolvency. The first is “illiquidity”, i.e. the inability of an entity to meet due payments.²¹ The second is “imminent illiquidity”, i.e. an entity is likely unable to fulfil payments when they fall due; however, BaFin can submit an application on this ground only with the consent of the concerned institution itself.²² The third ground for initiating insolvency proceedings is “over-indebtedness”, i.e. when the assets of a debtor no longer cover its liabilities.²³

In Spain, Article 2(1) of the Spanish Insolvency Act²⁴ provides that a declaration opening insolvency proceedings shall be appropriate in the event of insolvency of a common debtor. Paragraph (2) of the same provision defines the state of insolvency

²⁰ Law of 18 December 2015 on the resolution, reorganisation and winding up measures of credit institutions and certain investment firms and on deposit guarantee and investor compensation schemes.

²¹ Section 17 of the German Insolvency Act.

²² Section 18 of the German Insolvency Act; Section 46b(1) of the German Banking Act.

²³ Section 19 of the German Insolvency Act.

²⁴ Act 22/2003, dated 9th July, on Insolvency, as amended.

as a situation where a debtor is unable to duly fulfil his obligations as they fall due. The state of insolvency may be either current or imminent.²⁵

Table 1
Overview of national insolvency triggers for banks in four Member States

Member State	Legal reference(s)	Insolvency grounds
IT	Article 80 of the Consolidated Banking Law / Articles 17 and 20 of Legislative Decree No 180 of 2015	Where the conditions for entering resolution are met but resolution is not ordered because of a lack of public interest
LU	Article 129 of the Law of 18 December 2015 on resolution, reorganisation and winding up measures	<ol style="list-style-type: none"> 1. It is apparent that the suspension of payment scheme, as previously applied, is not able to rectify the situation which caused it; 2. The financial situation of the institution is shaken to such an extent that the institution will no longer be able to comply with the commitments with respect to the rights to claim or participate; or 3. The authorisation of the institution was withdrawn and this decision became final.
DE	Section 46b(1) of the Banking Act in conjunction with Sections 17-19 of the Insolvency Act	<ol style="list-style-type: none"> 1. Illiquidity (i.e. inability to fulfil due payments); 2. Imminent illiquidity (i.e. likely inability to fulfil payments when they fall due)²⁶; or 3. Over-indebtedness (i.e. assets no longer cover liabilities)
ES	Article 2 of Act 22/2003 on Insolvency	Current/imminent state of insolvency (i.e. (likely) inability of a debtor to duly fulfil his/her obligations)

Based on the above, a number of observations can be made. In Italy, it seems that the national insolvency triggers are fully aligned with the resolution triggers, since a bank which has been determined as failing or likely to fail but for which resolution is not ordered only due to the absence of public interest is put into compulsory administrative liquidation. This outcome was confirmed in the case of BPVi and VB, which were put into compulsory administrative liquidation following the ECB's failing or likely to fail determination and the no public interest assessment by the SRB.

In the other Member States, it can be observed that the national insolvency triggers are not always aligned with the resolution triggers. For one, the reason for the failing or likely to fail determination, which focuses on the “prudential” situation of a bank, i.e. (likely) breaches of prudential requirements that would justify the withdrawal of its authorisation, does not seem to be a ground to initiate insolvency proceedings at national level, although the possibility that such a bank situation could still meet one of the national insolvency grounds cannot be ruled out. State aid, which is a ground for a failing or likely to fail determination, cannot be found in the national insolvency triggers of those Member States either.

However, there are also similar triggers for resolution and national insolvency such as illiquidity or over-indebtedness. In Germany, for example, both illiquidity and over-indebtedness, which are also grounds for the failing or likely to fail determination, are grounds for initiating national insolvency proceedings. It seems that resolution triggers are set earlier in terms of timing, though, as they also cover “likely” illiquidity and “likely” over-indebtedness, in comparison to the insolvency

²⁵ See Article 2(3) of the Spanish Insolvency Act (as cited above).

²⁶ An application to initiate insolvency proceedings based on this ground may only be submitted to the court with the consent of the institution concerned.

triggers under German law²⁷ (see Table 2 below for a better overview of the comparison).

Table 2
Comparison between Union resolution triggers and insolvency triggers in Germany

Failing or likely to fail (BRRD/SRM Regulation)	Insolvency grounds under German law
(Likely) breach of supervisory requirements justifying the withdrawal of the authorisation	N/A
(Likely) over-indebtedness	Over-indebtedness
(Likely) illiquidity	Illiquidity Imminent illiquidity (application to the court based on this ground can only take place with the consent of the bank)
State aid is required (subject to certain exceptions)	N/A

4 Conclusion

The Union resolution framework was established to ensure that banks in financial distress could fail in an orderly manner without endangering public interests, in particular financial stability. Banks should in principle be wound up under normal insolvency proceedings and resolution actions should only be considered where normal insolvency proceedings cannot safeguard public interests to the same extent as resolution. According to the Union resolution framework, if an entity is not placed under resolution on the ground that the public interest criterion is not fulfilled, the relevant entity shall be wound up in an orderly manner in accordance with the applicable national law.

Whether a bank in such a situation will indeed go through normal insolvency proceedings depends on the applicable national law in a given case. However, national insolvency triggers in the Member States of the Union are not necessarily fully aligned with the resolution triggers under the Union resolution framework, as examined above.

As a consequence, in some circumstances and in some jurisdictions, a bank which has been determined as failing or likely to fail but for which resolution is not necessary in the public interest could end up in a limbo situation where it is neither resolved nor able to enter normal insolvency proceedings which would protect the creditors.

This situation would not be in line with what the Union legislator intended in respect of the interrelationship between resolution and insolvency proceedings. It also increases legal uncertainty and interferes with the level playing field in the banking union. It therefore seems vital to ensure that the risks that come with the limbo situation are avoided and that a bank which has been determined failing or likely to fail in the absence of public interest will be placed under national insolvency proceedings.

²⁷ Although “imminent” illiquidity can be a national insolvency trigger, it requires the consent of the bank concerned, which will be difficult to obtain in a practical case. Moreover, it is also not clear whether “imminent” as defined in German insolvency law would be interpreted in a similar way to “likely” illiquidity under the BRRD/SRM Regulation.



Emilie Yoo

Silvia Scatizzi

Failing or likely to fail but no resolution – a possible point of view

By Silvia Scatizzi¹

1 Introduction

The issue of bank insolvency law and particularly its interaction with the resolution framework, established by the Directive on Bank Recovery and Resolution (BRRD)² and by the Single Resolution Mechanism Regulation (SRMR)³ is a current topic of discussion. The discussion has been triggered by three recent cases of banks which were declared failing or likely to fail (FOLF) by the European Central Bank (ECB) and for which the Single Resolution Board (SRB) found that resolution action was not in the public interest. The concerned banks were Banca Popolare di Vicenza, Veneto Banca and ABLV Bank. The course of action provided for by the resolution framework in this circumstance, which is the application of normal insolvency proceedings under national law, led to different outcomes. Banca Popolare di Vicenza and Veneto Banca were put under administrative compulsory liquidation whereas the two legal entities forming the ABLV group were placed respectively under private liquidation in Latvia and under an insolvency “reorganization” proceedings (“suspensions de payments”) in Luxembourg. This presentation examines the relevant provisions of the resolution framework and discusses the issue of a potential harmonisation of bank insolvency proceedings.

2 What types of proceedings does the definition of “normal insolvency proceedings” in Article 2 (47) of the BRRD cover?

The definition in Article 2 (47) of the BRRD defines normal insolvency proceedings as “collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator or an administrator normally applicable to

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² Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190).

³ Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OJ L 225, 30.7.2014, p. 1).

institutions under national law and either specific to those institutions or generally applicable to any natural or legal person”.

This definition is very broad. It refers to national law, and therefore it encompasses any type of insolvency proceedings applicable to institutions under national law. It therefore includes any type of proceedings applicable to a debtor facing financial difficulties, whether reorganization or liquidation; it includes judicial and administrative procedures. In the case of the Latvian ABLV bank, the issue was raised whether a private liquidation procedure may be included in the definition of normal insolvency proceedings. Since the BRRD definition does not have the purpose of harmonising national insolvency proceedings, it seems that any legal mechanism provided for under national law which allows the collective satisfaction of the creditors of the institution may fall under the definition and therefore also including private liquidation procedures.

3 What is the purpose of this definition?

The purpose of the aforementioned definition (and in general of the rule that a bank for which there is no public interest in resolution should be wound up under normal insolvency proceedings in accordance with national law⁴) is to leave to national authorities the responsibility to deal with banks which do not pose problems to financial stability. It concerns the case of banks, which do not carry out critical functions for the economy and whose failure would not have any negative consequence for the financial system: for instance, very small banks or a residual bank, after the critical functions have been transferred to a purchaser or to a bridge bank. If a bank does not carry out critical functions or if such functions have been removed from a bank, such bank does not pose any threat to financial stability and therefore there is no reason for treating it differently from an ordinary company and for applying resolution, whose main purpose is ensuring financial stability. Therefore, the resolution framework leaves the responsibility of dealing with it to national authorities under national law. This is in line with the principle of subsidiarity, established by Article 5 of the Treaty of European Union according to which the Union shall act only if and in so far as the objectives of an action cannot be sufficiently achieved by the Member States, but can rather be better achieved at Union level. Since the objective of the resolution framework is to ensure financial stability throughout the Union, when financial stability is not threatened, Union action is not justified. Other objectives, such as the collective satisfaction of creditors, can be better achieved at Member State level.

⁴ In accordance with Article 32 (1) and (5) of the BRRD and Article 18 (1) and (5) SRMR resolution action may only be taken when it is in the public interest, i.e. only if winding up under normal insolvency proceedings would not meet the resolution objectives to the same extent.

4 Is a harmonisation of bank insolvency proceedings desirable?

The principles of subsidiarity and proportionality for any Union action would require strong arguments to support the case for any harmonisation of bank insolvency proceedings. Once the protection of financial stability has been ensured by the application of resolution tools when necessary, it seems that the general objectives of insolvency law which are to satisfy the creditors and to protect the stakeholders involved (debtor, creditors, including employees and tax agencies, guarantors of debts, suppliers, etc.) can be sufficiently achieved at national level.

In connection with the recent cases, calls have been made for a harmonisation of insolvency proceedings for banks, as the differences in the insolvency regimes applicable to banks at national level do not ensure the same outcome in terms of treatment of banks, which have been declared FOLF but for which there is no public interest in resolution⁵.

It may be argued, however, that different outcomes are the result of different policy choices at national level, aimed to protect – possibly to a different extent from Member State to Member State – different interests, such as the preservation of existing employment, the maximization of the value of a business, the protection of certain classes of creditors. While the objective of maintaining financial stability, which is the purpose of the BRRD/SRMR, can be better achieved at EU level, it seems arguable that the other interests identified above can be effectively protected at national level. In addition, harmonising insolvency proceedings would be a challenge. It is common knowledge that the objectives of insolvency proceedings differ, e.g. simple liquidation of assets or as an alternative reorganisation in an aim to rescue the business and to preserve employment. The procedural and substantive insolvency rules also differ widely. One can therefore imagine that the harmonisation of insolvency proceedings would not be easy to achieve, as it would seek to replace widely different national rules grounded in the social, economic and cultural traditions of the Member States with a set of common rules.

On the other hand, it is notable that the framework introduced by the BRRD/SRMR at Union level is incomplete in respect of an important part, i.e. the liquidation of the assets and the distribution of the proceeds to creditors, is missing. It may be argued that a harmonisation of the liquidation process would ensure equal treatment of creditors and other stakeholders throughout the Union and would facilitate the application of the principle that creditors cannot receive a worse treatment in resolution than the treatment they would have received in insolvency (“No-Creditor Worse Off” (NCWO) principle). This problem is particularly relevant in the Banking Union, in which nineteen different national insolvency proceedings apply. These divergent regimes represent a challenge for the analysis of the insolvency counterfactual compared to resolution for a cross-border bank, an analysis that the

⁵ See for instance IMF Euro Area Policies, Financial Sector Assessment Process, [Technical Note, Bank Resolution and Crisis Management](#), July 2018, paragraph 28, and J. Deslandes and M. Magnus, “[Further harmonising EU insolvency law from a banking resolution perspective](#)”.

SRB is required to conduct for both the purposes of the public interest test⁶ and of the application of the NCWO principle⁷.

Another argument that could plead in favour of a harmonisation is the benefits that a harmonised liquidation procedure would bring to a single European Deposit Insurance Scheme (EDIS). The Commission has tabled a proposal to set up such a scheme in the Banking Union⁸ and the European legislators are currently dealing with it. In the case of a bank failure, a deposit insurance scheme (DGS) pays the insured depositors and then becomes creditor of the insolvent bank for the same amount. In order to recover such credit, EDIS, like any DGS, would have to submit a claim in the insolvency proceedings of the failed bank. Harmonised insolvency proceedings at Union level would ensure that the same treatment would apply to claims by both EDIS and the national DGSs in terms of speed, efficiency and effectiveness irrespective of where the insolvency estate is situated.

At any event, in this context, a number of questions should be explored in view to support the case for harmonisation. What kind of problems do the differences in bank national insolvency proceedings create? Are these problems due to a lack of harmonisation of insolvency proceedings or rather to a lack of harmonisation of the conditions for the withdrawal of the bank authorisation? What kind of common outcome is desirable for banks declared FOLF but for which there is no public interest in resolution? Simply, that all these banks undergo normal insolvency proceedings within a given timeframe, irrespective of the type of proceedings to be applied? Or is it desirable that these banks are subject to the same type of harmonised insolvency proceedings in the different Member States? For example, should one consider only liquidation proceedings, excluding any type of reorganization?

Finally, the harmonisation of insolvency proceedings for banks is not to be confused with the policy, envisaged in the Commission Non-Performing Loans (NPL) action plan, of enhancing the procedures (individual and collective, including insolvency) for the accelerated enforcement of collateral⁹. This policy, considers banks in their position as creditors and not as debtors as it concerns the procedures used by banks for recovering debts from defaulting creditors. The goal of this policy is to improve the efficiency of loan enforcement procedures to enable banks to manage better the NPLs and to reduce the overall risks to financial stability in the Union. As such, the policy is justified by very different reasons from the harmonisation of bank insolvency law and it appears worthy of pursuing the policy because it contributes to strengthening banks as going concern rather than gone concern.

⁶ Pursuant to Article 18 (5) SRMR, resolution is necessary in the public interest only if winding up the bank under normal insolvency proceedings would not meet the resolution objectives to the same extent (i.e. ensuring critical functions, protecting stability of financial system, public funds, depositors and client funds/assets).

⁷ See Eurofi article by Elke Koenig, "[Why we need an EU liquidation regime for banks](#)".

⁸ Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme, COM/2015/0586 final – 2015/0270 (COD).

⁹ See Communication from the Commission on [Completing the banking union](#).

5 What would harmonisation entail?

The harmonisation of insolvency proceedings for banks could be very comprehensive or limited in certain aspects. The most comprehensive reform could be to introduce administrative liquidation proceedings similar to the specialized administrative insolvency regime for banks provided by the US legislation under the authority of the Federal Deposit Insurance Corporation. This would be a complete overhaul, as most Member States' legal systems do not provide for administrative insolvency regimes but only for insolvency proceedings led by courts.

A second possibility could be to identify certain crucial aspects of bank insolvency proceedings that would need to be harmonised to ensure certain common outcomes. The simplest harmonisation could focus on the triggering conditions and on the timing for commencement of proceedings in case of FOLF declaration and no public interest in resolution. It could be explored if the harmonisation of these elements would need to be accompanied by any amendment of the conditions for the withdrawal of the banking authorization.

Another possibility could be a deeper harmonisation of further aspects of the proceedings. One could examine whether a need for harmonisation of certain issues is greater than for other issues. By way of example, possible areas worthy of harmonisation might be: (i) the responsibility for the initiating commencement; (ii) the avoidance actions; (iii) the rules on termination of contracts, in particular labour contracts; (iv) the treatment of groups of companies in insolvency proceedings; and (v) the rules for practitioners and courts to communicate and coordinate insolvency matters having effects in two or more Member States.

Panel 4

Inviolability of the ECB's archives and
the role of national central banks and
national competent authorities



Introduction to the panel on the inviolability of the ECB's archives and the role of national central banks and national competent authorities

By Fabian von Lindeiner¹

1 Background

One would hardly expect the archive of a central bank to be the subject of intense legal debate and political action. Yet this is exactly what we are currently witnessing with respect to the archives of the European Central Bank (ECB).

The official archive accessible via the ECB's public website actually appears rather harmless. It comprises meeting minutes of the Committee of Governors of the Central Banks of the Member States of the European Community between 1964 and 1987, and a couple of released records dating back to the 1970s concerning preparatory work on monetary union.²

Nevertheless, in recent years there has been significant controversy surrounding the ECB's archive. Discussion has revolved around the scope and structure of the archive as well as its legal status and protection from undue interference by Member State authorities.

The preliminary climax of this controversy was reached in July 2018, when the European Commission issued its reasoned opinion on the seizure by Slovenian law enforcement authorities of ECB documents held by Banka Slovenije. This reasoned opinion underlines the Commission's view that Slovenia infringed its obligations under European Union law; and as a next step in these infringement proceedings, the European Commission can take the matter to the Court of Justice of the European Union. The Slovenian case followed another, less contentious, case that had occurred in Cyprus a few years before.

What is this all about, and why are the ECB's archives so topical nowadays?

¹ Head of the Governance and Civil Service Law Section, European Central Bank.

² See [About the Archives](#).

2 The cases of Cyprus and Slovenia

The attention of legal experts was drawn to the ECB's archives in 2013 when Cypriot authorities started to investigate the reasons for the banking crisis that affected the country's financial system in 2012-13. On two occasions, police authorities served search warrants without notice against the Central Bank of Cyprus. During the searches they confiscated hard disks and backup tapes, both of which included not only data of the national central bank but also ECB documents and information. The ECB and the Central Bank of Cyprus objected to the detention of these documents, invoking the inviolability of the ECB's archives. Their objections aimed to ring fence ECB documents through measures of organisational control. A technical solution was ultimately found that relied on indexation of the documents, and the ECB documents were effectively excluded from the subsequent investigation.

A similar situation occurred in Slovenia in 2016, when local law enforcement authorities looked into the causes of the 2013 bank bailout. The investigation focused, inter alia, on staff of Banka Slovenije, including the Governor at the time. In July 2016, a number of documents and computers were seized at the premises of the central bank. The ECB immediately contested the seizure. It argued that some of the digital or physical documents were protected under the Protocol on privileges and immunities, under which ECB archives are off-limits to national judicial authorities. The situation was different from the one in Cyprus in that the Slovenian police proceeded immediately with processing – and even printing – the information seized. Any ring-fencing would have come too late.

After several attempts at collaboration with the law enforcement authorities had failed, in part due to different prevailing views on the scope of the ECB's archives, the ECB took legal action in the Slovenian courts. The aim, of course, was not to interfere with the pre-criminal investigations but to protect the ECB's archives, which are not relevant for the inquiry and whose disclosure is not in the interests of the ECB due to reasons of confidentiality.

When its legal action was unsuccessful, the ECB filed a constitutional complaint before the Slovenian Constitutional Court. The final judgement of the Constitutional Court dismissed the complaint as inadmissible. It held that the ECB, as a legal entity of public law, lacked standing with regard to the procedural fundamental rights it had invoked under the Slovenian constitution. The Constitutional Court also left open the scope of the ECB's archives, and on neither of these contentious matters did it request a preliminary ruling from the Court of Justice of the European Union. The judgement thus effectively denied the ECB access to judicial protection and rendered ineffective the inviolability of the ECB's archives as guaranteed by primary Union law.

As different as these two case studies may be in terms of process and outcome, they both raise important legal issues. How are the ECB's archives structured, and who decides what belongs to these archives? And how can the archives be effectively protected against undue interference by national authorities?

3 Legal issues

At the heart of this discussion lies Article 2 of Protocol (No 7) on the privileges and immunities of the European Union. It applies to the ECB by virtue of Article 22, and states in refreshing brevity:

“The archives of the Union shall be inviolable.”

There are two major issues that this provision leaves open. First, it does not define the scope of the ECB’s archive, in other words what kind of documents and information are part of it. This substantive scope could for instance be defined, in line with Article 3 of the Headquarters Agreement concluded between the ECB and the Government of the Federal Republic of Germany in 1998, as:

“all records, correspondence, documents, manuscripts, photographs, films, sound recordings, computer programs and tapes or disks belonging to or held by the ECB, and to all information contained therein, irrespective of its location.”

Second, Article 2 of the Protocol does not define the concept of “inviolability”. A legal description is included in Article 1 of the Protocol that establishes the inviolability of the Union’s premises and buildings. In this respect, inviolability protects from search, requisition, confiscation or expropriation.

A third and very specific feature of the ECB’s archives deserves particular attention. The ECB does not exercise its tasks and responsibilities on its own. It conducts the monetary policy of the Union together with the national central banks of those Member States whose currency is the euro.³ It also carries out its banking supervision tasks within the Single Supervisory Mechanism (SSM) composed of the ECB and national competent authorities.⁴ Both tasks are executed in a specific multi-institutional structure and governance framework comprising both an independent Union institution and Member State authorities. The cases in Cyprus and Slovenia nicely illustrate the problem that this situation creates for the ECB’s archive. In both cases ECB documents were held at national central banks. The ECB had at best indirect possession of its documents, and it had no direct means at hand to protect its archives from seizure. While national central banks are obliged to follow ECB guidelines and instructions⁵, and national competent authorities within the SSM are required to follow the instructions given by the ECB when performing the tasks set out in Article 4 of the SSM Regulation,⁶ in practice the ECB has to rely on the diligence and collaboration of national law enforcement authorities looking to obtain evidence stored at national central banks and competent authorities. It is therefore hugely relevant to explore and confirm the scope of the ECB’s archives and the technical and legal means to protect them.

³ Article 282(1) of the Treaty on the Functioning of the European Union.

⁴ Article 6(1) of Council Regulation (EU) No 1024/2013 conferring specific tasks upon the ECB concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

⁵ Article 14.3 of the Statute of the European System of Central Banks and of the European Central Bank.

⁶ Article 6(3) of Regulation (EU) No 1024/2013.

4 Outlook

The panel discussion at the ESCB Legal Conference 2018 shed light on a number of very relevant aspects of the discussion. The panellists looked at the scope of the ECB's archives in the sense of both what they include and where they may be located. They also examined the protection of the ECB's archives according to primary Union law. Finally, and very importantly, the panel focused on the concrete obligations that flow from the principle of inviolability for institutions that are in physical or at least digital possession of ECB archives.

The discussion is far from complete, however, and it remains very relevant not only for the ECB but also for other European and other international institutions who need to be able to rely on the protection of their archives as one of the customary features of their legal status under public international law. For the ECB, further threats to the inviolability of its archives can be expected, particularly in view of Europe's still vulnerable banking system where shareholders, creditors, enquiry committees and prosecution authorities are – legitimately – very interested in what went wrong with a failing bank. Clarification of the open legal issues would therefore be welcome, and the sooner the better – for the benefit of the ECB, national central banks and competent supervisors, as well as national law enforcement authorities.

The inviolability of the ECB's archives

By Heiko Sauer¹

1 Introduction

In July 2016, in the course of a criminal investigation against central bank officials, Slovenian authorities seized information and hardware at Banka Slovenije, the national central bank of Slovenia. Among these seized documents was information that originated from the European Central Bank (ECB). Since the ECB had not authorised the seizure, the European Commission opened infringement proceedings against Slovenia.² It asserts that any seizure of any document or piece of information of the ECB infringes the inviolability of its archives. This case raises the question whether documents which originate from the ECB but are held by or located at national central banks or by national competent authorities within the Single Supervisory Mechanism (SSM) are covered by the inviolability of the ECB's archives.

2 Privileges and immunities under European Union law

To properly function and carry out the tasks they are presented with, international organisations require a variety of privileges and immunities.³ The concept of “functional necessity” takes into account that international organisations are inevitably located on the territory of a host state and, therefore, especially vulnerable.⁴ Additionally, it is crucial to protect the independence of an organisation's institutions from any interference by its Member States. According to Article 343 of the Treaty on the Functioning of the European Union⁵ (TFEU), the European Union (EU) shall enjoy in the territories of the Member States “such privileges and immunities as are necessary for the performance of its tasks”. In its second sentence, this provision extends its scope explicitly to the ECB. These privileges and immunities are laid down in more detail in Protocol No 7 on the privileges and immunities of the European Union⁶ (Protocol No 7). Article 2 of Protocol No 7 stipulates that “the archives of the Union shall be inviolable”. This provision covers all

¹ Professor of German and European Public Law, Rheinische Friedrich-Wilhelms-University Bonn. The presentation summarises the outcome of my Article “The Scope of the Inviolability of the ECB's Archives Revisited”, 43 *European Law Review* 711-728 (2018).

² European Commission, Press Release IP/17/1184 of 5 May 2017.

³ J. Klabbers (2015), pp. 131 et seq.

⁴ A. Reinisch (2016), p. 1054.

⁵ Consolidated version of the Treaty on the Functioning of the European Union, OJ C 326, 26.10.2012, p. 47–390.

⁶ Protocol (No 7) on the privileges and immunities of the European Union, OJ C 326, 26.10.2012, p. 266–272.

forms and pieces of documents and data as well as their storage.⁷ Under public international law, archives are protected regardless of their location.⁸ Accordingly, the inviolability covers the archives of the ECB inside as well as outside of its premises.⁹ Most importantly, this immunity prevents the Member States from any act of compulsory access to documents or data that form part of the European Union's archives.

3 The scope of the inviolability of ECB's archives

3.1 Criteria for forfeiture of protection under Protocol No 7

The fact that information which enjoys inviolability is protected "wherever located" does not necessarily mean that every ECB document is covered by the inviolability of its archives. A document which an organisation that enjoys immunity transmits to a Member State government is no longer protected because the organisation agrees with the access to the document – and thereby implicitly waives its protection. But under which circumstances does a communication of documents by the ECB to a national authority amount to a waiver of protection under Protocol No 7? Whether or not such communication waives the inviolability of the documents in question depends on the statement the communication implies: can it be reasonably conceived of as a waiver of the inviolability?

The answer to this question has to take into consideration the relationship between the EU institution in question and the national authority: a Member State authority can be associated with the Union so closely that an exchange of documents does not amount to a waiver of immunity.

There are two constellations of such close association of national authorities to the EU. If a Member State authority carries out tasks that have been conferred upon the EU, it cannot be conceived of as an external third party in its relationships vis-à-vis EU institutions. It is then substantially integrated into the EU and acts as its "extended arm".¹⁰ EU information held by the authority is thus covered by the inviolability of the EU's archives. If a national authority, as is the rule, acts on behalf of a Member State, but its action is to a large extent determined by EU law, such dependent status likewise rules out the qualification of an external third party. The national authority is then substantially within the legal sphere of the EU as well. The communication of documents by an EU institution to a Member State authority under

⁷ Denza (2016), pp. 160 et seq.; M. Möldner (2012), para. 20; M. Avbelj (2017), p. 479; Divisional Court, R (Bancoult) v. Secretary of State for Foreign and Commonwealth Affairs (No. 3), [2013] EWHC 1502 (admin), para. 44.

⁸ See P. Cahier (1962), pp. 209 et seq.; E. Denza (2016), p. 159; ILC Yearbook, 1958 Vol. II, at 96; 5th report of the Special Rapporteur of the ILC on relations between states and international organizations (second part of the topic), p. 6 para. 20.

⁹ M. Athen and O. Dörr (2013), para. 44; L.O. Petersen (2011), p. 148.

¹⁰ See, with regard to Article 51(1) of the EU Charter of Fundamental Rights, A. Hatje (2012), para. 17; T. Kingreen (2016), paras 8 and 13; J. Kühling (2009), pp. 680 et seq.

such circumstances does not entail a forfeiture of the protection under Protocol No 7 either. In light of these criteria, the relationship between, first, the ECB and the national central banks and, second, the ECB and the national competent authorities should be analysed.

3.2 Application of the criteria to ECB documents held by national central banks

Pursuant to Article 282(1) TFEU, the ECB and the national central banks shall constitute the European System of Central Banks. As the main part of the interaction between the ECB and the national central banks is carried out within the Eurosystem,¹¹ the presentation will focus on this relationship. Even though the Eurosystem is entrusted with objectives and tasks under the Monetary Union, it is neither vested with any competencies nor does it have the capacity to act.¹² The objectives and tasks of the monetary policy are assigned to the Eurosystem, but they can only be carried out by the ECB and by the national central banks. Since the necessary actions of the ECB's decision-making bodies can therefore not be deemed acts of the Eurosystem, the responsible entity "behind" it must be identified. As the Member States have transferred their powers in the field of monetary policy to the EU pursuant to Article 3(1) TFEU,¹³ any act within the framework of the Eurosystem has to be conceived of as an act on behalf of the EU. In legal terms, every single act or omission in the performance of tasks of the Eurosystem either by the ECB or by the national central banks is attributable to the EU.¹⁴ This makes it unconvincing to consider the national central banks as being external third parties in their relationship with the European Central Bank. A communication of documents by the ECB to a national central bank therefore never amounts to a forfeiture of the documents' protection under Protocol No 7.

In addition, the dependent position of the national central banks towards the ECB within the Eurosystem and the ESCB, as most notably reflected in Articles 9.2, 12.1 and 14.3 of the Statute of the European System of Central Banks and of the European Central Bank¹⁵ (the Statute), does not leave any room for the assumption that they have autonomous status within the Eurosystem and the ESCB. As a result, every ECB document held by a national central bank is covered by the inviolability of the ECB's archives.

¹¹ See F. Becker (2013), para. 47; M. Selmayr (2015), para. 160.

¹² F. Becker (2013), para. 20; B. Dziechciarz (2009), p. 47; U. Häde (2016), para. 2; W. Heun (1998), p. 867.

¹³ See, e.g. C.D. Zimmermann (2013), p. 815.

¹⁴ R. Torrent (1999), pp. 1230 et seq.; R. Smits (1997), pp. 94, 252; R.M. Lastra (2000), p. 173; J. Kokott (2011), para. 44.

¹⁵ Protocol (No 4) on the Statute of the European System of Central Banks and of the European Central Bank OJ C 326, 26.10.2012, p. 230–250.

3.3 Application of the criteria to ECB documents held by national competent authorities within the SSM

The SSM established a new interconnection between the ECB and the Member State supervisory authorities. This interconnection resembles the Eurosystem because it is, in itself, neither an entity vested with legal capacity nor an institution capable of acting. However, there is a significant difference between the Eurosystem and the SSM. While the constituent parts of the Eurosystem jointly perform tasks conferred upon the EU, the SSM effects a sort of “pooling” of the competencies of the Member States and the competencies of the ECB. Therefore, a single responsible entity behind the SSM does not exist: it is not the ECB alone to which it is assigned, but it is the ECB in conjunction with the Member States.¹⁶ Regulation no. 1024/2013¹⁷ (the SSM Regulation) could not confer the task of prudential supervision of financial institutions exclusively upon the ECB – in the sense that this task would subsequently be performed either by the ECB or by the national competent authorities on behalf of the ECB. This understanding of the SSM, as it has been put forward by the General Court in its judgment in the case of *Landeskreditbank Baden-Württemberg v European Central Bank*,¹⁸ contradicts Article 127(6) TFEU.¹⁹ Taking this provision seriously, one cannot but conclude that, as long as the national competent authorities are vested with the responsibility to supervise financial institutions, they carry out tasks of the Member States.²⁰

Therefore, the relationship between the ECB and the national competent authorities and their degree of autonomy within the SSM must be analysed. Starting with the conclusion, there is a variety of good reasons which support the assumption that the national competent authorities are largely in a dependent position vis-à-vis the ECB.²¹ The ECB alone is responsible for the effective and consistent functioning of the mechanism. The ECB's position as a guarantor of the functioning of the SSM distinctly illustrates its key position and already implies a certain degree of control over the national authorities. The latter's supervisory functions with regard to the less significant institutions are indeed performed under the supervision of the ECB which is entitled to issue regulations, guidelines or general instructions with binding effect pursuant to Article 6(5) of the SSM Regulation. Furthermore, the crucial position of the ECB is demonstrated by the fact that it may, at any given time, decide to directly exercise all the relevant powers in relation to one or more of the less significant institutions – if it deems this necessary.

¹⁶ Cf. C. Manger-Nestler (2017), para. 54; M. Lehmann and C. Manger-Nestler (2014), p. 9.

¹⁷ Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, OJ L 287, 29.10.2013, p. 63–89.

¹⁸ Case T-122/15, *Landeskreditbank Baden-Württemberg v European Central Bank*, EU:T:2017:337, paras. 50 et seq.

¹⁹ For the limited scope of Article 127(6) see, e.g. K. Alexander (2015), pp. 166 et seq.; C. Waldhoff (2013), paras. 72 et seq.

²⁰ Cf. G. Ter Kuile, L. Wissink and W. Bovenschen (2015), pp. 160 et seq.; G. Schuster (2014), p. 6.

²¹ See G. Lo Schiavo (2014), p. 132; C. Ohler (2015), § 5 para. 65; A. Thiele (2014), p. 521; U.H. Schneider (2013), p. 455.

Consequently, the national competent authorities are not only in a dependent position when they exercise their prudential supervisory functions, but also in a conditional position. Last but not least, the Member States' control over their supervisory authorities is severely restricted as a consequence of the independence of the national authorities. This reflects the closeness of the integration of the national authorities into a strongly Europeanised system of financial supervision. In sum, the national competent authorities have a considerably dependent position within the SSM. They cannot thus be regarded as external third parties in their relationship with the ECB. Therefore, a communication of documents by the ECB clearly does not imply that the inviolability the documents enjoy under Protocol No 7 is relinquished.

4 Concluding observations

The scope of the inviolability of the ECB's archives has to be understood extensively. As regards documents held on the ECB's premises, virtually no problems will arise. But numerous ECB documents and data are held by national central banks and by national competent authorities. Given the closeness of these actors and the lack of autonomy of the national institutions within both the Eurosystem and the SSM, they cannot be considered "third parties" in relation to the ECB. The communication of documents by the ECB to them cannot, therefore, be construed as implying a waiver of the immunity afforded by Protocol No 7. As a consequence, ECB documents held by national central banks and by national competent authorities are covered by the inviolability of the ECB's archives.

Effectively, the national central banks and the national competent authorities have two different archives: a decentralised European Union archive covered by inviolability under EU law and comprised of all ECB documents – and an archive of their own. The inviolability of the ECB's archives does not only render every measure of compulsory access to ECB documents or data unlawful. It also calls for the establishment of a sufficiently clear separation of documents, and it is incumbent upon national institutions to arrange for a sufficient separation of the different categories of documents. The responsibility to arrange for the necessary respect for the inviolability of the ECB's archives leaves the national authorities with substantial leeway, but they will eventually have to provide for some form of separation between the two categories of documents. Certainly, ECB documents and data must be easily recognisable for domestic authorities so that they can discern the legal limits they have to respect.²²

After all, the recently launched infringement proceedings against Slovenia will help to determine the scope of Article 2 of Protocol No 7 and to increase the sensitivity for the EU's privileges and immunities.

²² It should be sufficient in this regard to refer to the well-established principle under public international law that diplomatic luggage must be clearly marked because it enjoys immunity; cf. Article 27(4) of the Vienna Convention on Diplomatic Relations (500 UNTS 95); J. D'Aspremont (2011), paras 10 et seq.; different opinion E. Denza (2016), p. 160 who denies a requirement to mark documents.

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The protection of ECB archives stored at national central banks: the case of Cyprus

By Christoforos Dimitriou¹

1 Introduction

On the one hand, the topic of this paper borders legal technology. On the other hand, as explained in the last section, it relates to the core of the European unification process. We will look into the protection of the archives of the European Central Bank (ECB) stored at national central banks and, in the context of the Single Supervisory Mechanism (SSM), the national competent authorities. We will do this through the example of ECB archives stored at the Central Bank of Cyprus (CBC), which is both the national central bank of the Republic of Cyprus and the national prudential supervisor for credit institutions. The case under study is the seizure, on two occasions, of CBC's information technology (IT) equipment by Cyprus Police in the context of criminal investigations. As a result of the seizure, the investigators came into custody also of the ECB archives stored on the seized equipment.

We will first refresh our memory about the factual background: the Cypriot banking crisis of 2012-2013, which caused litigation in various fora as well as a series of official enquiries into the root causes of the crisis. In turn, this triggered a quest for information and search warrants were issued by the Court on two occasions. The warrants were executed by the Cyprus Police on the premises of the CBC. This paper gives insight into the execution of the search warrants, presents the measures taken for the protection of ECB information stored on the seized equipment and discusses the solution found at the end regarding the handling of this information by Cyprus Police. In the last section of the paper we will try to draw some lessons.

2 Factual background

The latest international financial crisis started from the United States in 2007-2008 and reached the European coast a few months later. Endogenous fiscal deficiencies came to light. Greece entered its first European Union (EU)/International Monetary Fund (IMF) financial assistance programme in 2010 and other countries followed. In the summer of 2011, the plan for the involvement of the private sector in a Greek

¹ Legal Counsel, Legal Department, Central Bank of Cyprus. The views expressed herein do not necessarily reflect the views of the Central Bank of Cyprus or the European Central Bank. The author would like to thank Ms Ioana Lucia Pasolea, Legal Analyst at the Directorate General Legal Services of the ECB, for reviewing the paper before publication and his family for their encouragement and patience during the making of this paper.

sovereign debt relief was announced: the Private Sector Involvement (PSI). In October 2011 the Euro Summit laid the foundation for a deeper haircut on Greek sovereign debt, the PSI+².

Three Cypriot banks had operations in Greece, namely Bank of Cyprus, Laiki Bank³ and Hellenic Bank. Bank of Cyprus and Laiki Bank had sizeable Greek government bond portfolios that participated in the PSI+. At the same time, the loan portfolios and liquidity of the Cypriot banks were deteriorating in both Greece and Cyprus. Laiki Bank sought state support for its recapitalisation in the first half of 2012. By the end of the first half of 2012, (i) the Cypriot sovereign debt rating fell below investment grade, (ii) almost no private funds were raised for Laiki Bank's recapitalisation and the Cyprus Government had to inject €1.8 billion in state aid and (iii) Bank of Cyprus also applied for state support. All of this culminated in June 2012, with an application by the Republic of Cyprus for an EU/IMF financial assistance and reform programme.

The negotiations for an EU/IMF programme for Cyprus did not conclude soon. By November 2012 the programme's banking sector restructuring requirements had been drafted and a due diligence exercise was under way to calculate the banks' recapitalisation needs. By January 2013 the Eurogroup had made clear that it would wait for the presidential elections in early 2013 in order to conclude the programme with the new Government. Through a series of Eurogroup meetings in March 2013 and amidst turmoil in Cyprus, the restructuring of the Cypriot banking sector within the context of a fully-fledged EU/IMF financial assistance programme crystallised. The programme included a bail-in as no EU/IMF funds would be disbursed for the recapitalisation of Bank of Cyprus or Laiki Bank⁴.

The capital adequacy of Bank of Cyprus was restored through a full contribution by equity and bond holders and, on top of that, a conversion of almost half of the uninsured deposits into shares. Thereafter, Laiki Bank's business was transferred to Bank of Cyprus, except for the uninsured deposits that were left behind in legacy Laiki Bank. With regard to the rest of the banking sector, the EU/IMF financial assistance programme did not preclude recapitalisation by the state using programme funds, and indeed the Cyprus Government injected recapitalisation funds into the cooperative credit sector⁵.

² “[W]e welcome the current discussion between Greece and its private investors to find a solution for a deeper PSI. Together with an ambitious reform programme for the Greek economy, the PSI should secure the decline of the Greek debt to GDP ratio with an objective of reaching 120% by 2020. To this end we invite Greece, private investors and all parties concerned to develop a voluntary bond exchange with a nominal discount of 50% on notional Greek debt held by private investors.”, [Euro summit statement](#) of 26 October 2011.

³ “Laiki Bank” is a commercial name to denote Marfin Popular Bank Public Co Ltd. In 2012 the company was renamed to “Cyprus Popular Bank Public Co Ltd”.

⁴ “[...] The programme money (up to 10bn [Euro]) will not be used to recapitalise Laiki and Bank of Cyprus. The Eurogroup is convinced that this solution is the best way forward for ensuring the overall viability and stability of the Cyprus financial system and its capability to finance the Cyprus economy.”, [Eurogroup statement](#) on Cyprus of 25 March 2013.

⁵ The economic adjustment programme for Cyprus at inception is set out in the [European Commission's occasional paper 149](#), May 2013.

3 Quest for information

The seizure under discussion in this paper, namely that of CBC's IT equipment, represents only a fragment of the instances from 2012-2013 onwards, where criminal investigators and other authorities tried to get a hold of information in CBC's possession. Throughout this period the CBC benefitted from the continuous and indispensable support and guidance of the ECB. We will present below the spectrum of information requests addressed to the CBC in connection with the crisis of 2012-2013.

3.1 Criminal investigation

In principle, criminal investigations in Cyprus are carried out by Cyprus Police. Where necessary, the Attorney General of the Republic of Cyprus gives guidance and instructions to the investigators and subsequently assesses the outcome of the investigation to decide whether to institute proceedings for an offence.

In 2013, after the application of resolution measures on Bank of Cyprus and Laiki Bank, the Attorney General of the Republic of Cyprus requested that a special team be established within Cyprus Police. The mandate of the team was to investigate into the causes of the near collapse of the banking sector and the economy of Cyprus, covering the period from 2006 to 2013. That team carried one of the two seizures under study in this paper. That same team also required on a number of occasions, both before and after the seizure, disclosure of documents from the CBC in the context of their investigations. In order to comply with such requests, the CBC had to identify responsive documents in its files and present them to the investigators.

3.2 Civil litigation and international arbitration

In the aftermath of the crisis, aggrieved depositors and investors in the banking sector initiated litigation against the banks concerned, the Republic of Cyprus and the CBC⁶. The litigation included applications for the judicial review of the resolution measures⁷ and claims for compensation. Such claims were either lodged before Cyprus District Courts or took the form of international arbitration. In the latter case, depositors and investors claimed to be foreign investors falling within the scope of bilateral investment treaties entered into by their country and the Republic of Cyprus.

⁶ Aggrieved depositors and investors lodged litigation also against EU institutions, including the ECB. Please refer to the landmark judgment of the Court of Justice of the European Union of 20 September 2016 in *Ledra Advertising* (Joined Cases C-8/15 P to C-10/15 P, *Ledra Advertising Ltd and Others v European Commission and European Central Bank (ECB)*, ECLI:EU:C:2016:701). See also the judgments of the General Court of 13 July 2018 in *Chrysostomides* (Case T-680/13, *Dr. K. Chrysostomides & Co. LLC and Others v Council of the European Union and Others*, ECLI:EU:T:2018:486) and *Bourdouvali* (Case T-786/14, *Bourdouvali and Others v Council and Others*, ECLI:EU:T:2018:487).

⁷ The landmark judgment on the applications for judicial review was delivered by the Supreme Court of Cyprus on 7 June 2013 in *Myrto Christodoulou* (joined cases 551/2013 etc. v. Central Bank of Cyprus and Republic of Cyprus).

Both in national civil litigation in Cyprus and in international arbitration of investment disputes, the common law concept of “discovery of documents” applies. This means that at some point in the proceedings, after the statements of claim and defence have been filed and before the hearing, the claimant requests the Court or the Tribunal to issue an order against the defendant for a discovery of documents relevant for the dispute and vice versa. As a result the CBC has found itself in a situation where it was required to identify all responsive documents in its “possession, custody or control”⁸ and make them available to the claimants for inspection.

3.3 Other inquiries and requests for access to information

The Cypriot banking crisis of 2012-2013 also triggered parliamentary inquiries and audits by the state auditor⁹. In this context, information and document disclosure requests were addressed to the CBC by committees of the House of Representatives, as well as by the Auditor General of the Republic of Cyprus.

In contrast, a legal framework for public access to information possessed by the CBC or the public sector in general was not available during the years that followed the crisis. This is because, until recently, there was no general regime in Cyprus for public access to information. The law on such access was enacted only in December 2017 with entry into force in December 2018¹⁰.

4 The search warrants

4.1 The execution of the search warrants

Search warrants were issued against the CBC on two occasions, in May 2015 and March 2016. They were executed on the premises of the CBC without notice.

The May 2015 investigation concerned data on credit facilities that had leaked to the press. The credit facilities in question had been granted by a particular credit institution to political parties and persons connected thereto. We were advised that a member of Parliament had submitted the complaint that triggered this investigation into breach of banking secrecy and personal data rules. In executing the search

⁸ This is the usual wording in the rules on evidence that apply or serve as guidance when a Court or Tribunal issues a document production order. See for example the [International Bar Association Rules on the Taking of Evidence in International Arbitrations \(2010\)](#), Article 3.

⁹ According to section 60 of the Central Bank of Cyprus Law of 2002 as amended, the Auditor General of the Republic may carry out financial and management audit of the activities of the CBC that are not related to the CBC’s tasks and competences emanating from the European System of Central Banks, and under the condition that his reports and audit activities do not touch upon the CBC’s independence. For these purposes “management audit” shall mean the audit of the operational efficiency of the CBC’s activities.

¹⁰ Law 184(I)/2017 on the right of access to public sector information, Official Gazette of the Republic of Cyprus, Annex I(I), No. 4633, 22 December 2017.

warrant, the investigators seized hard discs from the computers of the Governor and Governor's office staff. The seizure received press coverage.

The March 2016 search was part of an investigation carried out by the Cyprus Police special team mentioned in Section 3.1 above. The investigators had already received documents from the CBC under a Court order for disclosure of documents. The investigation concerned suspected acts of corruption, said to have occurred around 2006 and involving the Governor of the CBC at that time. In executing the search warrants, the investigators seized back-up tapes containing mailboxes and file shares. There was no press coverage of that search.

In both cases, confidential documents originating from the ECB were also stored on the seized equipment, as well as documents originating from the CBC that contained confidential ECB information.

4.2 [Were the investigations part of an attempt to encroach on central bank independence?](#)

The timing and other circumstances surrounding the May 2015 case suggest, in the author's opinion, that the investigation and in particular the search warrant and the way it was executed were not driven solely by a zeal for law enforcement. In contrast, the March 2016 search was merely a further step in an investigation that had started long before and which, given its subject matter, was not associated with persons in power at the time of the investigation.

The fate of the two investigations in a way confirms the above. Not long after the first seizure of May 2015, the investigators delivered back to the CBC the equipment, stating that no evidence had been found in it and that the investigation was still ongoing. There have been no developments since then. In contrast, the March 2016 investigation ended up in the criminal prosecution of a number of persons, including a former Governor of the CBC.

4.3 [The significance of CBC information](#)

The exact way in which central bank information is relevant for the purposes of criminal investigation varies from case to case. In the May 2015 search, the investigators were trying to trace the itinerary of a particular set of information. They were examining whether the CBC received and disseminated the data subsequently leaked to the press. This pertains rather to a forensic examination into the use of IT equipment. In contrast, the investigators in the March 2016 search were looking for documents relevant content-wise to their investigation to complement the evidence already collected by that time.

4.4 The investigators' options for getting access to CBC information

Criminal investigators in Cyprus have the power and have used it on several occasions to require document disclosure, including from the CBC. Under criminal procedure rules,¹¹ an investigator may issue a written order requiring a person to produce documents necessary or desirable for the purposes of the investigation. The addressee commits an offence if he or she refuses, without reasonable cause, to produce such document or documents. In certain cases, in particular under the anti-money laundering legislation, investigators may apply for a Court order requiring document disclosure¹².

Both in the case of orders addressed to it directly by the investigators and Court orders for disclosure of documents, the CBC had and used the opportunity to withhold disclosure of documents containing ECB information until a proper consultation with the ECB was held. Thereafter, the CBC disclosed the documents in accordance with the outcome of its consultation with the ECB¹³. This has been so even before the entry into force of the consultation requirements set out in Decision (EU) 2016/1162 of the European Central Bank of 30 June 2016 on disclosure of confidential information in the context of criminal investigations (ECB/2016/19)¹⁴.

Contrary to the situation of document disclosure requests, any objection to search warrants is by default post facto. Under Cyprus law search warrants are issued by a judge on the basis of information put before him or her by a criminal investigator under oath¹⁵. For the detention of things seized during the search, a further order is required, to be issued again by a judge. Both orders are quasi Court decisions and need to be reasoned.

The search warrants cannot be appealed. An affected party may apply to the Cyprus Supreme Court for a prerogative writ of certiorari, in essence, asking the Supreme Court to annul the search warrant on grounds of illegality. On the other hand, the order for detention of the things seized can be appealed¹⁶. It is open to debate whether these options to challenge the legality of the seizure, in case they were pursued in the cases under study, could have served as an effective means to protect the confidential ECB information stored on the seized equipment.¹⁷

¹¹ Cyprus Criminal Procedure Law, Cap. 155, section 6.

¹² Section 44 et seq. of Law 188(I)/2007 on the Prevention and Suppression of Money Laundering Activities, Official Gazette of the Republic of Cyprus, Annex I(I), No. 4154, 31 December 2007 as amended.

¹³ In the case of orders issued to the CBC under section 6 of the Criminal Procedure Law, Cap. 155, the withholding of disclosure of ECB information on the part of the CBC could be accommodated under the quasi right to refuse production for reasonable cause foreseen in the same section. No such provision can be found in the rules on Court document disclosure orders; still the requirement for a consultation of the CBC with the ECB prior to disclosure was upheld in practice by both the CBC and Cyprus Police.

¹⁴ OJ L 192, 16.7.2016, p. 73–76.

¹⁵ Cyprus Criminal Procedure Law, Cap. 155, section 27 et seq.

¹⁶ Cyprus Criminal Procedure Law, Cap. 155, section 32A.

¹⁷ For the sake of completeness, the legality of a search warrant or an order for detention can be challenged also in the context of criminal proceedings, that is, in case the criminal investigation culminates in criminal prosecution.

5 Protective measures

In the present section we will examine the steps taken by the CBC and the ECB and the solution found with the Cyprus Police, regarding the handling and the protection of confidential ECB information stored on the seized CBC equipment¹⁸. Throughout the process all three parameters of information security, i.e. confidentiality, integrity and availability, were relevant to some extent and had to be catered for.

5.1 The May 2015 seizure

With the involvement of CBC's IT experts and under the control of the criminal investigators, the hard discs under seizure were copied before being extracted from the computers. One copy remained with the CBC and one served as the forensic copy on which the investigators ran their examinations. Hash values were produced which allow to verify the integrity of the hard disk later on¹⁹. This stage of the process also ensured the availability of the data on the computers of the Governor and her office's staff after the seizure.

The CBC informed the criminal investigators in writing about the presence of ECB confidential information on the seized equipment. The CBC also notified the investigators of their confidentiality obligations with regard to this information under EU law, in particular Article 37 of the Statute of the European System of Central Banks and of the ECB²⁰ and Article 53 et seq. of the Capital Requirements Directive (CRD IV)²¹.

The ECB intervened. The ECB President sent a letter to the President of the Republic of Cyprus invoking the ECB archive inviolability²² under Protocol (No 7) on the Privileges and Immunities of the EU.²³ The ECB engaged a Cyprus lawyer who liaised with the criminal investigators. The ECB also deployed one of its IT experts who processed in the premises of the CBC the copies of the seized equipment to identify ECB documents through key word searches. This yielded a list of ECB documents. The list was first reviewed by the users of the computers from which the hard discs had been extracted to identify any false positive results. Thereafter it was

¹⁸ Both the Legal and Information Technology Department of the CBC, including the CBC's IT security officer at the time, were involved on the side of the CBC. That said, the CBC had no control of the process from start to end, nor was it present in all stages of the process. Therefore, the content of the present section is partly based on the information that other stakeholders kindly shared with the CBC.

¹⁹ A hash value is a numeric value of a fixed length that uniquely identifies data of arbitrary size.

²⁰ Protocol (No 4) on the statute of the European System of Central Banks and of the European Central Bank OJ C 326, 26.10.2012, pp. 230–250.

²¹ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

²² In contrast, when criminal investigation authorities address document disclosure requests to the CBC and the CBC complies with them subject to prior consultation with the ECB regarding confidential ECB information, no violation of the ECB archives is considered to occur.

²³ Protocol (No 7) on the privileges and immunities of the European Union, OJ C 326, 26.10.2012, pp. 266–272.

handed to the investigators who deleted these files from the forensic copies they were working on.

5.2 The March 2016 seizure

Immediately after the seizure, the investigators handed the seized back-up tapes back to the CBC IT department in order for their content to be extracted to hard discs. As in the case of the May 2015 seizure, one copy remained with the CBC and one served as the forensic copy on which the investigators would run their examinations. Analogous remarks about integrity and availability of data apply, as those made in Section 5.1 above.

The CBC informed the criminal investigators about the presence of ECB confidential information on the seized equipment and notified them of their confidentiality obligations, similar to the May 2015 case. The ECB engaged a Cyprus lawyer who liaised with the criminal investigators.

By the time of the March 2016 search, the CBC had acquired experience and built expertise in electronic discovery of documents, an area of legal technology. This happened in the context of international arbitration related to the banking sector, where the Republic of Cyprus had to comply with a series of document discovery requests from the claimants, granted by the Arbitral Tribunal²⁴. Although the CBC was not a party to this arbitration, its acts and omissions, if any, could be attributed to the Republic of Cyprus under the bilateral investment treaties concerned. Hence, in order for the document discovery requests to be addressed in full, the CBC's archives had to be searched as well. The CBC applied a methodology for a sophisticated document search in order to identify individual documents responsive to the discovery requests. This methodology involved the use of software which indexed into separate documents material from various sources (e.g. file shares, mailboxes and scanned paper files), and allowed searches to be conducted with key words and other parameters. By that time, Cyprus Police also had acquired such technology for the purposes of criminal investigations and indeed applied it to process the CBC equipment seized in March 2016.

Against this legal technology background, a keyword list was drafted by the ECB in consultation with Cyprus Police to capture ECB information. The investigators applied this keyword list on the seized information as ingested by their electronic discovery tool. The search results, i.e. the documents that contained one or more of the keywords suggesting that ECB information was contained therein, were deleted from the lot and therefore excluded from further searches for the purposes of the investigation.

²⁴ The international arbitration in question has been mentioned in Section 3.2 above.

5.3 Further considerations

First, we remark that in both the May 2015 and the March 2016 seizure, all stakeholders relied on legal technology. Documents containing confidential ECB information were identified by conducting key word searches. This process entails the risk of failing to identify some of the documents that contain ECB information. On the other hand, the use of legal technology – in particular for the seizure of March 2016 where robust infrastructure specifically built for electronic discovery of documents was used by the investigators – means that the investigators got access to the contents of the seized equipment through a well-structured and documented process. The audit trail functions of legal technology tools constitute an additional safeguard in this respect.

Second, in both the May 2015 and the March 2016 searches, the investigation did not concern the functions of the Eurosystem or the SSM. Hence, once identified, the ECB information that was stored on the seized equipment could be deleted from the lot without hindering the criminal investigation. Obviously, the solution found and applied in the cases under discussion would not serve all stakeholders if the subject matter of the criminal investigation was Eurosystem or SSM relevant.

6 Lessons learned

6.1 Public communication

Communication is crucial where a criminal investigation involves a national central bank or a national competent authority and receives press coverage. It is important that the reasons for any objections to the gathering of evidence, submitted on the basis of EU law and archival inviolability, are properly communicated to the public.

6.2 Quid juris?

The cases under study reveal the boundaries of the current rules and practice regarding the protection and inviolability of ECB's archives. Immunity and inviolability of international institutions' premises and archives derive from the world of diplomatic relationships. The Eurosystem and the SSM have clearly marked a European peoples' step further. These are structures that form part of public governance in the territory of the Member States concerned.

The adoption of the common currency, the participation of the ECB in the negotiation and monitoring of EU/IMF financial assistance programmes, the start of the SSM in November 2014, all these milestones mark the trajectory of European unification and bring along an ever increasing impact of ECB's decisions at the Member State level. These decisions often cause public debate, they affect financial institutions and the financial position of businesses and households and, in times of crisis, may fall within the scope of inquiries, litigation and investigation. Against this background one could

raise the question whether the inviolability of EU institutions' archives is still tenable at the current stage of European integration.

6.3 Early preparation

The cases under study reveal that early preparation of national central banks and national competent authorities in connection with criminal investigation might prove useful. A high level planning could include the following areas:

1. building expertise on forensic IT and electronic discovery of documents;
2. drafting procedures for the interaction with criminal investigation authorities;
3. building trust with criminal investigation authorities.

The obligation of national central banks and national competent authorities to protect the ECB's archives

By Tatyana Filipova¹

The recent cases of seizure of ECB documents held by national central banks (NCBs) triggered a discussion about the implications of the information management of the NCBs and the national competent authorities (NCAs) for the inviolability of the ECB's archives and raised the question of the NCBs' and NCAs' responsibility to protect the ECB's archives held by them.

The analysis below (i) explains the notion of the NCBs and NCAs as decentralised archives of the ECB; and (ii) elaborates on the obligations of the NCBs and NCAs regarding the separation of documents they hold concerning the tasks of the Eurosystem, the European System of Central Banks (ESCB) or the ECB and documents concerning the tasks that they carry out under national law, as well as the NCBs' and NCAs' procedural obligations concerning the production of ECB documents. Particular attention is paid to the question of whether the NCBs' and NCAs' current information management practices are sufficient to ensure compliance with the NCBs' and NCAs' obligation concerning the separation of documents. Finally, the paper looks at some ideas for clearly defining the NCBs' and NCAs' obligation to protect the ECB's archives.

1 Introduction

Pursuant to Article 2 in conjunction with Article 22 of Protocol No 7 to the Treaty on the Functioning of the European Union, the ECB's archives are inviolable. The application of Protocol No 7 in relation to the ECB is also stipulated in Article 39 of the Statute of the European System of Central Banks and of the European Central Bank.

The inviolability of the ECB's archives implies protection against any form of unilateral coercive interference in the archives of the ECB, with the purpose of ensuring the proper and independent functioning of the ECB.

The institutional structure of the Eurosystem, ESCB and Single Supervisory Mechanism (SSM) requires that the ECB's archives protected by Union primary law are located not only at the premises of the ECB but also at those of the NCBs and

¹ Head of the Legal Revision Supervision Section, European Central Bank. I would like to thank Karen Kaiser for her helpful and inspirational comments.

NCAAs.² From that perspective, it is irrelevant where the ECB's archives are located – at the ECB's premises or at those of the NCBs or NCAs – in order for them to enjoy protection.³

As demonstrated earlier in this book,⁴ owing to the particular characteristics of the Eurosystem, ESCB and SSM, the NCBs and NCAs do not qualify as “third or external parties” in the context of the protection of the archives when it comes to exercising Eurosystem, ESCB or ECB tasks. The ECB's archives are decentralised and partially held by the NCBs and NCAs.

The question arises as to how the ECB's archives are organised at the NCBs and NCAs.

The NCBs and NCAs have a dual function – one relating to their respective participation in the Eurosystem, ESCB and/or SSM, and another concerning their capacity to act as national authorities. As a result of this dual function, the NCBs and NCAs hold two different types of documents: Eurosystem and SSM documents and documents concerning the functions that they carry out under national law.

Therefore, from the perspective of the inviolability of the ECB's archives, both the NCBs and the NCAs have two different archives – a decentralised ECB archive and their own archives.⁵

However, this legal distinction does not lead to a physical separation of the two archives. In practice, documents belonging to the ECB's archives are often stored physically together with NCB and NCA documents. Even after the ECB introduced an electronic document management system, ECB documents leave that system at NCBs and NCAs and are circulated via email, downloaded to local systems or hard disks and printed out.

The Member States and their enforcement authorities are obliged under Article 4(3) of the Treaty on European Union to take any appropriate measure to ensure that the obligations arising out of the Treaties are fulfilled. Those obligations include obligations to protect the inviolability of the ECB's archives. However, the mixed storage of the two archives at the NCBs and NCAs leads to a situation in which documents that enjoy immunity might not be recognised – or even recognisable – as such. Hence, cases are possible where national enforcement authorities seize IT hardware in the context of national criminal investigations aimed at collecting evidence related to the exercise of national functions, but in fact seize the ECB's archives as well.

² As the euro area NCBs are an integral part of the Eurosystem and the Governing Council – the main decision-making body of the ECB comprising inter alia the governors of the euro area NCBs – ECB information is stored not only at ECB premises but also at those of the euro area NCBs. Similarly, as the SSM is composed of the ECB and the NCAs and the decision-making process involves the participation of the Supervisory Board – comprising inter alia representatives of the NCAs in each participating Member State – ECB information is also stored at the NCBs. See also Sauer, H. (2018a) and Sauer, H. (2018), Sections 3.2 and 3.3.

³ Sauer, H. (2018a) and Sauer, H. (2018), Sections 3.2 and 3.3.

⁴ *ibid.*

⁵ Sauer, H. (2018).

2 Obligation of NCBs and NCAs concerning the separation of documents

This paper argues that the NCBs and NCAs have an obligation to arrange for sufficient separation of the two archives they hold. The obligation is a secondary obligation flowing from Article 2 in conjunction with Article 22 of Protocol No 7, and is based on a twofold argument. First, as decentralised archives of the ECB, the NCBs and NCAs are obliged to contribute to the protection of these archives in their capacity as an integral part of the Eurosystem pursuant to Article 14.3 of the Statute of the ESCB and ECB and/or as members of the SSM pursuant to Article 6(1) of Council Regulation 1024/2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions.⁶ Second, since it follows from the duty of loyal cooperation with national enforcement authorities that the protection of the archives might be lost if documents are not separated at the NCBs and NCAs, the secondary obligation of the NCBs and NCAs to protect the decentralised archives includes an obligation to separate documents concerning the Eurosystem, ESCB and SSM from documents relating to their functions under national law.

This duty to ensure that the inviolability of the ECB's archives is adequately respected leaves considerable leeway for the national authorities to implement some system of sufficient separation between the ECB's documents and their own.

According to current information management practice within the Eurosystem, ESCB and SSM, the exchange of documents within the Eurosystem/ESCB/SSM should be carried out, to the maximum extent possible, via the ECB's document and records management system (DARWIN). However, the use of DARWIN does not prevent the NCBs or NCAs from using their own internal record management systems or other secure methods for the internal management of sensitive ESCB/SSM information. To ensure that such information is properly protected, each NCB or NCA is responsible for taking and implementing appropriate information technology and physical security measures in line with common Eurosystem and SSM policies. For instance, the policy on physical security protection measures requires that the protection applied to sensitive ESCB/SSM information should be proportional to the negative impact which could be caused by its unauthorised disclosure.

3 Should NCBs' and NCAs' obligations concerning the separation of documents be further defined?

The recent cases of seizure of ECB's archives stored in NCBs' IT hardware raised the question as to whether current practice is sufficient to comply with the NCBs' and

⁶ Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2015, p. 63).

NCAs' obligation concerning separation of documents and, if not, how potential new measures could be designed.

The obligation of the NCBs and NCAs concerning the separation of documents aims to make documents which are part of the ECB's archives and held by the NCBs and/or NCAs recognisable and protectable against any form of unilateral coercive interference, the ultimate objective being to ensure the proper and independent functioning of the ECB.

The abstract obligation of the NCBs and NCAs to separate documents, which has so far not been clearly defined and accommodates the existence of various information management systems at the NCBs and NCAs, did not make ECB documents recognisable and protectable against coercive interference of national authorities, as evidenced by the recent cases of seizure of ECB's archives. Based on this, one might conclude that the obligation of the NCBs and NCAs to separate documents might need to be further defined to ensure the inviolability of the ECB's archives.

This paper suggests two ideas for new measures:

- (i) First, to introduce an obligation for clear separation between documents concerning the exercise of ESCB/Eurosystem/SSM tasks and documents concerning the exercise of national tasks, by making DARWIN obligatory for ECB document management. This measure would ensure that ECB documents do not leave the ECB's information management system, are clearly recognisable as part of the ECB's archives and are protected as such in the event of intervention by national authorities with coercive powers, such as the seizure of NCB or NCA IT hardware.

The advantage of this solution is that it would clearly define the obligation of the NCBs and NCAs, leading to clear separation of the ECB's archives from NCB and NCA documents, which would help defend the privilege. The disadvantage is that there are a number of grey areas where the allocation to Union tasks and national tasks may not be clear. In addition, this measure should be weighed against the principle of organisational autonomy of the NCBs and NCAs. Finally, any conflict with national laws should be carefully examined.

- (ii) Second, to define the obligation for clear separation between documents concerning the exercise of ESCB/Eurosystem/SSM tasks and documents concerning the exercise of national tasks by adopting a more cautious approach when printing or downloading information from DARWIN, for instance by requiring that downloaded documents remain in separate folders or in a protected system. This solution would ensure that ECB documents are clearly recognisable as part of the ECB's archives and better protected in the event of intervention by national authorities with coercive powers.

This measure is less interventionist than the first one and possibly easier to implement. However, the disadvantages mentioned under the first solution relating to uncertainty over the allocation to Union and national tasks in some cases, the need to weigh it against the principle of organisational autonomy of the NCAs and NCBs, and potential conflicts with national laws, are also applicable to this measure and require careful analysis.

4 Procedural NCB/NCA obligations regarding the production of ECB documents to authorities with coercive powers

Under normal circumstances, if a national authority with coercive powers has a legitimate interest in the disclosure of ECB documents, it should ask the ECB for prior authorisation for the disclosure of such documents, as Article 2 of Protocol No 7 and the principle of loyal cooperation under Article 4 paragraph 3 of the Treaty on the European Union bar Member States from searching NCB or NCA archives insofar as they enjoy immunity under Union law.

In this context, the NCBs and NCAs have a number of procedural obligations flowing from Article 2 in conjunction with Article 22 of Protocol No 7.⁷ Some of these obligations have been further defined by the ECB. For instance, Decision ECB/2016/19 on disclosure of confidential information in the context of criminal investigations⁸ stipulates that the NCBs and NCAs have obligations to act as intermediaries between the ECB and the national criminal investigation authorities, to report to the ECB and to ask the national criminal investigation authorities to provide protection from public disclosure of confidential ECB information disclosed to them.

A further secondary obligation of the NCBs and NCAs flowing from Article 2 of Protocol No 7 is to provide assistance to the ECB in the event of seizure of the ECB's archives, for instance by protesting against such seizure, informing the ECB about the seizure and assisting the ECB in its interactions with the national authorities. Those obligations are dependent on the circumstances of the case in question and are not specified in legal acts or instruments. Please refer to the contribution by Christoforos Dimitriou⁹ earlier in this book for further details on these procedural NCB obligations and how they are performed.

⁷ See Section 2 above.

⁸ Decision (EU) 2016/1162 of the ECB of 20 June 2016 on disclosure of confidential information in the context of criminal investigations (ECB/2016/19) (OJ L 192, 16.7.2016, p. 73).

⁹ Dimitriou, C. (2018).

5 Conclusion

As laid down in Article 2 in conjunction with Article 22 of Protocol No 7 of the Treaty on the Functioning of the European Union, the ECB's archives are inviolable. Insofar as the NCBs and NCAs exercise tasks conferred on the Eurosystem, ESCB or ECB, they do not qualify as "third or external parties" with regard to the ECB's archives but act as decentralised archives of the ECB. Protection of this inviolability applies irrespective of where the ECB's archives are held – at the ECB's premises or at those of the NCBs or NCAs.

From the perspective of the inviolability of the ECB's archives, the NCBs and NCAs hold two different archives – a decentralised ECB archive protected by Union primary law, and their own archives containing documents related to functions that they carry out under national law. This legal distinction does not lead to a physical separation of the two archives. The mixed storage of the archives at the NCBs and NCAs creates certain challenges, as documents that enjoy immunity might not be recognisable and thus protectable, for instance where national enforcement authorities seize NCBs' or NCAs' IT hardware in the context of national criminal investigations aimed at collecting evidence related to the exercise of national functions.

The NCBs and NCAs have a secondary obligation flowing from Article 2 in conjunction with Article 22 of Protocol No 7 to arrange for sufficient separation of the two categories of documents held by them. This obligation leaves the national authorities considerable leeway to implement a system that ensures sufficient separation between the ECB's archives and their own. This obligation has so far not been clearly defined. Based on the recent cases of seizure of the ECB's archives stored on NCBs' IT hardware, however, one might argue that the obligation of the NCBs and NCAs to separate documents needs to be clearly defined to ensure that the objective and purpose of Article 2 of Protocol No 7 are achieved.

This paper suggests that this could be achieved either by making the ECB record and management system (DARWIN) obligatory for the management of ECB documents, thus ensuring that ECB documents do not leave the ECB system, are clearly recognisable as part of the ECB's archives and are better protected against unilateral coercive intervention by national authorities, or by adopting a more cautious approach when printing or downloading ECB documents from DARWIN to ensure that ECB documents are not broadly circulated, are recognisable as such and are better protected against coercive intervention by national authorities. The advantages of these suggestions need to be weighed against a number of legal and practical considerations.

The NCBs and NCAs have a number of procedural obligations related to the inviolability of the ECB's archives, which flow as secondary obligations from Article 2 in conjunction with Article 22 of Protocol No 7. The ECB has defined some of these obligations, for instance in Decision ECB/2016/19. Other obligations related to the provision of assistance to the ECB in the event of intervention by national authorities with coercive powers are determined by the circumstances of the case in question and are not specified in legal acts or instruments.

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Keynote speech



Europe and the Rule of Law

By Síofra O'Leary¹

1 Introduction

Few professional speaking engagements can be more awkward than a keynote speech at a conference dinner. The audience is enjoying a nice dinner after a hard day's work. A further day of heavy thinking awaits. The job of the speaker is to interrupt a well-earned dinner and, worse still, to make the audience think. The task on this occasion is also rendered difficult by the fact that one is addressing a room full of fellow lawyers, yes; but ones dedicated to legal questions relating to Economic and Monetary Union (EMU) and a euro area of nineteen EU Member States. What might a judge who serves in an international human rights court in a Council of Europe of forty seven quite heterogeneous States say which will give sufficient pause for thought without provoking silent indigestion?

Anyone familiar with the case-law of the European Court of Human Rights (ECtHR) knows that the daily fare of Strasbourg judges is far removed from the ESCB and the Eurosystem. In any given week legal questions cross judges' desks touching, inter alia, on the right to life;² alleged police brutality;³ whether convicted terrorists, if expelled, risk torture in their countries of origin;⁴ the fair trial rights, often of societies' less appealing members,⁵ or rights to privacy and family life in our ever-changing digital and social world.⁶ Legal issues relating indirectly to the euro and EMU do also occasionally make it to Strasbourg. However, as explained by my colleague Judge Koskelo at the 2017 ESCB Legal Conference, they have generally taken the form of

¹ Judge, European Court of Human Rights

² See, for example, *Lambert and Others v. France* [GC], no. 46043/14, ECHR 2015 (extracts); *Charles Gard and Others v. United Kingdom* no. 39793/17, 3 July 2017 or *Evans v. the United Kingdom*, no. 18770/18 [2018] ECHR 357.

³ See, for example, *Vasile Victor Stanciu v. Romania*, no. 70040/13, 9 January 2018.

⁴ See, recently, *M.A. v. France* no. 9373/15, 1 February 2018; *A.S. v. France*, no. 46240/15, 19 April 2018, or *X. v. the Netherlands*, no. °14319/17, 10 July 2018.

⁵ See, for example, *Ibrahim and Others v. the United Kingdom* [GC], nos. 50541/08, 50571/08, 50573/08 and 40351/09, ECHR 2016.

⁶ See, for example, *Merle Montet and Charron v. France*, no. °22612/15, 16 January 2018; *Oliari and Others v. Italy*, nos. 18766/11 and 36030/11, 21 July 2015; *Bărbulescu v. Romania* [GC], no. 61496/08, ECHR 2017 (extracts), or *Pihl v. Sweden*, no. 74742/14, 7 February 2017.

complaints resulting from the adoption of austerity measures in different EU Member States during and following the recent financial and sovereign debt crises.⁷

For the 2018 keynote address I chose the topic of *Europe and the Rule of Law*. It is principally the job of academics to fret over how to define the notion of the rule of law, whose content and reach is often contested.⁸ Judges grapple instead with its practical meaning and effects in concrete cases on a daily basis. As such, I will leave academic debate, however rich, aside and instead opt for a simple judicial shortcut, making my own the definition of the rule of law proffered by Lord Bingham, a former UK Master of the Rolls and Lord Chief Justice. Put simply, the rule of law means that:

“All persons and authorities within a state, whether public or private, should be bound by and entitled to the benefit of laws publicly and prospectively promulgated and publicly administered in the courts”.⁹

Thus, all exercises of public authority must be based on law and remain within its confines. When President Draghi declares that “the ECB is a rules-based institution” he is in essence declaring the institution’s adherence to the rule of law.¹⁰ The rule of law encompasses the principles of legality and legal certainty, of equality of individuals before the law and control of the executive wherever public freedom is at stake. It seeks to protect legitimate expectations, ensure the proportionality of decisions taken and measures applied, while also safeguarding defence rights and the independence of the judiciary itself. What links these different principles is the aim – to adopt the language of the Strasbourg Court – of protecting the individual

⁷ For a recent example see *P. Plaisier B.V. and Others v. the Netherlands* (dec.), nos. 46184/16 (47789/16, 19958/17) and 2 others, 14 November 2017. For a summary of relevant case-law see the [ECtHR factsheet on austerity measures](#). See also P. Koskela, “Relevance of fundamental rights for central bank policy and decision-making” in the session on “Judicial Review and Institutional Balance in European Law”, ECB Annual Legal Conference, 2017, pp. 133-145, and the report of the Council of Europe Steering Committee for Human Rights, *The impact of the economic crisis and austerity measures on human rights in Europe – Feasibility study*, CDDH (2015) R84 Addendum IV, 11 December 2015. For an article discussing the CJEU’s engagement with austerity cases from a rule of law perspective see C. Kilpatrick, “On the Rule of Law and Economic Emergency: The Degradation of Basic Legal Values in Europe’s Bailout” (2015) 35 *Oxford Journal of Legal Studies* 325-353.

⁸ See, variously, the discussion of the rule of law at domestic and European level in M. Andenas and D. Fairgrieve (eds.), *Tom Bingham and the Transformation of the Law. A Liber Amicorum*, OUP, 2009; P. Lemmens, “The Contribution of the European Court of Human Rights to the Rule of Law” in G. De Baere and J. Wouters (eds.), *The Contribution of International and Supranational Courts to the Rule of Law*, 2015, Edward Elgar, pp. 225-241; E. Steiner, “The Rule of Law in the Jurisprudence of the European Court of Human Rights” in W. Schroeder (ed.), *Strengthening the Rule of Law In Europe*, 2016, Hart, Oxford and Portland, pp. 135-154, or C. Tomuschat, “Democracy and the Rule of Law” in Dinah Shelton (ed.), *The Oxford Hand Book of International Human Rights Law*, 2013, OUP, pp. 469-496. See also the Report on the Rule of Law, Study no. 512/2009, adopted by the Venice Commission at its plenary session on 25 and 26 March 2011 and the Venice Commission’s Rule of Law Checklist, adopted in March 2016. For an explanation of differing academic schools of thought on the content and nature of the rule of law see Tomuschat, cited above.

⁹ See the speech delivered by Lord Bingham of Cornhill KG, House of Lords, 16 November 2006 and published as T. Bingham, “The Rule of Law” [2007] *CLJ* 67. The choice is a natural one for a common lawyer, not least due to the esteem in which Lord Bingham is universally held. For continental lawyers, this definition will appear narrower than the “Rechtsstaat” notion which prevails on the continent and which is, to an extent codified in the Council of Europe rule of law criteria, encompassing the principle of lawfulness, the separation of powers, the independence of the judiciary and respect for fundamental rights, including equality before the law.

¹⁰ See the ECB press conference of 5 March 2015, discussed, from a political perspective, by M. Selmayr in his keynote speech in 2015, “How political are the institutions of economic and monetary union? The cases of the European Central Bank and the European Commission”, *ECB Annual Legal Conference 2015* pp. 261-275.

from arbitrariness, especially in relations between the individual and the State.¹¹ The rule of law requires that fundamental rights, as part of a binding legal order, impose both constraints and demands on public authorities, on their decision-making and on the manner in which that decision-making occurs.¹²

Moving from the EU to the Council of Europe and thus from the case-law of the Luxembourg court to that of the Strasbourg one, based on the Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR, subsequently also referred to as the Convention), I propose to demonstrate how the Luxembourg court's infrequent and abstract, some would even say esoteric, past references to the rule of law are becoming more frequent but also more central to the legal reasoning underpinning its judgments. This reflects the nature of the times in which we and the EU 28 are now living but also perhaps the Luxembourg court's increasingly constitutional vocation.

Turning then to the Strasbourg court, the latter has consistently held that the rule of law forms part of and inspires the fabric of the whole Convention and is inherent in all its articles.¹³ The EU's judicial engagement with and indeed concern for the rule of law is of relatively recent vintage and the Luxembourg court generally views the rule of law through the prism of the effectiveness and autonomy of EU law itself. For the Strasbourg Court, in contrast, respect for the rule of law, human rights and the requirements of a democratic society are a set of intertwined and mutually reinforcing foundational principles which have always lain at the core of the Convention and the rights and freedoms it provides. Moreover, concern for the rule of law has not recently come into vogue in Strasbourg because quite simply it has never been out of vogue.¹⁴

So I propose a journey from Luxembourg to Strasbourg and from relatively abstract and what may appear to be quite sanitised legal notions to concrete, indeed vivid, examples from the Strasbourg court's case-law of what rule of law dysfunction actually looks like in practice.

¹¹ See, for example, *Winterwerp v. the Netherlands*, 24 October 1979, no. 6301/73, Series A no. 33 (detention of the mentally ill and the right to freedom and security in Article 5 ECHR), or *Malone v. the United Kingdom*, no. 8691/79, 2 August 1984, Series A no. 82 (interception of phone calls by the security services and the right to private life under Article 8 ECHR). As regards the EU, see the principles which the European Commission considers define the core meaning of the rule of law in, *A new EU framework to strengthen the rule of law*, COM (2014) 158 final: "[...] legality, which implies a transparent, accountable, democratic and pluralistic process for enacting laws; legal certainty; prohibition of arbitrariness of executive powers; independent and impartial courts; effective judicial review including respect for fundamental rights; and equality before the law".

¹² See further Koskelo, cited above, p. 133.

¹³ See, variously, *Engel and Others v. the Netherlands*, 8 June 1976, §55, Series A no. 22, or *Amuur v. France*, 25 June 1996, §50, Reports of Judgments and Decisions 1996-III.

¹⁴ See, from the perspective of a judge of the CJEU, T. von Danwitz, "Values and the rule of law: Foundations of the EU – an inside perspective from the ECJ", speech delivered at King's College London, 2 March 2018, "Only a few years ago, it would have seemed rather inconceivable that a major conference such as th[is] one [...] would or could have been introduced on those terms [in the title]. Not that values or the rule of law were absent in EU law, but rather because dealing with that subject would have been considered too academic, or at least impractical, too sophisticated and certainly completely out-dated". Contrast, for an analysis of the pivotal role played by the rule of law in the Strasbourg context, the articles by Lemmens and Steiner, current and former judges at the ECtHR, cited above.

A separate and final question will be why, as lawyers, bankers, ECB members and broader EU institutional actors you too are concerned by such dysfunction.

2 The rule of law and the European Union

In the preamble of the 1957 Treaty of Rome the founding Member States resolved to “ensure the economic and social progress of their countries”, “strengthen the unity of their economies” and “pool [...] their resources to preserve and strengthen peace and liberty”. It is striking, to say the least, that, given the wartime ashes from which the ECSC and EEC Treaties arose, the Treaty of Rome laid some of the foundations for and stepping stones towards EMU, but remained entirely silent on both human rights and the rule of law.¹⁵

Like other cornerstones of the EU’s constitutional architecture¹⁶ – primacy, direct effect and indeed an explicit commitment to respect fundamental rights – it was the CJEU which cemented the status of the European Community, as it then was, as a “Community based on the rule of law”.¹⁷ EU law buffs will know that I am of course referring to the landmark judgment of *Les Verts* from 1986.

This first judicial reference by the CJEU to the rule of law was followed by the addition of explicit references to that notion in the EU Treaties following successive intergovernmental conferences. Early references appeared largely declaratory or symbolic, with the Member States merely confirming in the Maastricht Treaty “their attachment to the principles of liberty, democracy and respect for human rights and fundamental freedoms and of the rule of law.”¹⁸ However, the legal significance of the rule of law was gradually reinforced; a reinforcement which was not unrelated to

¹⁵ See however Article 173 EEC for a generic reference to *rules of law*: “[the Court of Justice] shall have jurisdiction in actions brought by a Member State, the Council or the Commission on grounds of lack of competence, infringement of an essential procedural requirement, infringement of this Treaty or of any rule of law relating to its application, or misuse of powers”.

¹⁶ The CJEU regards the Treaties as the EU’s basic constitutional charter and in Opinion 2/13, on accession of the EU to the ECHR, it identified the component elements of its constitutional architecture, not least the principle of conferral of powers referred to in Articles 4(1) TEU and 5(1) and (2) TEU; the institutional framework established in Articles 13 TEU to 19 TEU; the fact that the Treaties are an independent source of law; the principles of primacy and direct effect and the fundamental rights recognised by the Charter. See further below for discussion of Opinion 2/13.

¹⁷ *Parti écologiste “Les Verts” v. European Parliament*, Case 294/83, EU:C:1986:166, § 24, where the CJEU held that the acts of the European Parliament were also susceptible to judicial review under Article 173 EC Treaty, despite explicit reference being made only to acts of the Council and the Commission. For some authors, like J.H.H. Weiler, the fountainhead was, however, *Van Gend en Loos*, 26/62, EU:C:1963:1, where the CJEU recognised the constitution of a new legal order.

¹⁸ See the preamble to the TEU following the Maastricht Treaty in 1992. One of the objectives of the newly introduced Common Foreign and Security Policy (CFSP) was also to develop and consolidate democracy and the rule of law, respect for human rights and fundamental freedoms. In the Single European Act (SEA) of 1986 the Member States had expressed their determination to “work together to promote democracy on the basis of the fundamental rights recognized in the(ir) constitutions and laws [...], in the [ECHR] and the European Social Charter” – the first explicit reference to fundamental rights in an EU Treaty. No mention was made of the rule of law, the 5th recital to the SEA speaking instead of “compliance with the law”.

successive waves of EU enlargement from 2004 onwards.¹⁹ Following the Treaty of Lisbon, Article 2 TEU now provides that:

“The Union is founded on the *values* of respect for human dignity, freedom, democracy, equality, the rule of law and respect for human rights, including the rights of persons belonging to minorities. These values are common to the Member States [...] in a society in which pluralism, non-discrimination, tolerance, justice, solidarity and equality between women and men prevail”.

As you well know, Article 7 TEU provides for both preventive and sanctioning mechanisms to defend these values, previously characterised as principles. The first mechanism involves the determination of a clear risk of a serious breach by a Member State of the listed Article 2 values. The second determines the existence of a serious and persistent breach, which can only be established on the basis of unanimity but may be followed, on the basis of a qualified majority, by a suspension of certain Treaty derived rights, including voting rights.²⁰

Sadly, Article 7 TEU – like Article 50 TEU, the subject of Joseph Weiler’s 2017 keynote speech – has not remained a dead letter. To date, the European Commission has issued four Rule of Law Recommendations in relation to Poland,²¹ submitted a Reasoned Proposal for a Decision of the Council on the determination of a clear risk of a serious breach of the rule of law by Poland under Article 7(1) TEU,²² issued, in July and August this year, a letter of formal notice and reasoned opinion, respectively, concerning the law on the Supreme Court²³ and referred to the CJEU, under the Article 258 TFEU infringement procedure, the law on the Ordinary Courts Organisation, given particularly the retirement regime it institutes.²⁴ In September 2018, the European Parliament debated a draft proposal for a Council decision triggering the Article 7(1) TEU procedure in relation to Hungary.²⁵

During the period of Treaty amendments referred to above, the *Les Verts* case was not of course the only example of the rule of law being mustered by the Luxembourg

¹⁹ See ex-Article 6(1) TEU which, following the Treaty of Amsterdam, provided that: “the Union is founded on the principles of liberty, democracy, respect for human rights and fundamental freedoms, and the rule of law, *principles* which are common to the Member States” (emphasis added). Thereafter, a provision was also inserted which enabled the EU to subject its Member States to EU sanctions if guilty of a serious and persistent breach of those principles. The CJEU has relied on this reference to the rule of law in its case-law. See, for example, *Gestoras Pro Amnistía and Others v. Council*, C-354/04 P, EU:C:2007:115, § 51, where the rule of law was still a principle rather than a value.

²⁰ See Article 7(1)-(3) TEU.

²¹ See the [recommendations](#) adopted on 20 December 2017, 27 July 2016, 21 December 2016 and 27 July 2017. See further the European Commission’s Fact Sheet on Commission action on the Rule of Law in Poland: Questions & Answers, Brussels, 20 December 2017, IP/17/5367.

²² COM (2017) 835 final.

²³ See the [press release](#) published by the European Commission on 14 August 2018 following the issuing of that reasoned opinion.

²⁴ See Case C-192/18, pending, and the 20 December 2017 press release referred to above. For earlier CJEU cases involving Poland in which rule of law questions were explicitly or implicitly at issue see also *Commission v. Poland*, C-286/12 EU:C:2012:687 or the order of the CJEU in *Commission v. Poland* (forest of Białowska), C-441/17 R, EU:C:2017:877, § 102.

²⁵ See the Sargentini report of the Committee on Civil Liberties, Justice and Home Affairs, debated on 11 September 2018.

court to bolster its judicial reasoning or result. However, for the large part, judicial references were infrequent and their purpose or effect relatively vague.²⁶

How things have changed. It is difficult to think of key Luxembourg Grand Chamber judgments in recent years where mention is not made of the rule of law.

Take, for example, *Gauweiler*, a first preliminary reference from the German Federal Constitutional Court involving legal questions and leading to a judgment with which this audience is very familiar.²⁷ The rule of law was not *explicitly* mentioned by the Court in its 2015 judgment but it was employed by Advocate General Cruz Villalón to considerable effect. Having explained how the EU could not survive in its present form if it were made subject to an absolute reservation, ill-defined and virtually at the discretion of each of the Member States, in the form of a category described as “constitutional identity”²⁸, he explained that:

“the Court of Justice ha[d] long [...] given preference to [...] constitutional traditions [common to the Member States] when establishing a particular culture of rights, namely that of the Union. The Union has thus acquired the character, not just of a community governed by the rule of law, but also of a ‘community imbued with a constitutional culture’.”²⁹

Another example can be found in the *Schrems* case. The applicant, a well-known digital rights activist, contended that, in the light of the revelations made in 2013 by Edward Snowden concerning the activities of the United States intelligence services (in particular the National Security Agency), U.S. law and practice did not offer sufficient protection against surveillance by the public authorities of the data transferred to that country. In its 2015 judgment invalidating the Safe Harbour Decision which the Commission had concluded with the U.S. authorities,³⁰ the CJEU emphasised that:

“the Court’s settled case-law should be recalled according to which the European Union is a union based on the rule of law in which all acts of its institutions are subject to review of their compatibility with, in particular, the Treaties, general principles of law and fundamental rights [...]”.³¹

As a result, the Commission’s Safe Harbour Decision could not escape judicial review.

²⁶ In *Mangold* (C-144/04, EU:C:2005:709) and *Kücükdeveci* (C-555/07, EU:C:2010:21), for example, the rule of law references were restricted to the citation of a recital of Council Directive 2000/78/EC of 27 November 2000 establishing a general framework for equal treatment in employment and occupation (OJ 2000 L 303, p. 16).

²⁷ *Gauweiler and Others v. Deutscher Bundestag*, C-62/14, EU:C:2015:400.

²⁸ To be distinguished from “national identity”, which is referred to in Article 4(2) TEU.

²⁹ See the Opinion of Advocate General Cruz Villalón, *Gauweiler and Others*, C-62/14, EU:C:2015:7, § 61.

³⁰ Commission Decision 2000/520/EC of 26 July 2000 pursuant to Directive 95/46/EC of the European Parliament and of the Council on the adequacy of the protection provided by the safe harbour privacy principles and related frequently asked questions issued by the US Department of Commerce (OJ 2000 L 215, p. 7).

³¹ *Schrems*, C-362/14, EU:C:2015:650.

Previously in 2008, in *Kadi v. Council of the European Union*, the Luxembourg court had held that the Union judicature must, in accordance with the powers conferred on it by the Treaties, ensure the review, in principle the full review, of the lawfulness of all EU acts in the light of fundamental rights. This included review of EU measures which, like the contested regulation on asset-freezing, are designed to give effect to United Nations Security Council resolutions. The Court rejected the argument that judicial review was excluded due to the deference required of the EU's institutions vis-à-vis the institutions of the United Nations. The regulation in question had been adopted on foot of a UN Security Council resolution. The CJEU explained that such immunity would have constituted a significant derogation from the scheme of judicial protection of fundamental rights laid down in the Treaties in a community based on the rule of law:

“review [...] of the validity of any Community measure in the light of fundamental rights must be considered to be the expression, in a community based on the rule of law, of a constitutional guarantee stemming from the [...] Treat[ies] as an autonomous legal system which is not to be prejudiced by an international agreement”.³²

These are not isolated cases. In the fields of environmental protection, data protection, employment and social policy or intellectual property similar and increasing references to the rule of law can be found.³³ Again, EU law buffs will recognise that this sample of cases bears testimony to the greatly expanded scope of EU law and the resulting changes in the type of legal question with which the Luxembourg court is now confronted. If questions relating to fundamental rights and the rule of law were previously somewhere in the CJEU's periphery,³⁴ they are now very much centre stage.

However, even as the Court of Justice increasingly acquires the mantle of a fundamental rights adjudicator, in some cases it is the absence of an explicit reference to the rule of law which is striking. Take, for example, *Opinion 2/13* in which it examined the compatibility with the EU Treaties of the draft agreement negotiated by the European Commission and the Council of Europe which would have provided for the accession of the EU to the ECHR. The latter is of course a legal obligation under Article 6(2) TEU. I am looking purely at the legal language and reasoning of the Court in the Opinion, not at the outcome which, from the

³² See *Kadi v. Council of the European Union*, C-402/05 P and C-415/05 P, EU:C:2008:461, §§ 305-330, particularly § 316. See also *Rosneft*, C-72/15, EU:C:2017:236, §§ 72-73 (where the CJEU analysed its jurisdiction – which is limited in the field of the CFSP – to examine in the context of the preliminary reference procedure the legality of asset-freezing measures imposed on natural or legal persons), or *H. v. Council and Others*, C- 455/14, EU:C:2016:569, § 41: “[...] as is apparent from both Article 2 TEU, which is included in the common provisions of the EU Treaty, and Article 21 TEU, concerning the European Union's external action, to which Article 23 TEU, relating to the CFSP, refers, the European Union is founded, in particular, on the values of equality and the rule of law [...]. The very existence of effective judicial review designed to ensure compliance with provisions of EU law is inherent in the existence of the rule of law [...]”.

³³ See *Commission v. Poland*, C-441/17 R, cited above, § 102 (environmental protection); *Schrems*, cited above, § 60 (data protection); *Liga van Moskeeën en Islamitische Organisaties Provincie Antwerpen VZW and Others*, C-426/16, EU:C:2018:335, § 38 (veterinary legislation); *Spain v. European Parliament and Council of the European Union*, C-146/13, EU:C:2015:298 (intellectual property).

³⁴ For example, see *Hauer v. Land Rheinland-Pfalz*, 44/79, EU:C:1979:290 for a reminder of the type of disputes in which EEC fundamental rights protection arose.

perspective of EU law can be both defended and in certain regards criticised.³⁵ As it has done since *Van Gend en Loos*, the Court stressed in that case that the EU has a new kind of legal order, the nature of which is peculiar to the EU, with its own constitutional framework and founding principles, a particularly sophisticated institutional structure and a full set of legal rules to ensure its operation.³⁶ The Treaties were emphasised by the plenary Court as being the EU's "basic constitutional charter", citing *Les Verts*. Yet the plenary court uttered not a word about the rule of law, not even when Article 2 and the EU's common values were referenced.³⁷

In *Aranyosi and Căldăraru*, a judgment of fundamental importance to both the functioning of the European Arrest Warrant (EAW) mechanism and the principles of mutual trust and mutual recognition which underpin the Area of Freedom, Security and Justice (AFSJ) more generally, the Court made no explicit mention of the rule of law. It concentrated instead on the need for EU instruments, even those based on mutual recognition, to respect fundamental rights. It should be recalled that many legislative instruments in this field, including the Framework Decision on the EAW, are based on mutual trust; a mechanism which may be counterintuitive for national judges used to verifying the compliance of such measures with national ordinary and constitutional law. In *Aranyosi*, the CJEU asserted the fundamental rights underpinnings of the system:

"The principle of mutual recognition on which the European arrest warrant system is based is itself founded on the mutual confidence between the Member States that their national legal systems are capable of providing equivalent and effective protection of the fundamental rights recognised at EU level, particularly in the Charter."³⁸

It followed that, where the judicial authority of the executing Member State is in possession of evidence of a real risk of inhuman or degrading treatment of individuals detained in the issuing Member State, having regard to the standard of protection of fundamental rights guaranteed by EU law and, in particular, by Article 4 of the Charter, that judicial authority is bound to assess the existence of that risk when it is called upon to decide on the surrender to the authorities of the issuing Member State of the individual sought by a European arrest warrant. The consequence of the execution of such a warrant must not be that that individual suffers inhuman or degrading treatment. The judgment was a ground-breaking one, with or without reference to the rule of law.

³⁵ For examples of measured commentaries which succeeded in doing both see C. Barnard, "[Opinion 2/13 on EU accession to the ECHR: looking for the silver lining](#)" or D. Halberstam, "It's the Autonomy, Stupid! A Modest Defense of Opinion 2/13 on EU Accession to the ECHR, and the Way Forward" (2015) 16 *German Law Journal* 105 or University of Michigan Public Law Research Paper No. 439.

³⁶ Opinion 2/13, § 158.

³⁷ *Ibid.*, §§ 164 and 168.

³⁸ *Aranyosi and Căldăraru v. Generalstaatsanwaltschaft Bremen*, C-404/15 and C-659/15 PPU, EU:C:2016:198.

However, the growing importance now attached to the rule of law in Luxembourg (and not just in Brussels) is seen most clearly in two CJEU judgments handed down in 2018. In the first case it was the CJEU which decided to construct its reasoning around the rule of law – contrary to the approach proposed by the European Commission – in the second case it was the national referring judge which obliged the CJEU to do so.

In *Associação Sindical dos Juizes Portugueses* a group of Portuguese judges argued that salary reductions imposed as a consequence of the type of austerity measures referred to earlier constituted an interference with their judicial independence and thus with the rule of law itself; the former being an essential constituent of respect for the latter. The Luxembourg court stressed again that one of the foundational values of the EU is the rule of law. Mutual trust between EU Member States and, in particular, their courts and tribunals is based on the fundamental premise that Member States share a set of common values which includes respect for the rule of law. It held that:

“Article 19 TEU, which gives concrete expression to the value of the rule of law [...] stated in Article 2 TEU, entrusts the responsibility for ensuring judicial review in the EU legal order not only to the Court of Justice but also to national courts and tribunals [...] The Member States are therefore obliged, by reason, inter alia, of the principle of sincere cooperation, set out in the first subparagraph of Article 4(3) TEU, to ensure, in their respective territories, the application of and respect for EU law. [...] The very existence of effective judicial review designed to ensure compliance with EU law is of the essence of the rule of law”.

The judgment is seen as establishing an innovative principle, namely that Article 19 TEU, as a self-standing rule, is a relevant basis for and parameter of judicial review, and the principle of judicial independence which it enshrines is a principle not only relevant for Union courts but also for national ones.³⁹

The Luxembourg court’s judgment in the Portuguese judges’ case was probably not intended to read like a veiled invitation,⁴⁰ but it did not take long for national courts to seize the opportunity it presented. The second prominent rule of law case this year, *LM*, also involved the EAW. In April 2018, the Irish High Court asked the CJEU whether an authority requested to execute an EAW was obliged to enforce a warrant issued by Poland given reforms of the Polish judiciary which have put that Member State on the brink of an Article 7 TEU procedure and which, according to the subject of the arrest warrant, endangered the possibility of his receiving a fair trial.⁴¹ In

³⁹ The relevance of this for EU law lies in the fact that it is established CJEU case-law that not all national measures may be examined in the light of the Charter, but only those that fall within the scope of EU law (see *Åkerberg Fransson*, C-617/10, EU:C:2013:105). The Portuguese judgment is being read as meaning that the Charter may now become engaged in certain cases via Article 19 TEU.

⁴⁰ See further D. Sarmiento, “[On Constitutional Mode](#)”: “in *Associação Sindical dos Juizes Portugueses* the Court went all the way and provided an intriguing judgment that is certainly not mostly about Portuguese judges, but rather about Polish and Hungarian judges”.

⁴¹ *Minister for Justice and Equality v. Celmer*, order for reference from the High Court of Ireland of 12th March 2018, now referred to on the Curia website, following the adoption by that court of an anonymisation policy in preliminary references involving natural persons, as *LM*, Case C-216/18 PPU, EU:C:2018:586.

essence, the question in the *LM* case was whether the EAW system, premised as you know on mutual trust, could operate when a presumption of mutual trust and confidence could or might no longer be relied upon due to rule of law deficiencies. The referring judge held, based on Venice Commission reports as well as the evidence which had led the Commission to adopt its reasoned proposal in relation to Article 7 TEU, that there was evidence of interference with the independence of the judiciary in Poland and with respect for the rule of law. What was a Member State executing authority to do when confronted with a warrant issued by a Member State in breach of one of the Article 2 values, in particular, the rule of law?

In its judgment in the *LM* case, delivered on July 25th 2018, the CJEU established a procedure for domestic judges to address Article 7 TEU concerns, obliging them to assess both the existence of systemic deficiencies in the legal system of the issuing state and the existence of an individual risk of an unfair trial. A two-stage process is required. First, the executing court must assess reliable, specific, and properly updated material concerning the operation of the justice system in the Member State which had issued the EAW and determine whether there was a real risk of a breach of the fair trial rights of the person concerned, also with regard to a potential lack of independence of the courts.⁴² Second, if the first stage confirms the existence of systemic deficiencies, the executing judiciary must specifically and precisely assess whether, in the case at hand, there were substantial grounds for believing that the requested suspect will run the real risk of being subject to a breach of the essence of the right to a fair trial.⁴³ Again, it is noteworthy that throughout its analysis of the rule of law, judicial independence and fair trial guarantees, no mention was made in the *LM* judgment of Strasbourg case-law.⁴⁴

What these recent Luxembourg cases reveal is not only the judicial distance covered in the EU since the first *Les Verts* reference to the rule of law, but also the altered European and national contexts in which the CJEU and referring courts are operating these days. It is worth noting, as I said, that in some CJEU judgments the rule of law references are central and explicit, while in others they may be implicit or entirely absent. In some judgments the Treaties, the Charter and the Convention all feature whereas in others no reference is made to the Convention or to the Strasbourg court's long-established case-law in any given field. I will return to the relevance of this point in my conclusion.

⁴² *LM*, cited above, § 61, relying on *Aranyosi*, cited above, § 89 and *Associação Sindical dos Juizes Portugueses*, §§ 64-67.

⁴³ *LM*, cited above, § 68. Note that, with *LM* pending before the CJEU, the High Court of England and Wales had adjourned an appeal in the case of *Lis v. Poland*, in order for the appellant to be able to address a new Article 6 ECHR ground with reference to the preliminary reference in *LM*. See the reports of this and other UK cases in G. Hepburne Scott, "EAWs: Is Poland on a final warning?" *New Law Journal*, 20 April 2018.

⁴⁴ Contrast the CJEU judgment delivered the same day and also concerning the EAW in *ML*, C-220/18 PPU, EU:C:2018:589, where in §§ 60, 76 and 97 the CJEU made detailed reference to ECtHR case-law on Article 3 ECHR in relation to conditions of detention. A further piece of this ever more complicated puzzle emerged shortly after the *LM* judgment when, in August 2018, the Polish Supreme Court itself decided to question the CJEU directly, referring five questions relating mostly to the interpretation of the principle of judicial independence in the light of EU primary law, namely Articles 2, 4(3), 19(1) TEU as well as Article 47 of the Charter. The [Polish Supreme Court referral decision](#) is available. For comments see R. Grzeszczak and P. Ireneusz, "[The Rule of Law Crisis in Poland: A New Chapter](#)".

3 The rule of law and the ECHR

Turning to the European Convention and the Strasbourg court, in *Golder v. the United Kingdom*, my judicial predecessors noted in 1975 that:

“[while] the Preamble does not include the rule of law in the object and purpose of the Convention, [it] points to it as being one of the features of the common spiritual heritage of the member States of the Council of Europe [...].

They then added:

“... it would be a mistake to see in this reference a merely ‘more or less rhetorical reference’”.⁴⁵

Ever since *Golder*, where the Court established that the right to a fair trial included the right of access to a court, it has used the rule of law as an interpretative tool for the development of substantive guarantees under the rights set forth in the different articles and Protocols of the Convention. It has stressed that the importance of certain Convention rights stems from their being central to democracy and the rule of law, these two notions being interdependent.

But beyond judicial rhetoric, of which, admittedly, there is an abundance in both Luxembourg and Strasbourg, what does rule of law dysfunction look like in practice? I will provide you with three Strasbourg examples.

3.1 The rule of law and non-enforcement of domestic judgments

As stated at the outset, the principle of legal certainty is one of the fundamental aspects of the rule of law. It requires, on the one hand, that where the courts have finally determined an issue “their rulings should not be called into question”⁴⁶ and, on the other, that final judgments must be enforced.⁴⁷

In *Ivanov v. Ukraine*, an army veteran complained of the prolonged non-enforcement of judgments ordering the authorities to pay him pension arrears.⁴⁸ The case raised two recurring problems in Ukraine – the prolonged non-enforcement of final domestic decisions and the lack of an effective domestic remedy to address this. These problems had led to the finding of violations of Articles 6 and 13 of the Convention in over 300 cases in respect of Ukraine and at the time of the *Ivanov* case, 1,400 similar applications were pending. As a result, the Court considered it

⁴⁵ *Golder v. the United Kingdom*, n° 4451/70 21 February 1975, Series A n° 18, § 34. Article 3 of the Statute of the Council of Europe had of course provided that every member State of the Council must accept the principle of the rule of law, human rights and democracy and that these three core values are closely interlinked.

⁴⁶ See *Brumărescu v. Romania*, no. 28342/95, § 61, ECHR 1999-VII.

⁴⁷ See, variously, in relation to Articles 6 and 1 of Protocol No. 1, *Immobiliare Saffi v. Italy*, no. 22774/93, 28 July 1999; as regards Article 8 and family disputes, *Nuutinen v. Finland*, no. 32842/96, 27 June 2000 and *Mezl v. the Czech Republic*, no. 27726/03, 9 January 2007; or in relation to Article 8 and environmental issues, *Giacomelli v. Italy*, no. 59909/00, ECHR 2006-XII.

⁴⁸ *Yuriy Nikolayevich Ivanov v. Ukraine*, no. 40450/04, 15 October 2009.

appropriate to apply its pilot-judgment procedure, designed to identify and resolve systemic problems of this nature.⁴⁹ It found a violation of Articles 6 and 13 in the *Ivanov* case and ordered Ukraine to introduce into its legal system, at the latest within one year from the Court's judgment becoming final, an effective remedy.⁵⁰

Ukraine failed to adopt the measures ordered despite the execution procedure engaged by the Council of Europe's Committee of Ministers. Consequently, the question of the non-enforcement of the 1999 pilot judgment and the non-enforcement of domestic judicial decisions which had led to the declaration of a systemic violation returned to the Grand Chamber in the case of *Burmych and Others* in 2017.⁵¹ The Grand Chamber observed that, since the introduction of the first applications in 1999 it had received some 29,000 *Ivanov*-type applications, of which 14,430 had been examined by various judicial formations of the Court. However, 12,143 of those applications, the majority of which were lodged in the years 2013-2017, were still awaiting judicial examination.

The *Ivanov* pilot judgment had thus clearly not succeeded in achieving its aim. Post-*Ivanov* cases accounted for almost one third of all the repetitive applications pending before the Court and the volume of cases had continued to grow despite the measures taken and guidance given. The Grand Chamber considered that nothing was to be gained, nor would justice be best served, by the Court's repetition of its findings in a lengthy series of comparable cases. This would place a significant burden on its own resources, with a consequent impact on its considerable caseload. Only a lasting solution to the root cause of the problem adopted in the execution process could provide an adequate response to the present situation. A requirement to continually deliver individual decisions in cases where there was no longer any live Convention issue could not be said to be compatible with the Court's principle task under Article 19. Nor did that judicial exercise contribute usefully or in any meaningful way to the strengthening of human rights protection under the Convention. It was for the Committee of Ministers to supervise the execution of the judgment and ensure that the State had discharged its legal obligation under Article 46, including the taking of such general remedial measures as may be required by the pilot judgment in relation to affording relief to all the other victims, existing or potential, of the systemic defect found. As a result, the Grand Chamber decided to strike the 12,000 plus applications out of the list of cases pursuant to Article 37(1) (c) of the Convention and to transmit them to the Committee of

⁴⁹ The pilot judgment procedure was conceived as a response to the growth in the Court's caseload, caused by a series of cases deriving from the same structural or systemic dysfunction, and to ensure the long-term effectiveness of the Convention machinery. The dual purpose of the procedure was, on the one hand, to reduce the threat to the effective functioning of the Convention system and, on the other, to facilitate the most speedy and effective resolution of a dysfunction affecting the protection of Convention rights in the national legal order. By incorporating into the process of execution of the pilot judgment the interests of all other existing or potential victims of the systemic problem identified, the procedure aimed to afford proper relief to all actual and potential victims of that dysfunction, as well as to the particular applicant in the pilot case.

⁵⁰ Pending the adoption of the above measures, the Court adjourned for a one-year period the proceedings in all Ukrainian cases lodged after the delivery of the pilot judgment concerning solely the non-enforcement or delayed enforcement of domestic judgments. EUR 2,500 was awarded to the applicant in respect of non-pecuniary damage; a not inconsiderable sum in Ukraine in 2009.

⁵¹ *Burmych and Others v. Ukraine* (striking out) [GC], nos. 46852/13 et al, ECHR 2017 (extracts).

Ministers in order to be dealt with in the framework of the general enforcement measures set out in the pilot judgment.

The *Ivanov* and *Burmych* cases give you a taste – numerically a dramatic one – of rule of law dysfunction. The nature of the violation is less striking than the next category of cases I will refer to, but the numbers tell the whole story, with the Committee of Ministers estimating 120,000 plus non-enforced judgments in the state in question. This of course has consequences not only for the citizens of the respondent State, but also for the Convention system. A Court with limited resources seized of 12,000 plus applications in relation to a question on which its case-law is clear, is deflected from other very serious human rights violations or from dealing with new and crucial questions in other fields, not least those relating to migration, terrorism or digital privacy.

Lawyers from euro area Member States, which is a relatively cosy club consisting of 19 States, could of course react to the *Ivanov* and *Burmych* saga with the comfort which geographical and political distance provides. Ukraine is not only not a euro area Member State it is not even an EU Member State, or a candidate for EU membership. However, leaving aside the geo-political short-sightedness of such a stance, it is worth remembering that the association agreement between the EU and its Member States and Ukraine came into force on 1st September 2017.⁵² A quick perusal of the terms of that agreement reveal the extent to which a functioning judicial system, with sufficiently speedy and effective enforcement of domestic judgments, is not a matter of mere legal or judicial rhetoric in that very real economic context.

3.2 The rule of law, unacknowledged detention and secret rendition cases

The second category of cases – examples of rule of law dysfunction or complete rule of law break down or suspension – are thankfully far less numerous but considerably more chilling. What happens when an individual is subject to “extraordinary rendition”, which entails detention “outside the normal legal system” and which the Strasbourg court considers, “by its deliberate circumvention of due process, is anathema to the rule of law and the values protected by the Convention”?⁵³

In cases like *El-Masri* we get an answer. The applicant, a German national, who was travelling in December 2003 on a bus destined for Skopje was questioned at the Macedonian border about the validity of his passport as well as possible ties with several Islamic organisations. Later he was taken to a hotel room in Skopje where he was held for twenty-three days. During his detention, he was watched at all times and interrogated repeatedly. His requests to contact the German embassy were refused. On one occasion, when he stated that he intended to leave, a gun was pointed at his head. He later commenced a hunger strike to protest against his

⁵² OJ 2014 L 161, p. 3.

⁵³ See *El-Masri v. the former Yugoslav Republic of Macedonia* [GC], no. 39630/09, § 239 ECHR 2012.

continued detention. On 23 January 2004, handcuffed and blindfolded, he was put in a car, taken to Skopje Airport, placed in a room where he was beaten severely by several disguised men, stripped, sodomised with an object, placed in a nappy and dressed in a dark blue short-sleeved tracksuit. Then, shackled and hooded, and subjected to total sensory deprivation, he was forcibly marched to a CIA aircraft, which was surrounded by Macedonian security agents. When on the plane, the applicant was thrown to the floor, chained down, forcibly tranquillised and flown in that position to Kabul where he was held captive for five months. In May 2004 the applicant was returned to Germany via Albania.

The Court found, *inter alia*, that the treatment to which the applicant had been subjected amounted on various counts to inhuman and degrading treatment contrary to Article 3 of the Convention. He had lived in a permanent state of anxiety owing to his uncertainty about his fate during the interrogation sessions and his suffering had been increased by the secret nature of the operation and the fact that he had been kept incommunicado for twenty-three days in a hotel, an extraordinary place of detention outside any judicial framework. As regards the treatment at the airport, although the applicant had been in the hands of the special CIA rendition team, the acts concerned had been carried out in the presence of Macedonian officials. Consequently, the respondent State had to be regarded as responsible under the Convention for acts performed by foreign officials on its territory with the acquiescence or connivance of its authorities. The applicant had not posed any threat to his captors. Thus, the physical force used against him at the airport had been excessive and unjustified in the circumstances. The measures had been used in combination and with premeditation, with the aim of causing severe pain or suffering in order to obtain information, inflict punishment or intimidate the applicant. Such treatment amounted to torture contrary to Article 3. The ECtHR found it:

“[...] wholly unacceptable that in a State subject to the rule of law a person could be deprived of his or her liberty in an extraordinary place of detention outside any judicial framework [...]”.⁵⁴

Once again, there may be an unspoken or inadvertent tendency on our part to comfort ourselves that while this case concerned an EU citizen, the events took place on the territory of a non-EU, albeit European, State. However, violations of Articles 3, 5 and 6 of the Convention have been found in relation to EU Member States in similar rendition cases. Take, for example, *Al Nashiri v. Poland* where the applicants alleged that they were victims of an “extraordinary rendition” by the CIA to a CIA operated secret detention site in Poland with the knowledge of the Polish authorities for the purpose of interrogation.⁵⁵ Once there they were subjected to so-called “enhanced interrogation techniques” and to “unauthorised” interrogation methods, including in Mr Al Nashiri’s case, mock executions, prolonged stress positions and threats to detain and abuse members of his family. They were subsequently secretly removed from Poland on rendition flights before ultimately arriving at the US Naval Base in Guantanamo Bay. The Court of Human Rights

⁵⁴ *El-Masri*, cited above, § 236.

⁵⁵ *Al Nashiri*, no. 28761/11, 24 July 2014.

found violations of Articles 2, 3, 5 and 6 of the Convention. As regards the latter, it held:

“The Court has taken a clear, constant and unequivocal position of in respect of the admission torture evidence. No legal system based upon the rule of law can countenance the admission of evidence – however reliable – which has been obtained by such a barbaric practice as torture. The trial process is a cornerstone of the rule of law. Torture evidence irreparably damages that process; it substitutes force for the rule of law and taints the reputation of any court that admits it. Torture evidence is excluded in order to protect the integrity of the trial process and, ultimately, the rule of law itself. The prohibition of the use of torture is fundamental.”⁵⁶

3.3 The rule of law and judicial independence

My third and final example concerns judicial independence, the subject at the heart of the Court of Justice’s judgment in the *LM* case and of the Commission’s Article 7 rule of law recommendations in relation to Poland. It is also the subject of decades of Strasbourg case-law.

The applicant in *Báka v. Hungary* was a former judge of the ECtHR who later publicly criticised, in his capacity as President of the Hungarian Supreme Court, proposed legislative reforms of the judiciary. Subsequent constitutional and legislative changes resulted in the premature termination of his mandate as President, excluding the possibility of judicial review of that termination. He mainly complained under Article 6 about a lack of access to court and under Article 10 about a disproportionate interference with his freedom of expression.

The Grand Chamber held that it was doubtful that the exclusion of judicial review in Mr. Báka’s case complied with the rule of law and, given the growing importance (in international and Council of Europe instruments, as well as for international courts and bodies), of procedural fairness in cases involving the removal of judges, the Court concluded that the exclusion of the applicant from any judicial review of the premature termination of his mandate violated his right of access to a court under Article 6.

As regards freedom of expression, the Court held that the Government had not discharged the onus of proof (neither through the reasons provided at the time domestically nor to the Court) to explain why the termination of the applicant’s mandate had been necessary. In this context, the Grand Chamber underlined the particular importance of the applicant’s office, the functions and duties of which included expressing his views on legislative reforms likely to have an impact on the judiciary and its independence. The applicant had stayed within this strictly professional perspective so his expression clearly concerned a debate on a matter of “great public interest”. This meant that the applicant’s position and statements called for a high degree of protection, for strict scrutiny of any interference therewith as well

⁵⁶ Ibid., § 564.

as for a correspondingly narrow margin of appreciation. Underlining the importance of the independence and irremovability of judges, noting the chilling effect of the premature termination of the applicant's mandate on other judges and given the lack of effective and adequate safeguards against abuse (given the violation of Article 6(1) referred to above) which are required by the procedural aspect of Article 10, the Court concluded that it had not been shown that the premature termination of the applicant's mandate was necessary in a democratic society and found that there had been a violation of Article 10 of the Convention.⁵⁷

So there you have three very different but stark examples of what rule of law dysfunction looks like in practice and of the daily fare of the European Court of Human Rights whose job it is to respond to individual complaints in relation to such alleged dysfunction.

4 Conclusions

As I indicated at the outset, a final and separate question is why lawyers gathered to discuss the regulatory framework governing economic and monetary union in the euro area should invest in rule of law issues? While Frankfurt, Brussels and Strasbourg are geographically quite close, the cases I have just described would seem to set the European Court of Human Rights and the rule of law issues with which it deals a world apart. But are they? Are there not reasons of a general and a specific nature which suggest that rule of law questions must be central to what all national and European institutions do?

On a specific level, the stability and proper functioning of states, which are key elements of economic life and determinative to a great extent of economic health, are based on strong democratic institutions working within an effective rule of law framework.⁵⁸ Stability, as a goal, was prominent in the Treaty of Rome, and remains so in the TFEU. Notwithstanding the differences between economic and monetary policy objectives enshrined in the Treaties and unpicked by Luxembourg judges in the 2012 *Pringle* judgment,⁵⁹ stability is central to what the ECB and national central banks do. The importance of rule of law issues to the EU and, implicitly, to wider Europe, are captured by the Dutch Prime Minister in the following terms:

“Those who say that the rule of law is a national matter only, and that the EU should focus solely on the single market have it all wrong: the single market can flourish only if the rule of law applies in all member states, and if all businesses know their investments are safe and any disputes will be resolved by judges who are

⁵⁷ *Báka v. Hungary* [GC], no. 20261/12, judgment of 23 June 2016. See also, on the dismissal of judges, *Volkov v. Ukraine*, no. 21722/11, judgment of 9 January 2013; *Erményi v. Hungary*, no. 22254/14, judgment of 22 November 2016, and *Denisov v. Ukraine*, no. 76639/11, pending before the Grand Chamber.

⁵⁸ See V. Colaert and F. Tulkens, “Introduction” in A.-P.A. Dumont et al, *The Increasing Impact of Human Rights Law on the Financial World*, Intersentia, 2016, p. 6 and L. Pech, “Rule of law as a guiding principle of the EU’s external action”, CLEER Working Papers 2012/3, TMC Asser Institute, p. 7.

⁵⁹ *Pringle v Government of Ireland*, C-370/12, EU:C:2012:756.

independent of the government in office. Erode the rule of law and you erode the single market. Erode the single market and you erode the Union.”⁶⁰

On a much more general note, I would like to bring you back to the early nineties and the dramatic geo-political changes which Europe was undergoing with new democracies emerging on the doorstep of the newly baptised EU. After 1992, the Council of Europe doubled its membership and between 1992 and 1997 the ECHR entered into force in all the Central and Eastern European States which later acceded to the EU. This was no mere coincidence. With the prospect of the EU more than doubling its own membership, a set of criteria were established, dubbed the *Copenhagen criteria* after the European Council at which they were agreed. Their purpose was to set out the rules of future accession and subsequent membership of the EU. The criteria firmly anchored conditionality into the accession process, with the newly added Articles 2 and 7 TEU designed to encourage adherence thereafter. New Member States, and indeed older ones, are required to ensure the stability of institutions guaranteeing democracy, the rule of law and human rights.⁶¹ Membership of the Council of Europe and ratification of the ECHR were key in this regard. Why? Because in the words of one EU legal commentator:

“it is the key task of the EC[t]HR, among other international institutions, to keep European legal orders in check”.⁶²

I have outlined above, through concrete cases, how the Luxembourg and Strasbourg courts engage with rule of law issues. The latter have always been and remain central to the judicial work of the Strasbourg court. The Convention cases described above sought also to put paid to the idea that the rule of law is a dry, vague notion, pulled from the judges’ toolbox with the same frequency and with as much effect as a tired magician’s rabbit. As my predecessors made clear in the *Golder* case, reference to the rule of law is not a matter of rhetoric.

But it may be worth asking, with two European courts now addressing rule of law questions, where do we go from here? I leave you with two thoughts: one judicial, the other financial.

On the judicial front, having worked in both courts I have limited patience for an academic thesis according to which the two European courts are jealous of their respective jurisdiction and reluctant to cite or rely on the case-law of the other. An overall analysis of the case-law of both courts demonstrates that this thesis is

⁶⁰ Speech by the Prime Minister of the Netherlands, Mark Rutte, at the Bertelsmann Stiftung, Berlin, 2 March 2018, “Underpromise and overdeliver: fulfilling the promise of Europe”.

⁶¹ See further C. Hillion, “The Copenhagen Criteria and their Progeny” in C. Hillion (ed.), *EU Enlargement: A Legal Approach*, Oxford, Hart Publishing, 2004 and D. Kochenov, “The ENP Conditionality: Pre-Accession Mistakes Repeated” in L. Delcour and E. Tulmets (eds.), *Pioneer Europe. Testing EU Foreign Policy in the Neighbourhood*, Baden Baden, Nomos, 2008. The economic Copenhagen criteria called for the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union.

⁶² See D. Kochenov, “EU Law without the Rule of Law: Is the Veneration of Autonomy Worth It?” (2015) 21 *Yearbook of European Law* 1-23, 10. See also C. Closa, D. Kochenov and J.H.H. Weiler, “Reinforcing Rule of Law Oversight in the EU” RSCAS Working Paper 2014/25 on the question whether mechanisms to deal with individual human rights violations are the best way to address rule of law deficiencies.

overstated.⁶³ That being said, I have also long been of the view that recognition of the equal legal value of the Charter of Fundamental Rights of the EU in the Treaty of Lisbon was not a signal for EU institutions, whether judicial or other, to downgrade or ignore the role and contribution of the Convention, the Strasbourg court or indeed the Council of Europe.⁶⁴ It would seem strange, when core fundamental rights issues, indeed overarching human rights principles such as the rule of law, and questions which go to the heart of democracy become political issues in Brussels and legal ones in Luxembourg not to refer to the very Convention which the Luxembourg court previously recognised as having “special significance”⁶⁵ and to the case-law of the European human rights court whose one and only judicial role is to interpret and apply that Convention. This is, moreover, a judicial role the Strasbourg court has been exercising for over six decades, often in the most difficult and sensitive of cases. It is unsurprising, therefore, to read some commentators’ concern, in response to judgments like *LM*, referred to above about the Luxembourg court’s silence in rule of law cases on the role of the Strasbourg court and the absence of references to Strasbourg case-law:

“The ECJ’s silence about the – actual and possible – roles of the European Court of Human Rights is particularly disturbing [...] it might be recalled that one court – albeit it [be] the ECJ – might not always be enough for safeguarding the rule of law”.⁶⁶

The words of the President of the CJEU in his speech at the opening of the Strasbourg judicial year in January 2018 are much more encouraging than the silence in judgments like *LM* might otherwise suggest:

“Qualitatively, the Charter facilitates a more coherent, comprehensive and systemic interpretation of fundamental rights. That said, it does not follow from the fact that the Charter is centre stage in the EU system of fundamental rights protection that the CJEU is required to adopt an isolationist or ‘EU- centric’ approach. On the contrary, the Charter mandates the CJEU to embrace openness and dialogue, in the field of fundamental rights, with the legal orders that surround the EU. [...] Thus, the CJEU is required to engage in a constructive dialogue with the national courts – notably national Constitutional and Supreme Courts – and, of course, the EC[t]HR. Consequently, the Charter has not only codified but has also given new impetus to

⁶³ See further S. O’Leary, Courts, Charters and Conventions: Making Sense of Fundamental Rights in the EU (2016) LVI Irish Jurist 4-41, 24-27.

⁶⁴ See, inter alia, Article 6(3) TEU: “Fundamental rights, as guaranteed by the European Convention for the Protection of Human Rights and Fundamental Freedoms and as they result from the constitutional traditions common to the Member States, shall constitute general principles of the Union’s law”; the preamble of the Charter: “This Charter reaffirms, with due regard for the powers and tasks of the Community and the Union and the principle of subsidiarity, the rights as they result, in particular, from the constitutional traditions and international obligations common to the Member States, the Treaty on European Union, the Community Treaties, the European Convention for the Protection of Human Rights and Fundamental Freedoms, the Social Charters adopted by the Community and by the Council of Europe and the case-law of the Court of Justice of the European Communities and of the European Court of Human Rights” or Article 52(3) of the Charter: “In so far as this Charter contains rights which correspond to rights guaranteed by the Convention for the Protection of Human Rights and Fundamental Freedoms, the meaning and scope of those rights shall be the same as those laid down by the said Convention. This provision shall not prevent Union law providing more extensive protection”.

⁶⁵ See *Kadi*, cited above, § 283.

⁶⁶ See the comments on *LM* by C. Dupré, “[Individuals and judges in defense of the rule of law](#)”.

the case law of the CJEU in respect of the general principles of EU law, where it has held that the Convention has ‘special significance’.⁶⁷ With the entry into full legal force of the Charter, I am tempted to say that the Convention has now ‘a very special significance’ in the EU legal order. [...] Moreover, the meaning and scope of the rights recognised by the Charter are directly influenced by the Convention. This ‘esprit d’ouverture’ shows that the Charter is by no means a rival to the Convention, nor is it intended to impose competing obligations on the EU Member States in the field of fundamental rights. On the contrary, the Charter invites cooperation with Strasbourg.”⁶⁸

This seems to capture precisely what the relationship should be. The two European courts’ tasks are very different, yet in some cases similar fundamental rights questions do and will arise. As the scope of EU law expands, instances of this will increase. Both courts must remain sensitive to this. As I have indicated, in many judgments the CJEU engages with Strasbourg case-law. However, in some key judgments it is surprising when it does not. Yet, it would seem a mistake, in the years ahead, and given the times in which we are living, to ignore or squander the wealth of the Convention court’s jurisprudential *acquis* in the field of fundamental rights in the name, inter alia, of primacy, effectiveness or autonomy.

Turning to the financial question, this is territory where judges fear to tread. Yet when the effective functioning of the judicial institution in which they work is at stake, are they not obliged to do so? Since 1959 the Strasbourg court has dealt with almost 800,000 applications and delivered over 20,000 judgments. By the end of August 2018, 60,400 applications were pending before a judicial formation. Interstate cases, involving Georgia and Russia and Ukraine and Russia are also pending. Gargantuan efforts have been made to reduce the docket from the all-time 2011 high of approximately 160,000 pending applications. Yet the Court operates on an annual budget of just over 71 million euros. Significant budgetary contributions in the past years have been withheld from the Council of Europe by two Member States. It is the Council of Europe and not of course the Court which deals with these financial questions; yet the Court’s resources and its ability to deal with its docket also depends on how and if the Council of Europe can resolve these issues.

Why, you might ask again, is this of relevance to the EU? There are numerous reasons, of which I will mention only a few. All 28 current members of the EU are Council of Europe members and all are subject to the ECHR. In a June 2018 document issued by the Article 50 working party outlining grounds for the future EU-UK agreement post-Brexit in the field of police and judicial cooperation in criminal matters, a condition of cooperation is the UK’s continued membership of the ECHR, with a proposed “guillotine clause” being proposed should the UK leave the

⁶⁷ President Lenaerts referred to *ERT*, C-260/89, EU:C:1991:254, § 41 as an example of a case in which this significance had been referred to explicitly.

⁶⁸ K. Lenaerts, “[The ECHR and the CJEU: Creating Synergies in the Field of Fundamental Rights Protection](#)”, Solemn hearing for the opening of the Judicial Year 26 January 2018.

Convention system.⁶⁹ This position may of course change, as negotiations are ongoing, but the importance attached to the ECHR is clear. While the Commission may have supervised applicant states' compliance with the Copenhagen criteria from the mid-1990s onwards, it was the Council of Europe and Strasbourg court which largely did the work on the ground, handing down hundreds and thousands of judgments and decisions which led to fundamental reforms in the legal systems of the accession states. Of the top ten states in terms of pending applications before the Court, four are EU Member States. The list includes newer accession states like Hungary, Poland and Romania, but also a founding Member State, Italy.

In short, if the Strasbourg court is Europe's rule of law shepherd, responsible for keeping a watchful eye on 47 European states for human rights, rule of law and democratic malfunctions, is it wise in the present climate to stand silently by as the shepherd is left without sheepdogs, rod, or shelter of any kind?⁷⁰ At a political level, there seems to be recognition, at least in some quarters, that this is unwise; yet little if any concrete action has followed.⁷¹

The Copenhagen criteria are not, as the cases I have referenced demonstrate, of mere historical importance and interest. Mechanisms to protect democracy, fundamental rights and the rule of law remain as relevant today as they were pre-accession; so too is the specialised human rights court designed to protect them.⁷² To ignore this is to ignore both the strength and the fragility of the EU and of the wider Council of Europe.

⁶⁹ See also, in a judicial context, the recent judgment of the CJEU in *RO*, Case C-327/18 PPU, EU:C:2018:733. The CJEU found that the uncertainty to which the UK's decision to withdraw from the EU, notified under Article 50 TEU, gives rise does not constitute a grounds for non-execution of an EAW issued by the UK. In reaching that conclusion it pointed out in § 52 that: "the United Kingdom, is party to the ECHR [...]. Since its continuing participation in that convention is in no way linked to its being a member of the European Union, the decision of that Member State to withdraw from the Union has no effect on its obligation to have due regard to Article 3 of the ECHR [...]".

⁷⁰ See the [reports on the Council of Europe budgetary crisis](#), following the withholding or alteration of contributions by some states, 16 March 2018. See also the selected examples of new threats to the rule of law in Council of Europe member States in the report of the Committee of Legal Affairs and Human Rights, PACE, 7 September 2017. 3 of the 5 member States listed (Bulgaria, Romania and Poland) are EU Member States and a 4th (Turkey) is a long-standing candidate for EU membership.

⁷¹ In July 2017, in a speech by Federica Mogherini at the Council of Europe's Committee of Ministers, the EU's High Representative for Foreign Affairs and Security Policy stated: "In the meantime, it is essential for us to strengthen the European Court of Human Rights, and to make sure it can continue to deliver on its mandate, that is for us a fundamental mandate. The Court today needs both political and financial support. Politically, there is a duty to always respect its decisions, even when some of us do not agree with them. This is the very essence of the rule of law. But there is more. Following recent decisions, the Court might be faced with an unprecedented number of cases. I think it is in our common interest that all Member States will intervene locally to prevent this excessive amount of cases coming to the Court. But on top of that, all Member States should secure the necessary financial resources for the Court. And we, as the European Union, are willing to show our support to secure the functioning of the Court".

⁷² See, for details, the recent report of the Secretary General of the Council of Europe, *State of Democracy, Human Rights and the Rule of Law. Role of Institutions. Threats to Institutions*, May 2018.

Panel 5
The future of the European Master
Agreement



Introduction to the panel on the future of the European Master Agreement

By Otto Heinz¹

One of the main attractions of working for a central bank and the European Central Bank in particular, especially in the financial law area, is that from time to time one can have international projects that go beyond the daily routine, combining law, finance, politics and innovation with a touch of history.

The work on the European Master Agreement (EMA) is exactly such a project.

It is admittedly highly *technical*, as one would expect from a master agreement in the financial law area.

The *financial* aspects are key as the EMA needs to cater for several different types of complex financial transactions by counterparties. These include derivatives, repos, lending, deposits, securities lending and foreign exchange transactions and require not only diverse product knowledge but also a clear grasp of key legal concepts and business understanding.

Given its *multijurisdictional* nature, it gives us the chance to tackle and compare legal issues in different legal orders. No other master agreement is used under the laws of so many jurisdictions as the EMA. In fact, it provides a special opportunity for scholars and practitioners who are interested in comparative law to see how different legal concepts can be implemented in several different jurisdictions, sometimes with only fine differences.

As will be described today, the EMA is also an *innovative* master agreement in many ways – in fact, many of its merits are down to its innovative nature. It is not yet known widely enough in just how many respects the EMA is unique, displaying progressive features that distinguish it from other master agreements. Moreover, in several instances the EMA has brought about innovations that were only subsequently replicated by the market.

Politics admittedly also plays a role. For example, the question arises regarding the extent to which different stakeholders want to rely on the courts and laws of a given third country with respect to their contractual framework and high-profile financial litigation, especially if this third country is outside the European Union. In any event, it is counter-intuitive or at least not self-evident that banks in Spain and Poland, for example, would use English law documentation, a jurisdiction entirely unrelated to them. And as will also be described later today, relying on the courts and laws of a jurisdiction outside the Union causes a number of different additional complications.

¹ Head of the Financial Law Division, European Central Bank.

And with this, in the light of Brexit, we also sense the touch of history, as the EMA has been developed and used in Europe over the years. It is in many ways a very European project, with all its merits and also difficulties, uniquely conceived in the Union.

The ECB and the Eurosystem are committed to supporting the EMA. I expect us to take an active catalyst role going forward, and one manifestation of this support is today's EMA panel on the agenda of the ESCB legal conference. I get the sense that this catalyst role is gaining traction across the board. For example, this afternoon we will cover another very important recent example of the central banks' catalyst function when we talk about the ESTER project relating to benchmarks. At the same time, it is fundamental to consider that this catalyst function is not without limits. As we discussed and assessed in the conference yesterday, the market economy principle in the Union legal order should also be taken into account when the fine details of such a catalyst role are elaborated. It is fundamental that such intervention be proportionate and justified and it should not unduly interfere with the market. And this certainly applies to the master agreements market as well.

Also with this principle in mind, it should be clear, however, that the EMA is not a public sector project as such. I recall that following some recent press articles about the EMA reform and how it is supported by the Eurosystem, I received a call from the US Federal Reserve and a concerned group of US counterparties asking whether there will be an official requirement to use the EMA in Europe. I was able to assure them that we do not oblige anyone to use the EMA on a mandatory basis (admittedly I did not mention that we would not have the power to do so anyway). In fact, the EMA should be attractive enough that counterparties choose to use it because of its own merits. Accordingly, the project is actually driven by the private sector, with the support of central banks.

We have discussed the EMA on various occasions in the European Financial Markets Lawyers Group (EFMLG), made up of senior financial lawyers of major euro area banks, with some EFMLG colleagues also in the audience. The EFMLG has even set out its concerns and proposals regarding the EMA to the European Banking Federation (EBF). Several EFMLG members and their institutions are active participants in the updating of the EMA. I also expect the group to follow and support the EMA going forward, even if the EMA is used to a different extent by the banks of EFMLG members. During the discussions there was also a consensus in the EFMLG that Brexit and the uncertainties around English law as a jurisdiction in the future outside the Union underline the benefits of the EMA and provide a unique window of opportunity.

I think today's panel is an appropriate representation of the different stakeholders driving the EMA. We are certainly fortunate that our impressive team of speakers from four different institutions accepted the invitation.

We have *Sébastien de Brouwer*, Chief Policy Officer at the EBF, the main sponsor of the EMA. I think it is fair to say that Sébastien is also the best person to speak about the political aspects of the EMA, including the interaction with the different national banking associations and the strategy relating to developing this master agreement.

He will recall the history of the EMA, introduce the special issues relating to Brexit and describe the current EMA reform project.

Our second speaker is *Yolaine Fischer*, the Head of the European and Financial Law Division at the Banque de France. Yolaine will introduce the specific considerations for central banks when using the EMA. In this context she will set out the answers to two key questions from a central bank point of view: first, why should national central banks (NCBs) support the EMA, in other words what are the EMA's key advantages to NCBs, and second, how should they best provide this support.

To cover the matter properly, it is fundamental to get an insight into private sector considerations as well. I am very glad that *Holger Hartenfels*, the Managing Director and Associate General Counsel at Deutsche Bank, is here with us today. Holger and his colleagues at Deutsche Bank are instrumental in the ongoing project to update the EMA to reflect recent regulatory and market developments. Holger will introduce the structure of the EMA and its different elements, describe the changes that are foreseen, and comment on Deutsche Bank's considerations when using the EMA. I expect Holger's presentation of the EMA's unique and innovative features, distinguishing it from other master agreements, to attract particular attention. Holger and Deutsche Bank, as users of several different master agreements in different markets around the world, are uniquely positioned to assess the merits of the different types of contractual frameworks.

The final member of our panel is *Volker Enseleit*. Volker is inter alia in charge of the legal aspects of our foreign reserve and own fund investment activities at the ECB. He will add a number of important considerations about the governance of the master agreements and the involvement of different stakeholders.

There is clearly still a lot of work to be done with respect to the EMA. In addition to the immediate tasks of updating the agreement and the related legal opinions in the different jurisdictions, there are several other important issues to tackle. The governance of the EMA should be further established to function on an ongoing basis. The strategy behind the promotion of the EMA needs to be thought through, selecting the target entities and target jurisdictions. Marketing aspects should not be neglected either. For example, law firms in different jurisdictions can act as champions, promoting the EMA. It is also fundamentally important that the benefits of the EMA, particularly with regard to cross-product netting and marketing, receive adequate recognition through capital requirements. Regulatory change could also be considered in this context.

I believe today's panel will tackle all these different issues and provide a comprehensive overview of the joint efforts of the private and public sector to relaunch the EMA. It is also intended to demonstrate the Eurosystem's strong support for this project. I anticipate that we will have several similar events on this topic in the future, including training sessions hosted by the ECB and the NCBs on the EMA. We hope that many of you in the audience will be more interested in this following today's discussions.

So before I have to interrupt myself, in my capacity as panel chair, because of the need for strict timekeeping, I will quickly hand over to Sébastien.

The European Master Agreement (EMA)

By Sébastien de Brouwer¹

1 Background to the European Master Agreement

Master agreements are standard documents which cover both domestic and cross-border transactions between counterparties. These agreements play a key role in safeguarding the interests of financial institutions, especially when dealing with repurchase transactions (repos), derivatives transactions (swaps) and certain other financial instruments. Master agreements provide a set of common terms and set out the procedures for the underlying transactions. They seek to reduce credit risk through the application of contractual termination clauses and methods of payment netting. In case of default, close-out netting and liquidation methods for such transactions are foreseen. Comprehensive contractual relationships between the parties are set out in the general provisions of such master agreements, in their special provisions and the annexes. Accordingly, it is essential that parties to such master agreements are fully aware of the legal implications and the extent to which the provisions of the master agreements are enforceable.

Amongst these master agreements, the European Master Agreement (EMA) was developed by the European Banking Federation to replace existing master agreements used within the Union for repos and securities lending transactions. The structure was highly innovative due to the possibility to be used for different products.

The EMA was first published² on 29th October 1999 and jointly sponsored by the European Banking Federation (EBF), the European Savings Banks Group (ESBG) and the European Association of Co-operative Banks (EACB). France and Germany were at the time the main promoters of the EMA. Since the beginning it has been supported by the European Central Bank (ECB). It has undergone many revisions (2001, 2004, 2009, 2013 and now in 2018).

The EMA was created to provide a standard text which could be used in different languages (it is available in seven languages: English, French, German, Greek, Italian, Portuguese and Spanish) and under different national laws within the European Union.

The **European Master Agreement** was designed from the start as a multi-product agreement with the ultimate aim to document all trading transactions under one

¹ European Banking Federation.

² The full text of the EMA is available on the [EBF's website](#).

master agreement. As mentioned above, initially the EMA covered repos and securities lending transactions. However, in early 2004 its scope was extended to interest rate derivatives transactions, options and foreign exchange transactions. Moreover, the product annex for deposits and loans was added in 2009.

A single standard multi-product agreement offers many advantages not least that of avoiding the risk of inconsistencies among numerous single product master agreements; speeding up the negotiation process by reducing the volume of master agreements handled and the number of legal opinions required; the inclusion of a close-out netting mechanism which reduces credit risk and hence regulatory capital requirements for financial institutions; reducing the risk of documentation backlogs; simplifying and reducing the number of domestic and cross-border master agreements used within the Union by one master agreement.

The EMA is also designed to be multi-jurisdictional. This means that contracting parties may choose the particular governing law under which it is to operate as well as its contractual language, in this way taking into account individual national legal requirements.

The aim is also to encourage replacement of existing domestic agreements as these create different standards and a fragmentation of the market. In some countries (e.g. Czech Republic) where no domestic master agreements exist, the EMA offers a standard for documentation.

2 The opportunity of a further development of the European Master Agreement and its market acceptance

It is fair to acknowledge that the EMA's clear potential has not yet been fully realised and that it could have a more significant role in the financial legal infrastructure of the Union and the euro area. This is notably owing to the lack of support for the EMA.

It is currently used in a relatively limited way by parties at local level and not a lot for cross-border transactions. This is a pity as the EMA provides for wider use through a standard content across the EU. Further, numerous local master agreements are used besides the EMA in the EU Member States although they could be replaced. It is worth mentioning, that the EMA is required to be used by the ECB and the Eurosystem and the Union as a matter of policy.

The advantages of the EMA and its current deficiencies are well known. As it was not always the case, the legal text itself needs continuous updating to reflect market developments. The same holds true for the legal opinions on the EMA in different jurisdictions which need to be updated regularly. In the absence of such updates, market counterparties will continue to have concerns about the use of the EMA. More in general, the governance of the EMA should be improved and a clear strategy should be defined to support and develop the EMA and its market acceptance.

The topic becomes particularly relevant due to the fact that most of the current standard market documentation in Europe for derivatives, repos and securities lending is governed by English law, and subject to the jurisdiction of English courts. In light of Brexit, English law will no longer be an EU Member State law. Subjecting a master agreement in future to the jurisdiction of the English courts would mean solving disputes in a jurisdiction outside the Union (see below for more detail).

For that reason certain members of the EBF, national banking associations and banks (with the support of the ECB and the European Financial Market Lawyers Group (EFLMG))³ have called upon the EBF to take the necessary measures to address and ensure the long-term viability of the EMA. This requires a concerted effort by the private and public sector.

3 The specific circumstances of Brexit

It might be particularly important to address the long-term viability of the EMA in the light of Brexit although the final form of Brexit has not been agreed yet.

The current market standard documentations in Europe for derivatives (i.e. the ISDA master agreement), for repos and for securities lending (i.e. the Global Master Repurchase Agreement (GMRA) and the Global Master Securities Lending Agreement (GMSLA)) are governed by English law with the jurisdiction of English courts. A key consideration to take into account is that English law will no longer be the law of an EU jurisdiction. Until now, as the UK is part of the EU and the EEA, this means any English court judgement is automatically recognised and enforced across EU Member States and EEA countries. Without some type of deal that replicates the effects of the EU and EEA membership, English law would become a third country law after Brexit. One of the consequences is that English court judgements would not be automatically recognised in EU Member States and EEA countries. That does not mean that an English court judgement will ultimately be recognised and enforced. However, it potentially means more expenses, more uncertainty and more red tape. Indeed, English court judgments will be treated in the same way as any decision of a non-EU court (including US ones). This will lead to uncertainties as to the conformity of the decision by the relevant jurisdiction where exequatur and enforcement are sought. These will need to be assessed and confirmed by a national court.

Some banks and firms in the Union and EEA may consequently be willing to retain the convenience of automatic recognition across the Union and the EEA by opting for an EU law governed master agreement after Brexit. Counterparties may also want to retain specific benefits of EU legislation.

Brexit will also entail that contracts which are subject to English law, have to be amended as the United Kingdom will become a third country to the Union. As way of

³ The European Financial Market Lawyers Group (EFMLG) is a group of senior legal experts from the EU banking sector dedicated to undertaking analysis and initiatives intended to foster the harmonisation of laws and market practices and facilitate the integration of financial markets in Europe. It is hosted by the European Central Bank (ECB) which also ensures its Secretariat.

illustration, in order to conform to the Bank Recovery and Resolution Directive (BRRD)⁴ Union counterparties to an English law governed agreement will need to include a provision with respect to the contractual recognition of bail-in (Article 55 BRRD) and with respect to the contractual recognition of resolution stays (Articles 68- through 71 BRRD). In addition, Brexit will also raise issues relating to the authorisation and the provision of investment services in the Union with respect to counterparties based in the United Kingdom.

Conversely, with regard to derivatives, repos and securities lending the benefits of using master agreements governed by a law within the EU legal framework include: the automatic recognition and enforcement of judgments obtained in one EU Member State in another EU Member State; the legislative framework protecting financial collateral arrangements; recognition, EEA resolution authorities' exercise of their bail-in powers (write-down and conversion) or temporary resolution stays under BRRD implementation legislation and certainty on certain insolvency related matters. It is what the EMA offers as an agreement in local language, governed by different EU Member State laws with jurisdiction of the courts of that EU Member State. Given that the EMA covers derivatives and repos but also other types of financial transactions, it also enables cross-product netting, unlike other master agreements (e.g. the ISDA master agreement).

This development should also be put into perspective with the modernisation of judicial frameworks in some EU Member States. These countries build up capacity to hear cases (including pleadings and evidence to be provided) in English. Such modernisation relates to disputes in international trade relations, including, without limitation, cases relating to transactions on financial instruments and master agreements. For example, such capacity is built in international chambers within the Paris Commercial Court and the Paris Court of Appeal.

This situation represents a crucial window of opportunity for the EMA that should be seized.

4 Overview of the current EBF strategy for the development of the EMA and its market acceptance

Supported by a number of banks, the ECB and the EFLMG, the EBF has revived a group of experts (the EMA Support Group) to address the long-term viability of the EMA. As main sponsor of the EMA, the EBF is driving and coordinating the different efforts to implement the agreed strategy which is broken down into steps and actions in three keys areas.

⁴ Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council Text with EEA relevance (OJ L 173, 12.6.2014, pp. 190–348).

5 Update of the agreements

It is of utmost importance that the EMA documentation is updated regularly to reflect the latest market and legislative development, as it is done in the case of other master agreements. This is the responsibility of the EBF and it is currently being done as a first step so that the updating of legal opinions (as more closely described below) takes into account the latest version of the EMA. Priority was given up to now to the changes deriving mostly from legislative changes at EU level. This work should be finalized by the end of the year 2018.

6 Update of the legal opinions

As referred to above, it is also of utmost importance that the legal opinions are updated on a yearly basis. Without such regular updates of legal opinions, the long-term viability of the EMA is not ensured. According to current set-up, the update of the legal opinions is driven by the local banking associations with local banks and firms (contrary to the update of the EMA documentation which is centralised at the EBF). The EBF has decided to revert to the original approach whereby the updating of legal opinions was decided and effected centrally at the EBF. For the purposes of supporting the update of legal opinions, it is however considered to also involve interested stakeholders in the local market. The local banking associations should be associated, as they are aware of the needs of local counterparties and national requirements.

7 Governance, strategy and promotion of the EMA

With a view to ensuring the long-term viability of the EMA, it is of fundamental importance that the governance of the EMA is strengthened. The main responsibility for this lies in the hands of the EBF. A strategy is being defined to ensure that not only agreements and legal opinions are updated. The proper promotion of the EMA at European and local level has to be ensured as well. This requires the support of other relevant stakeholders (i.e. national banking federations, central banks, market players).

Amongst the other issues that are being discussed for the longer term the possible replacement of local master agreements with the EMA is of utmost importance. There are indeed several jurisdictions in the Union and the euro area where local master agreements are still being used. These local master agreements are sponsored by the national banking associations. In order to channel more resources to the EMA, to increase its use, and to reduce fragmentation in the markets, the question arises regarding the extent to which such local master agreements could be replaced by the EMA. For this purpose, the EMA (with local law, local jurisdiction and local language) could be more actively promoted. This would help making parties in the national markets more familiar and comfortable with it.

Finally, it appears that the EMA is at a crossroads. The agreed strategy should offer the opportunity – with the support of relevant stakeholders i.e. banks, national banking associations, the ECB, the Eurosystem and other counterparties – to increase the use of the EMA at domestic and cross-border levels. Furthermore, the EMA offers an important alternative to other master agreements in the context of Brexit. These positive aspects diminish, in no way at all, the need for a concerted effort from the private and public sectors.

The importance and benefits of the EMA, in particular for Union central banks. The role Union central banks could play in supporting the EMA

By Yolaine Fischer¹

Now that you know a great deal about the European Master Agreement (EMA), we propose to focus on two crucial and quite practical questions. First, what are the benefits of the EMA, especially for Union central banks? Second, what could Union central banks do in order to support the EMA?

In short, I will try to answer the following question: why and how Union central banks should or could promote the EMA?

My presentation will therefore follow a very simple structure. In my first part, I will expose the main reasons why the EMA should be promoted by Union central banks. In my second part, I will suggest some ideas of how this promotion could be implemented.

1 Introduction

Before getting into the substance, I need to highlight some elements of the context.

First, I want to underline the current diversity of master agreements used today in Europe to provide a contractual framework for financial transactions.

Regarding cross-border transactions, several different templates of master agreements may be used. Besides, in each country, there are also other master agreements templates, generally used for domestic transactions.

Each master agreement has two main features which distinguish it from other master agreements, namely it covers a specific type of transactions (derivatives, securities lending, repurchase transactions, etc.) and it is conceived and subject to the rules of a specific governing law. Sometimes the master agreement lets the parties choose between several possible governing laws. For instance, historically, the International Swaps and Derivatives Association (ISDA) master agreement could be governed either by English law or by the law of the State of New York. Very recently, due to the

¹ Head of the European and Financial Law Division at Banque de France and member of the ESCB Legal Committee. The views expressed only reflect those of the author, and not necessarily those of the Banque de France. The author wishes to thank Stéphane Béraud for his enthusiastic and inspiring views regarding the need to promote the EMA, as well as Gisèle Toli for her feedback regarding recent negotiations of financial master agreements.

Brexit perspective, the ISDA has developed two new versions of its master agreement, respectively under French law and under Irish law. Another example is the EMA, which is quite specific regarding the issue of governing laws, since its vocation is to encompass all the Member State governing laws (this subject will be developed in Part 2.1.3 below).

In practice, this means that each financial player – like central banks – generally uses several types of master agreements, depending, first, on the type of transaction it intends to execute with each counterparty and, second, on the result of the negotiation with each counterparty, which may have its own preferences.

So, as you will have understood, the market of financial master agreements is a real competitive market.

Second, I would like to point out that, despite the diversity of financial master agreements, there is in practice, at least for cross-border transactions, a massive predominant use of master agreements governed by Anglo-Saxon and notably English law, even between counterparties which are not Anglo-Saxon.

When you think about it, this is absolutely not optimal since in Europe most legal systems are civil law systems, which are very different from common law systems.

Moreover, the Brexit perspective makes this situation even more suboptimal, since English law will become a non-Member State governing law for master agreements, and English courts and proceedings will no longer be subject to Union law. This situation will create very concrete difficulties, as already explained in the previous presentation.

2 Why? ...or the benefits of the EMA

What are the benefits of the EMA? The question is all the more interesting as, until now, the EMA has not totally managed to be widely used, even on European financial markets.

The advantages of the EMA come from its two main features: an exceptional ambit and a European vocation.

2.1 The exceptional ambit of the EMA

The ambit of the EMA is exceptional because it is simultaneously multi-product, multi-lingual and multi-jurisdiction.

2.1.1 The EMA is a multi-product agreement

The EMA covers, in one single agreement, several types of transactions: repurchase transactions (repos), securities lending, derivatives, deposits and loans, whereas other master agreements usually deal with only one of these products.

The main benefits are the following.

First, the simplicity: for each of your counterparties, you do not need to negotiate and sign several contracts, the EMA is sufficient. This is all the more true for central banks which trade mainly derivatives and repos.

Second, once you have signed your EMA, you benefit from one single contractual framework with your counterparty which is also far simpler to manage.

Last, but not least, your financial risks are reduced. Indeed, in case of default of your counterparty, the perimeter of the netting will cover a wider range of transactions. Let us take an example: let us suppose that you and your counterparty B usually trade financial transactions together and, one day, B goes bankrupt. Let us say that regarding repos, you owe 40 to B, and B owes 70 to you and that, regarding derivatives, you owe 30 to B, and B owes 10 to you.

If you have two separate master agreements for repos and derivatives, then regarding repos your risk is equal to $(70 - 40) 30$, and regarding derivatives you have no exposure since, in total, you are the debtor of 20. In this case, you will therefore have to pay 20, and you will remain with a risk of 30.

But if you have an EMA, you will be entitled to net all the transactions, so your risk will be equal to $(80-70) 10$.

2.1.2 The EMA is a multi-lingual agreement

The EMA is translated into several European languages. It makes its use simpler and friendlier for lawyers, especially regarding the fact that legal concepts do not always have strict equivalents in other legal systems.

Besides, under certain laws and circumstances, the signature of an agreement in our own language may be compulsory, especially for entities in charge of public tasks such as central banks. This is the case for instance in France with the law called “loi Toubon”².

2.1.3 The EMA is a multi-jurisdictional agreement

In theory, with the EMA you can choose any Member State’s law as governing law of the agreement. In practice, you will probably choose a governing law which benefits

² Loi n° 94-665 du 4 août 1994 relative à l’emploi de la langue française.

from an up-to-date legal opinion. But, still, you have the choice between several Member State's laws.

This is a considerable advantage because you can choose your own law, or at least a law close to it – like another continental law –, so that you can better control the legal risks.

This is all the more useful for central banks which contrary to large private banking groups generally do not benefit from foreign branches with lawyers competent in foreign laws.

Moreover, this wide choice of governing laws opens the possibility to use the EMA not only for cross-border transactions but also in a domestic context.

The EMA also limits a possible reputation risk for a central bank to find itself in the situation where, because of the governing law of the agreement, it would unwillingly circumvent rules which it would have publicly supported.

Finally, another crucial advantage, in particular with Brexit, results from the choice of the competent court, as already explained in the previous presentation, notably with regard to the issue of the enforcement of decisions.

2.2 The European dimension of the EMA

We have seen the advantages resulting from the EMA's exceptional ambit. This ambit results from the EMA's very vocation, i.e. its European vocation, which has also its own advantages.

However, I must specify here that these advantages are not fully exploited today. For this reason the EMA still needs some help to find the entire place it deserves.

Indeed, it can be observed in practice that some counterparties are sometimes reluctant to use it, because they consider that the legal opinions are too old, or sometimes simply because they are not familiar with it.

Still, using an EMA, under the condition that it is regularly updated, brings a high level of confidence regarding compliance with European requirements since, naturally, the EMA's sponsors pay a specific attention to them.

Finally, the EMA, thanks to its European vocation, appears as the best means to limit or even break the largely prevailing position of some Anglo-Saxon financial master agreements. As we saw, in the context of Brexit, this is all the more important as a hard Brexit would create new legal risks.

The EMA is therefore not only a means to improve the legal certainty of financial transactions, especially for Union central banks, but also a strategic lever to promote European continental financial centres, including European continental law firms.

2.3 Intermediary conclusion

As a conclusion regarding the benefits of the EMA, I wish to underline again that it is not only a means to simplify and alleviate the operational burden. If regularly updated, it can also increase very considerably the legal certainty of transactions, because it is by nature risky for lawyers to work with agreements governed by foreign laws, especially when they are radically different as in the case of common law and continental law.

If the EMA is beneficial to the reduction of financial risks and to the improvement of the operational simplicity and legal certainty of European System of Central Banks (ESCB) transactions, then it is beneficial to the achievement of the ESCB's tasks.

In particular, the EMA helps to achieve compliance with Article 18 of Protocol No 4 on the Statute of the European System of Central Banks and of the European Central Bank (ECB). Indeed, according to this article, the ECB and the national central banks may conduct lending operations based on "adequate collateral". In order to be "adequate", an obvious pre-requirement is that the legal certainty of the collateral transfer be ensured.

In short, it is in the interest of the ESCB and in line with its tasks to support the EMA.

3 How?

Let us see how we could bring such support. My suggestions are of two types. First, Union central banks could give the example by expanding their own use of the EMA as much as possible. Second, Union central banks could bring support to the EMA by helping it not only to be regularly updated, but also to be better known by financial players.

3.1 Let us give the example

What can we do internally?

The first step would be to check the consistency of the internal operational process with the EMA requirements, especially when the new updated version of the EMA will be available.

On this basis, we could update – or, as the case may be, create – our model of Specific Provisions containing all the provisions to negotiate before the signature of each EMA.

Then, we could adopt an internal contractual policy requiring that the EMA be systematically proposed to new counterparties (if need be, with some possible exceptions).

In order to get the consent of the counterparties, we could also prepare the list of arguments justifying our preference for the EMA. For instance, in certain cases, the choice of the EMA may be a Eurosystem requirement. This is the case when a national central bank acts as agent of the ECB for the management of its foreign reserve assets, in relation to transactions made with European counterparties³. In other cases, this choice could be justified, for example, by the reduction of legal risks by choosing a Member State's law, the reduction of reciprocal net exposure, etc.

Regarding existing counterparties with which we have already signed another master agreement, we could suggest to switch to the EMA on different occasions, for instance, when we contemplate a new type of transactions which would in any case require the signature of an additional agreement. Besides, in any case, with Brexit, many master agreements may have to be renegotiated, for instance, if UK entities move their contracts to subsidiaries in the Union. This could also provide a large opportunity to expand the EMA.

3.2 Let us bring support to the EMA

In order to be widely used, the EMA needs, first, to be regularly updated and, second, to be better known by financial players. To this end, several types of actions can be contemplated.

First, Union central banks could bring their operational support to the EMA's updates. This is what the ECB, Bundesbank and Banque de France are currently doing through their participation to the technical group set by the European Banking Federation in charge of the EMA's ongoing update.

It would also certainly be useful to co-organise events with the European Banking Federation, such as seminars addressed to public authorities and domestic financial players, to sensitise them to the importance of the EMA, and training sessions on EMA in order to familiarise financial lawyers with its content, as usually done for other financial master agreements.

Second, Union central banks could bring their financial support for the regular update of the various legal opinions.

Finally, Union central banks could help monitoring the consistency of the EMA with draft regulations, whether national or European.

As counsel to public authorities, they could even have a proactive role and impulse regulatory changes likely to reinforce the EMA, when appropriate. This is clearly what ISDA has just done in France (in the perspective of the adoption of its master

³ See Guideline of the European Central Bank of 20 June 2008 on the management of the foreign reserve assets of the European Central Bank by the national central banks and the legal documentation for operations involving such assets (recast) (ECB/2008/5) (OJ L192, 19 July 2008, p. 63).

agreement under French law), e.g. by obtaining the enlargement of netting to spot foreign exchange transactions⁴.

Finally, Union central banks could also plead, in their own country, for the creation of a special court dedicated to international financial litigation, as recently made in France with the creation – in addition to the already existing specialised chamber of the *Tribunal de Commerce de Paris* – of a special chamber of the Court of Appeal of Paris dedicated to international trade litigation.

4 Conclusion

In brief, the extension of the use of the EMA across the whole European financial markets could be our target if Brexit runs its full course.

I have certainly not been exhaustive on the EMA's benefits and on the actions we could undertake to promote it. But in any case, I hope the first thing you will do when coming back to your respective central banks will be to discuss with the relevant people, in order to prepare what could be, because of a regrettable context from an Union construction perspective, at least a positive big bang in the area of financial contracts.

⁴ See explanatory memorandum of the [French Projet de loi relatif à la croissance et la transformation des entreprises \(ECOT1810669L\)](#): “L'article 23 rassemble un ensemble de mesures destinées à poursuivre le renforcement de l'attractivité de la place financière (...). (...) L'association internationale des Swaps et Dérivés (ISDA) a recherché un ou plusieurs droits de l'Union européenne à 27 dans lesquels rédiger son contrat-type pour parer aux conséquences juridiques du Brexit : son développement en droit français constitue un enjeu majeur pour la Place. Le Haut comité juridique de place a travaillé aux conditions de développement du contrat type en droit français, et a mis en évidence la nécessité de modifier le droit sur quelques points très spécifiques : (i) en droit français, le champ des opérations éligibles à la compensation-résiliation ne couvre pas les opérations de change au comptant (spot FX) et la vente, l'achat, la livraison de métaux précieux ou encore les opérations sur quotas de CO2, ce qui est identifié comme un frein au développement du contrat en droit français (...).”

European Master Agreement (EMA) – structure and new developments

By Holger Hartenfels¹

The Master Agreement for Financial Transactions, commonly known as the European Master Agreement (EMA) is a multi-language, multi-jurisdictional and multi-product master agreement, which covers a broad range of transactions. The strength of the EMA is its ability to support cross-product netting and cross-product margining and its unique building block structure, which provides parties with a maximum of flexibility. Although the EMA so far has weathered the test of time, a review and modernisation of its provisions would address various developments of the past years. This article provides an overview of the structure of the EMA and the main changes that are currently under discussion.

1 Background, characteristics and strength

The EMA was developed in late 1997² with a view to establishing a single standard of legal documentation on European level that could supplement and support the introduction of the euro, the new euro reference rates (e.g. EURIBOR and EONIA) and the development of new euro denominated money market operations.³

In spring 1998, three European banking associations, namely the European Banking Federation, the European Savings Bank Group and the European Association of Cooperative Banks decided to jointly sponsor the new documentation and published the first version of the EMA on 29 October 1999.⁴ The EMA was modified in 2001 and substantially revised in 2004. The European Central Bank (ECB) started using the EMA for repurchase transactions with counterparties organised in the European Union and Switzerland in November 2001.⁵ Since March 2005, it is also being utilized for over-the-counter (OTC) derivatives.⁶

¹ Managing Director and Associate General Counsel, Deutsche Bank.

² See Bosch, U. (1999), pp. 135-137; Harding, P., Johnson, C. (2011), p. 338.

³ See Stadler, V., Lannoo, K. (2000), p. 16.

⁴ A copy of the 2004 version of the EMA can be downloaded from the [website of the European Banking Federation](#).

⁵ See Guideline of the European Central Bank of 16.11.2001 amending Guideline ECB/2000/1 on the management of the foreign reserve assets of the European Central Bank by the national central banks and the legal documentation for operations involving the foreign reserve assets of the European Central Bank (ECB/2001/12), (OJ L 310, 28.11.2001, p. 31).

⁶ See Guideline of the European Central Bank of 11.3.2005 amending Guideline ECB/2000/1 on the management of the foreign reserve assets of the European Central Bank by the national central banks and the legal documentation for operations involving the foreign reserve assets of the European Central Bank (ECB/2005/6), (OJ L 109, 29.4.2005, p. 107).

The EMA is a multi-language, multi-jurisdictional and multi-product agreement. It has been published in seven languages⁷ and can be used under various national laws, in particular the laws of all Member States of the European Union. The products covered by the EMA include repurchase transactions, securities lending transactions, OTC derivatives, deposits and loans. The EMA's flexible building block structure allows for multiple uses: The EMA allows for single-product master agreements as well as multi-product master agreements. As a result, the EMA is equally suitable for an agreement relating, for example, only to OTC derivatives and a master agreement covering both OTC derivatives and securities financing transactions (SFT) like repurchase or securities lending transactions.

The most notable strength of the EMA is its ability to support cross-product netting and cross-product margining.

Unlike other market standard documentation, the EMA does not require any additional contractual arrangement to support cross-product netting (such as "bridges" or "master masters") to synchronise the termination of the bilateral transactions under multiple single-product master agreements in order to combine the close-out amounts calculated under such master agreements into single net amounts. Under the EMA, all transactions, irrespective of product types covered, are terminated, closed-out and netted at the same time, in accordance with the same provisions and under the same governing law.⁸

The EMA's structure could also be helpful to alleviate concerns that have led to specific regulatory constraints. The regulatory recognition of cross-product netting is still subject to limitations and specific organisational requirements,⁹ partially for good reasons. The combination of single-product master agreements through "bridges" or "master masters" adds complexity and legal risks,¹⁰ especially if master agreements are governed by different laws. Cross-product netting under the EMA avoids such complications.

Similarly, the regulatory recognition of cross-product margining is limited. The European uncleared margin rules for OTC derivatives¹¹ require separate margining. Reducing OTC derivative exposure through securities borrowed under an SFT would only be possible, if the borrowed securities qualify as "eligible collateral" as defined

⁷ The available languages include: English, French, German, Greek, Italian, Portuguese and Spanish.

⁸ Bosch, U. (1999), p. 139 refers to the EMA as the "more consistent, and perhaps more credible, structure".

⁹ See Article 295 point (c) and Article 296(3) Regulation (EU) No 575/2013 of 26.6.2013 on prudential requirements for credit institutions and investment firms and amending regulation (EU) No 648/2012 (CRR) (OJ L 176, 27.6.2013, p. 1, and corrigendum published in OJ L 321, 30.11.2013, p. 6); Cross-product netting can only be used by institutions that have received approval to use the internal model method (IMM). It is limited to the netting of derivatives and SFT and requires the competent authority to notify the European Banking Authority (EBA). Article 429a CRR excludes cross-product netting for leverage ratio purposes.

¹⁰ The additional legal risks are referred to in Article 296(3) point (b) CRR, which requires supplemental legal opinions on the impact of the "bridge" or "master master" on the material provisions of any master agreement that is included in the cross-product netting.

¹¹ See Commission Delegated Regulation (EU) 2016/2251 of 4.10.2016 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty (OJ L 340, 15.12.2016, p. 9).

in Article 4 Delegated Regulation (EU) 2016/2251. This means that, e.g. borrowed shares would have to be part of a main index specified pursuant to Article 187(8) point (a) CRR. Further, all thresholds or minimum transfer amounts would have to be calculated based on the OTC derivatives' exposure only.

However, considering the latest European initiatives, especially the introduction of a new clearing threshold for financial counterparties,¹² it is expected that a considerable number of financial counterparties with small OTC derivatives portfolios, like mutual funds, will no longer be subject to the uncleared margin rules for OTC derivatives. These market participants would then be able to fully benefit from cross-product margining.

2 Building block structure

Another characteristic of the EMA is its “building block” structure.¹³ A master agreement based on the EMA documentation will always consist of the general provisions that apply to all transactions and product types (the General Provisions) and those provisions which constitute the agreement negotiated and executed by the parties (the Special Provisions), and one or more product annexes. The master agreement can be supplemented by an annex, which provides for the exchange of variation margin (the Margin Maintenance Annex). To highlight the technical terms defined in the EMA, these are referred to using capital letters.

The General Provisions form the basis of the agreement, comparable to the pre-printed forms of the French *Convention cadre FBF relative aux opérations sur instruments financiers à terme* or the German *Rahmenvertrag für Finanztermingeschäfte*. The General Provisions contain contractual principles that are applicable to all transactions and all product types. They include terms relating to purpose and structural interpretation of the master agreement and the single agreement concept (Section 1 General Provisions), terms governing the confirmation of transactions (Section 2 General Provisions), terms regarding the performance of payment and delivery obligations (Section 3 General Provisions), including the settlement netting (Section 3(4) General Provisions), provisions on termination and close-out netting upon an event of default or change of circumstances (Sections 6 and 7 General Provisions) and clauses on governing law and jurisdiction, including arbitration (Section 11 General Provisions).

The General Provisions are supplemented by the Product Annexes for the relevant product types and the Margin Maintenance Annex (see Chart 1). The Product Annexes include all terms that are only relevant for the respective product type, such

¹² See Proposal of the Commission for a Regulation amending Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivatives contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories, dated 4.5.2017 (COM/2017/0208 final): Introduction of a new Article 4a(1) Regulation (EU) No 648/2012.

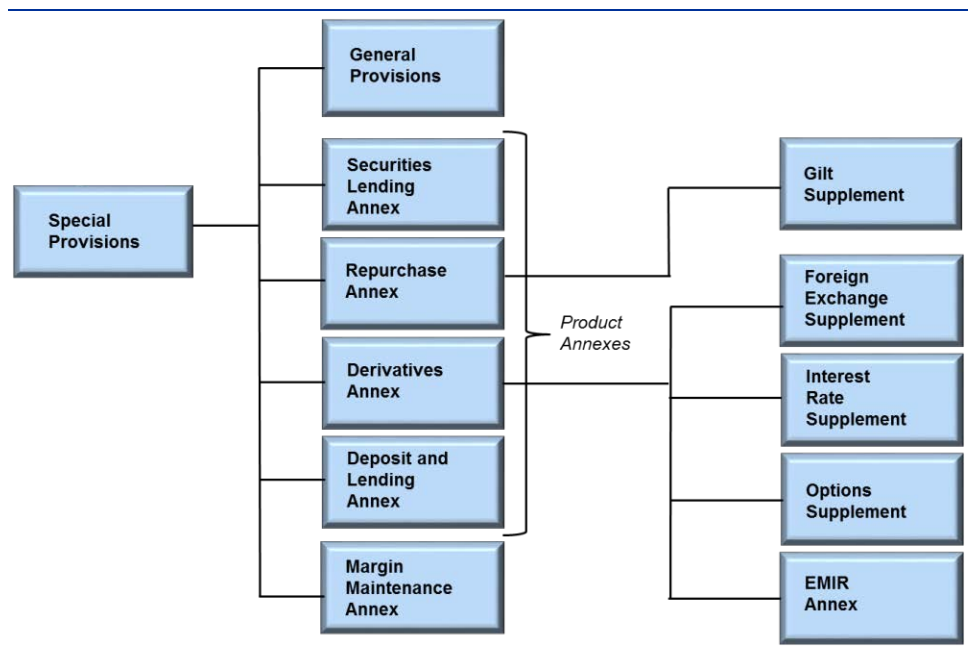
¹³ See also the overviews in Bosch, U. (1999), pp. 140-142; Behrends, H. (2016), pp. 136-141; Bergfort, M. (2009), pp. 451-460; Harding, P., Johnson, C. (2011), p. 338, Hartenfels, H (2005), pp. 67, Jahn, U, Reiner, G (2017), § 114(5).

as provisions on late delivery of securities and consequential damages for securities loans and repurchase transactions. Some Product Annexes, like the Derivatives Annex or the Repurchase Annex, have additional supplements for specific transaction types, like interest rate derivatives or repos on gilt-edged securities.

The Special Provisions are the only part of the master agreement that is negotiated and executed by the parties. They incorporate by reference the General Provisions and specify the applicable Annexes and Supplements. They also contain the selections and modifications of the General Provisions and Annexes agreed between the parties. The Special Provisions are therefore comparable to the Schedule to the ISDA Master Agreements or to Annex I to the Global Master Repurchase Agreement.

The Special Provisions determine whether the master agreement is a single-product master agreement or a multi-product master agreement, and whether the master agreement is subject to variation margin requirements or not. A derivative master agreement similar to the German *Rahmenvertrag für Finanztermingeschäfte* consists of the following components: the Special Provisions, the General Provisions, the Derivatives Annex and the Interest Rate Supplement.

Chart 1
Building block structure



3 Need for modernisation

The core of the EMA documentation, its General Provisions, reflects the market standard as of 2004, i.e. prior to the global financial crisis of 2007-2008. Although the

EMA has weathered the test of time so far, a review and modernisation of its provisions is necessary to address numerous developments.¹⁴

As the documentation practice has gradually changed over time, the EMA needs to adapt. Major trends in documentation practice are the shortening of grace periods applicable to events of defaults, especially to insolvency and failure to pay events. Notice provisions have been modernised¹⁵ and situations have been addressed in which parties impeded the receipt of a notice in order to prevent its effectiveness. Another important trend that already started after the Asian Crisis in 1997-1998 and gained momentum following the terrorist attack on the World Trade Centre on 11 September 2001 is the inclusion of clauses that address force majeure and impracticability.¹⁶

The financial markets and the post-trade processing of transactions have also experienced considerable developments. Negative interest, new day count fractions and business day definitions (TARGET2), to name only few, need to be addressed. The development of new transaction types, like forward-starting repurchase transactions that create derivative-type of counterparty credit risk exposure, need consideration as well.

The legislative initiatives which reshaped the regulatory framework applicable to financial transactions in response to the global financial crisis of 2007-2008 have been, and continue to be major drivers for the modernisation of market standard documentation. Particularly important in this respect are the European Market Infrastructure Regulation (EMIR),¹⁷ the Securities Financing Transactions Regulation (SFT Regulation)¹⁸ and the Benchmark Regulation (BMR).¹⁹ Most of the organisational requirements established by Article 11(1) EMIR and the related Delegated Regulation (EU) No. 149/2013,²⁰ especially the requirements for timely confirmation, portfolio reconciliation and dispute resolution, are reflected in the EMIR

¹⁴ On 15.12.2009, one year after the Lehman Brothers' collapse, the European Financial Markets Lawyers Group organised a high-level legal symposium in London to discuss the lessons learned from the financial crisis. The main conclusions have been summarized in [report dated 12.04.2010](#).

¹⁵ See the comprehensive overview of notification provisions used in standard market documentation, including those that still mention "telex" or "telexfax", in European Financial Markets Lawyers Group (2010), Annex 2, pp. 43-44.

¹⁶ See the comprehensive overview of force majeure clauses used in standard market documentation in European Financial Markets Lawyers Group (2003), Annex 2, pp. 41-44. See also Hartenfels, H. (2005), p. 74 on the 2001 proposals of the Federal Reserve Bank's Global Documentation Steering Committee (GDSC) and on the observation that the EMA does not provide yet for a robust force majeure clause.

¹⁷ Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4.7.2012 on OTC derivatives, central counterparties and trade repositories (OJ L 201, 27.7.2012, p. 1).

¹⁸ Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25.11.2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012 (SFT-R) (OJ L 337, 23.12.2015, p. 1).

¹⁹ Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8.6.2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 (OJ L 171, 29.6.2016, p. 1).

²⁰ Commission Delegated Regulation (EU) No 149/2013 of 19.12.2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on indirect clearing arrangements, the clearing obligation, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a CCP (OJ L 52, 23.2.2013, p. 11).

Annex published in 2013. However, the margin requirements for uncleared OTC derivatives outlined in Article 11(3) EMIR and in the Delegated Regulation (EU) 2016/2251 are still to be implemented.

Last but not least, numerous court decisions have influenced documentation over time. One example are the court rulings on the effectiveness of the condition precedent clause in Section 2(a)(iii) of the ISDA Master Agreement,²¹ a clause which find its equivalent in Section 3(3) of EMA's General Provisions. The court rulings and the following discussion with the UK regulators prompted the International Swaps and Derivatives Association, Inc. (ISDA) to propose the 2014 Amendment Agreement²² which modifies the condition precedent clause by introducing a time limit on the operation of that provision.

4 Proposed changes

On 26 September 2016, the European Banking Federation formed a small working group,²³ which developed a concept and comprehensive working plan for the modernisation of the EMA. The working group has created first drafts of amendments for substantially all parts of the EMA documentation. The working group plans to finalise the revisions by the end of the year 2018. The following overview focusses on the main changes that are currently under discussion.

4.1 General Provisions

Among the changes that the working group is considering is a modification of Section 2(2) General Provisions governing the confirmation practice under the EMA to provide the parties with more flexibility. The condition precedent clause in Section 3(3) General Provisions could be amended to better cope with the legal concepts prevailing in civil law jurisdictions (e.g. the right to withhold performance),²⁴ the Special Provisions could also include a sample clause to allow parties to limit the exercise of its withholding rights. The Business Day definition in Section 3(7) General Provisions will be modified to refer to the TARGET2 system. The working group is contemplating a new definition of Margin to distinguish between title transfer financial collateral and security financial collateral in Section 3(9) General Provisions,

²¹ See for United Kingdom: Court of Appeal in *Lomas v JFB Firth Rixson Inc* [2012] EWCA Civ 419 (3.4.2012); previous High Court decisions include: *Lomas v JFB Firth Rixson Inc* [2010] EWHC 3372 (Ch); *Lehman Brothers Special Financing Inc v Carlton Communications Ltd* [2011] EWHC 718 (Ch); *Pioneer Freight Futures Co Ltd v Cosco Bulk Carrier Company Ltd* [2011] EWHC 1692 (Comm) and *Britannia Bulk plc v Pioneer Navigation Ltd* [2011] EWHC 692 (Comm); for the U.S.A.: *Metavante Case*, *Lehman Brothers Holdings, Inc, et al* (Case No 08-13555(JMP)), Bankr SDNY, 15.9.2009).

²² International Swaps and Derivatives Association, Inc., (2014) press release "[Amendment to the ISDA Master Agreement for use in relation to Section 2\(a\)\(iii\) and explanatory memorandum](#)" dated 19.6.2014.

²³ The working group includes representatives from the European Central Bank, national central banks and of the private banking sector.

²⁴ See Article 1219 of the French *Code Civil* (as modified by the *Ordonnance* n°2016-131 of 10.2.2016): "*Une partie peut refuser d'exécuter son obligation, alors même que celle-ci est exigible, si l'autre n'exécute pas la sienne et si cette inexécution est suffisamment grave.*"

and to potentially support in future the exchange of initial margin in accordance with Article 19 Delegated Regulation (EU) 2016/2251. The representations under Section 5 General Provisions could be modernised by broadening the title transfer representation to cover the provision of Title Transfer Margin and by adding new representations with respect to the accuracy of specified information. The Event of Defaults specified in Section 6(1)(a) General Provisions will likely see a shortening of grace periods for Failure to Pay or Deliver, Cross Default and Insolvency events and the Merger without Assumption event may be modernised. The Change of Circumstances specified in Section 6(1)(b) General Provisions could see substantial changes. The working group is also looking at the introduction of a new Impossibility Event, which addresses a potential force majeure or act of state with appropriate waiting periods. Further, the clause on Credit Event upon Restructuring may be extended to cover additional events, like change in ownership or restructuring of capital, which may also impact on the creditworthiness of a party. Section 6(4) General Provisions will likely introduce the new concept of a “relevant entity”. This concept would mean that if an Event of Default or certain Change of Circumstances occurs with respect to such relevant entity, e.g. a parent company or subsidiary of a party, the termination of the transactions outstanding under the master agreement may be permitted. The working group is reviewing additional methodologies for the calculation of Transactions Values in the definition of Final Settlement Amount in Section 7(1)(a) General Provisions. The manner of giving Notices specified in Section 8 General Provisions could be modernised by deleting telex and clarifying the meaning of electronic messaging systems. The Governing Law clause in Section 11(1) General Provisions may be clarified by the addition of non-contractual obligations.

4.2 Margin Maintenance Annex

For the Margin Maintenance Annex, the working group is discussing substantial revisions to reflect the uncleared margin requirements outlined in Delegated Regulation (EU) 2016/2251. The focus is on the exchange of variation margin and the title transfer of eligible collateral within one Business Day, subject to the permitted minimum transfer amounts, but without any thresholds. The exchange of initial margin and the segregation requirements outlined in Article 19 Delegated Regulation (EU) 2016/2251 will likely be addressed by a separate annex or a new supplement, to be drafted at a later point in time. The menu provided in Section 1(2) Margin Maintenance Annex that enables parties to choose between the margining of single transactions, cross transaction margining within a specified product type (e.g. OTC derivatives only) or cross-product margining will continue to exist. However, the scope of margining may be broadened to cover deposits and loans and to support parties that want to enter into margin lending transactions. The definition of Exposure in Section 1(3) Margin Maintenance Annex could be restructured to better distinguish between the different product types. The timing of the calculation and the notification of the margin requirement and the transfer of eligible collateral specified in Section 1(1) and 2(2) Margin Maintenance Annex will likely be aligned with the uncleared margin requirements outlined in Delegated Regulation (EU)

2016/2251. A new list of eligible collateral and a new obligation to substitute ineligible collateral in a timely fashion may be introduced in Section 2(3) Margin Maintenance Annex. The provisions governing the substitution of collateral could be redrafted and a new provision on dispute resolution may be introduced.

4.3 Repurchase Annex

Only minor adjustments are expected regarding the Repurchase Annex. Negative pricing rates could be addressed in Section 2(6) of the Repurchase Annex and forward-starting repurchase transactions may either be reflected in the Repurchase Annex or in a new supplement, to be drafted at a later point in time.

4.4 Derivatives Annex

No fundamental changes are expected with respect to the architecture of the Derivatives Annex and the “bridge” provided in Section 2 Derivatives Annex that enables parties to agree on any market standard documentation suitable for confirming their OTC derivatives.²⁵ What may be introduced, however, is a new section on late deliveries and a new provision that implements the organisational requirements of Article 28(2) BMR, i.e. a clause that addresses the event that a reference rate or other benchmark is materially changed or discontinued. The Interest Rate Supplement will likely see new provisions on negative interest rates and a modernisation of day count fraction definitions in Section 4(7) Interest Rate Supplement.

4.5 Outlook

While the working group’s efforts with respect to the modernisation of the EMA documentation continue, the next tasks are already on the horizon. A new draft instruction letter will be developed, which will form the basis for the commissioning of new legal opinions necessary for the EMA to be successfully placed in the market²⁶. In addition, the working group will also consider the appropriate announcement of the new EMA and the preparation of supporting material for a planned roadshow and subsequent trainings.

²⁵ See Bergfort, M (2009), p. 457.

²⁶ The availability of written and reasoned legal opinions is a prerequisite for the regulatory recognition of close-out netting under Article 296 CRR.

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Governance and supporting architecture relating to the EMA

By Volker Enseleit¹

The European Central Bank (ECB) has supported and used the Master Agreement for Financial Transactions, commonly referred to as the European Master Agreement (EMA), almost from the time the EMA was created. From 2005 to 2006, the ECB replaced most of the other master agreements it had used at that time for certain transactions with European counterparties with the EMA. As a result, the ECB's European counterparties were, from that time onwards, only offered the EMA for most types of transactions carried out by the ECB in the financial market. Despite the use of the EMA by the ECB and by certain euro area national central banks (NCBs), the EMA is still not widely used in the European financial market. There are several reasons which could have led to this result. The ECB assessed the situation and decided in 2018 to further support the EMA and to cooperate with the European Banking Federation (EBF) in relation to governance and the supporting architecture of the EMA.

1 Background

The ECB is one of the main users, if not the main user, of the EMA. The EMA is a multi-language, multi-jurisdictional and multi-product agreement, which the ECB – also being active in several jurisdictions, in several languages and involved with several product types – considered an appropriate agreement for its activity. Despite the ECB's use and public support of the EMA, the EMA did not become market standard documentation for financial transactions within its scope in Europe. As a consequence of this the ECB encounters certain difficulties when negotiating its financial contracts with its European trading counterparties given that the ECB's counterparties are only familiar with the English-law-governed market standard documentation that they currently use. Owing to the ECB's difficulties in negotiating its master agreements and also owing to Brexit (which, if actually implemented, will cause the governing law of the documentation currently constituting market standard to no longer be a law of a European Union jurisdiction), the ECB considers that the EMA should be more strongly supported by the ECB and certain euro area NCBs. Thus, the ECB has decided on a set of measures to support the EMA. Such measures are laid out below.

Before setting out a description of the measures, note in particular that the EBF, in cooperation with the European Savings Bank Group and the European Association

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of Cooperative Banks, is the sponsor of the EMA. The cooperation by the ECB and certain euro area NCBs is not meant to change the current sponsorship set-up.

2 Legal opinions

In the past, the legal opinions for the EMA were not kept updated on a yearly basis. The other master agreements that constituted, and constitute market standard in Europe for their respective product areas are governed by English law and benefit from English-law legal opinions on their legality, validity and binding nature, as well as on their enforceability in accordance with their terms. In addition, the English-law legal opinions are supplemented by legal opinions that currently relate to 65 jurisdictions, such that the main jurisdictions in which the users of these master agreements are located are also covered as regards the effect the national law of the place of incorporation of the relevant user might have on such a master agreement.

Legal opinions are required for the recognition of contractual netting as risk-reducing under Article 295 of the Capital Requirements Regulation (CRR)². The effect of the netting should be that one single net amount constitutes the exposure of one counterparty to the other counterparty under a master agreement. Competent authorities shall recognise netting agreements only where the conditions set out in Article 296 of the CRR are fulfilled, which includes, inter alia, that the relevant counterparty has provided the competent authority with a written and reasoned legal opinion to the effect that, in the event of a legal challenge to the netting agreement, the counterparty's claims and obligations would be one single net amount. The legal opinion shall refer to the jurisdictions in which the counterparties are incorporated and in which the branches that are involved are located, as well as the law governing the individual transactions included in the netting agreement. Thus, the requirement to have a complete set of up-to-date legal opinions is of high importance.

The costs for legal opinions are significant and, as a result, the ECB decided that it will contribute to the costs associated with the EMA and, above all, the costs for the legal opinions. The ECB took this decision despite the fact that neither the ECB nor the counterparties require the legal opinions for capital relief purposes as regards financial transactions with the ECB, given that exposures to central banks are assigned a 100% risk weight under Article 114 of the CRR. However, as it is a user (in fact, the main user) of the EMA, the ECB considered it appropriate to contribute its share of the costs associated with the EMA. Also, the fact that a legal opinion is important as regards the legal validity, binding nature and enforceability of the master agreement to which the legal opinion relates should not be neglected at times when the capital relief aspect is often the most prominent one. The ECB invited the euro area NCBs to contribute to the costs of the legal opinions as well. The costs of the legal opinions shall, therefore, be covered partly by this means and partly by a subscription fee for individual users. The master agreements currently constituting

² Regulation (EU) No 575/2013 of the European Parliament and of the Council of 25 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013).

market standard for their respective product category are directly financed by the different associations sponsoring the relevant master agreement via a membership fee which practically includes a subscription fee. This has not been the approach chosen by the EBF before now. Members of the EBF consist of the national banking associations as opposed to the commercial banks directly. It is now envisaged that the commercial banks will subscribe directly to obtain the legal opinions for the individual jurisdictions required. The fact that the other master agreements used internationally in Europe only have one governing law (English law) makes the task of establishing legal opinions significantly easier. In contrast to this, the governing law clause of the EMA is meant to be freely amendable without the text of the EMA being changed (other than the change in the governing law clause). Thus, the same wording as the master agreement shall be used (in different languages) across all European jurisdictions and, consequently, the number of legal opinions is significantly higher. Legal opinions are currently planned for Austria, Belgium, Czech Republic, Denmark, England, France, Germany, Hungary, Ireland, Italy, Luxembourg, Netherlands, Poland, Slovenia, Slovakia, Spain and Sweden, but the precise list of jurisdictions is still under discussion. It is also being considered whether a staggered approach should be taken, such that legal opinions relating to the most important jurisdictions, as a function of the EMA's use in the latter, shall be covered first with legal opinions. Note that these legal opinions replace the English-law legal opinion only, when comparing the situation of the EMA with the other market standard master agreements. The equivalents of the other legal opinions, i.e. the non-English-law legal opinions relating to the International Swaps and Derivatives Association (ISDA) Agreement and the Global Master Repurchase Agreement (GMRA) are non-existent in relation to the EMA. However, the content of such opinions could be covered as additional content by the legal opinions relating to legal validity, binding nature and enforceability. This will need to be assessed when the legal opinions are established.

The modernisation of the EMA currently being undertaken by the EBF working group (including staff of the ECB, the Banque de France and the Deutsche Bundesbank) will lead to a new version of the EMA which will first have to be reviewed by law firms. Once the final version of the EMA is decided upon, the first set of legal opinions will need to be established. This first review of the EMA and the initial legal opinions might still lead to changes in the EMA (where mandatorily required in a certain jurisdiction only, given that such changes would also have to be assessed in all other jurisdictions and might have a negative impact on the legal robustness of the EMA in such other jurisdictions). The plan is to then provide legal opinions on a yearly basis. The costs of the yearly legal opinion updates will be lower than the costs of the initial legal opinions and, in the ECB's view, are not of such a level that, with the help of the ECB and certain euro area NCBs, could not be covered.

3 Use of the EMA by the ECB and euro area NCBs

The ECB invited all euro area NCBs to increase their use of the EMA. While euro area NCBs are free to decide which legal documentation they use for the financial transactions carried out to manage their own reserves, the ECB assessed the extent

to which the use of the EMA could be increased by euro area NCBs and found significant additional possibilities for using the EMA. Not all euro area NCBs currently use the EMA, and those using it do not use it for all types of financial transactions covered by the EMA. The ECB has encouraged euro area NCBs to explore the extent to which it would be possible to increase the use of the EMA, especially in the light of Brexit.

The ECB also considers that it could be beneficial for euro area central banks to have direct contact with the EBF, linked to the euro area NCBs' use of the EMA, so that both the EBF and euro area central banks could be swiftly informed about market developments or legal changes to enable both sides to benefit from quickly updated documentation. The direct feedback loop would allow amendments to be quickly implemented so that response times could be reduced. The market participants would also benefit from this, given that the euro area central banks could effectively channel market needs to the EMA's sponsor. Also, the contribution to the EBF working groups would enable the interaction between the euro area central banks and the EBF to be smooth, and since communication channels already exist, effective processes are in place and already tested.

4 Training

For a master agreement to be successful, it is essential that users of the agreement receive training on the documentation. The plan of the EBF and the ECB is to involve those law firms that will be mandated with the issuance of the legal opinions to also provide training sessions on the EMA. These law firms could act as local ambassadors of the EMA and also benefit from the feedback provided by market participants during the training sessions. Staff of the ECB and euro area NCBs could also provide training sessions and share their practical experience and insight gained while preparing the new EMA version. The ECB and euro area NCBs could also host such training sessions at their premises, which would be seen as a sign of support for the EMA. This would thus ensure training opportunities all over Europe. The importance of the central banks was widely seen during the recent financial crisis and the reputation of central banks increased significantly. Thus, the euro area central banks' backing of the EMA might be powerful and widely noticed.

5 Marketing

The ECB is of the view that marketing efforts by the EBF could and should be increased. While the EMA has, in the past, not been intensively marketed, the ECB considers that such marketing might be helpful in order to increase the knowledge of, the use and thereby the familiarity with the EMA by market participants. Brexit and the fact that English law will, post-Brexit, no longer constitute a law of a Union jurisdiction, is seen by the ECB as a window of opportunity. Market participants might reconsider the use of the documentation currently constituting market standard, as such documentation is governed by English law. Given that the EBF will be in a

position – well in advance of Brexit – to present a new EMA which has been reviewed and updated to reflect the new (post-financial crisis) regulation, market counterparties might reassess their current choice of English-law-governed master agreements. An alternative, supported by the ECB, will then be available, and the ECB considers this a good opportunity for the EMA to become market standard.

In the past, the ECB provided the EBF with three letters of support (spread over several years), signed by the respective Presidents of the ECB at the time, and the ECB's intention was that the EBF would, with the help of the national banking associations, present these letters to the commercial banks across Europe and thereby achieve a significant marketing effect. However, among other things, the lack of up-to-date legal opinions and the non-updated EMA itself might have constituted the main obstacles to the EMA becoming market standard. The ECB is of the view that these two main obstacles will soon be appropriately addressed and should no longer be an issue. This is at a time when market participants are seen by the ECB as likely to be reassessing the use of their documentation governed by English law.

6 Conclusions

At the time of the Brexit preparations, the ECB decided to intensively support the EMA, by contributing financially and providing assistance in various other fields. ECB staff and the staff of the Banque de France and the Deutsche Bundesbank contributed to the work of the EBF in updating the EMA and arranging for functional governance and supporting architecture for the EMA. The ECB invited the euro area NCBs to increase their use of the EMA so that more financial transactions in the Union will be documented under the EMA. The euro area NCBs were also invited to contribute financially to ensure that the legal opinions are financed and updated annually. In addition, training sessions will be arranged and the ECB offered to host them at its premises. The ECB also invited the euro area NCBs to offer training at their premises. The ECB's aim is to use the window of opportunity created by Brexit and to provide banks in the Union with an alternative to English-law-governed master agreements so that the banks can continue to have master agreements governed by the laws of a Union jurisdiction. This would also result in the counterparties being familiar with the documentation the ECB uses for its financial transactions, making it easier for the ECB to establish the contractual relationship.

Panel 6

The use of guarantees in different
Eurosystem operations – consolidation
of doctrine



Kestutis Laurinavicius

Olga Stavropoulou

Sarah Palmer

Introduction to the panel on the use of guarantees in different Eurosystem operations – consolidation of doctrine

By Kestutis Laurinavicius¹

The eligibility of guarantees in Eurosystem operations, particularly in monetary policy lending operations, has been regulated in the Eurosystem's collateral framework for a considerable time. The requirements currently in place were drafted some 15 years ago (and did not change substantially throughout the global financial crisis); it is therefore timely to reflect on the Eurosystem's experiences when accepting guarantees and consider whether the requirements are still clear, how they have been applied and whether any lessons have been learned. At the same time, changes in the regulatory space, such as the introduction of resolution regimes or the elaboration of prudential supervisory requirements for guarantees with respect to financial institutions, raise new issues related to the use of guarantees which also require careful consideration. We should therefore look into the role guarantees play in monetary policy operations and whether the requirements for guarantees still reflect that role and address the relevant risks.

Furthermore, since the Eurosystem defines a common set of requirements applicable to guarantees governed by different national laws, the specific national law context needs to be considered to assess whether such guarantees are compatible with the expectations of the Eurosystem as regards the possibility of recourse to the guarantor. Blanket acceptance of any legal construction or written undertaking referring to the performance of a certain obligation (even if this construction is called a "guarantee") is therefore unwarranted. The possibility of accepting guarantees issued by public sector bodies also entails a need to reflect on the legal aspects of such guarantees when formulating the requirements for them and when performing a legal assessment in an individual case.

1 Eurosystem collateral framework and the role of guarantees in its monetary policy operations

It is common for central banks to operate in financial markets by conducting lending or other operations with market participants in order to achieve their monetary policy objectives. As a result of such operations, central banks acquire financial instruments or have exposures to market participants which need to be managed. In this context, it is worth recalling that under the Treaty on the Functioning of the European Union and the Treaty on European Union (the Treaties), the Eurosystem is required to lend

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to its monetary policy counterparties only against adequate collateral. Article 18.1 of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank, second indent, provides that the Eurosystem may conduct credit operations with credit institutions and other market participants, with lending being based on adequate collateral. The concept of adequate collateral indicates that the Eurosystem has certain policy discretion as to how eligible collateral is defined.² The Eurosystem's definition of adequate collateral has two dimensions. First, it is to protect the Eurosystem from incurring losses in its credit operations. Second, sufficient collateral should be available to a broad set of counterparties so that they can obtain the necessary amount of liquidity from the Eurosystem.³ The definition of adequate collateral therefore helps the Eurosystem to achieve its primary objective of price stability.

The existence of collateral ensures that in the event of a default by the counterparty, the central bank has recourse to other assets. Though such situations would be rather rare, as monetary policy operations are conducted with regulated financial institutions, the possibility and consequences of loss could be serious.⁴ The collateral framework thus aims at establishing a set of criteria mitigating the relevant risks. When defining such criteria, the Eurosystem is guided by the principles of protection, consistency, simplicity and transparency.⁵ Among the risks to be mitigated is legal risk, as the Eurosystem central banks should be able to realise collateral if a counterparty defaults.⁶ The collateral framework therefore includes certain requirements addressing the legal aspects related to collateral. The Eurosystem is also subject to certain requirements under the Treaties, such as the prohibition of monetary financing,⁷ and the requirement to act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources.⁸

On the basis of these fundamental considerations, the details of the Eurosystem collateral framework are set out in the legal acts governing its monetary policy operations, primarily the General Documentation.⁹ These legal acts provide that a guarantee in Eurosystem monetary policy operations plays a role as a possible enhancement of collateral. A standalone guarantee has never been accepted as collateral.¹⁰ To the extent that the creditworthiness of a guarantor plays a role in assessing collateral,¹¹ the Eurosystem defines certain requirements that guarantees should fulfil in order to be eligible. Essentially, guarantees need to fulfil certain legal

² See Siekmann et al (2013), pp. 1019-1020; Smits (1997), p. 273; de Tomasi (2005), p. 356; Weenink (2003), p. 1359.

³ ECB (2013), p. 71; ECB (2015), p. 15.

⁴ See also Chailloux et al (2008), p. 7.

⁵ Mersch (2018a), p. 2.

⁶ Bindseil et al (2017), p. 12.

⁷ Article 123 TFEU.

⁸ Article 127(1) TFEU.

⁹ Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (ECB/2014/60) (OJ L 91, 2.4.2015, p. 3).

¹⁰ Mersch (2018b), p. 2.

¹¹ See Article 113 of the General Documentation. Also, pursuant to Article 128(2), a guarantee could be required as an additional risk control measure in order to accept certain assets.

requirements as regards the characteristics of the guarantee itself, the obligations of the guarantor should be ranked equally with its other unsecured obligations, the guarantor should comply with the Eurosystem's credit quality requirements under the rules of the Eurosystem credit assessment framework for eligible assets, the guarantor should be one of the type of specified entities and it should be established in one of the listed jurisdictions.¹²

It is clear, therefore, that guarantees play only a supplementary role in the Eurosystem's collateral framework, allowing credit assessment with respect to collateral to be made on the basis of guarantees provided they meet the requirements set out in the General Documentation.

2 Eurosystem requirements with respect to the features of guarantees

The General Documentation not only includes an understandable requirement that a guarantee should be legally valid, binding and enforceable against the guarantor,¹³ but also more specifically refers to the key legal features of a guarantee. In particular, a guarantee should be unconditional and irrevocable. It should also be payable on first demand, i.e. it should be independent from the marketable asset or credit claim it covers. Guarantees given by public sector entities with the right to levy taxes could also provide for prompt and punctual payment following any default.¹⁴ These provisions are supplemented by a requirement that for guarantees given by entities other than public sector entities with the right to levy taxes, a legal confirmation should be obtained concerning the legal validity, binding effect and enforceability of the guarantee.¹⁵ The confirmation should also cover the unconditional, irrevocable and first-demand nature of the guarantee.

These requirements make it clear that the guarantee should cover a failure to perform on the part of the principal obligor, such as the issuer of an eligible debt instrument which has been acquired or appropriated in the event of default by the monetary policy counterparty for any reason, including in insolvency. The Eurosystem central banks should also be able to proceed directly against the guarantor, without having to exhaust remedies against the principal obligor and certainly without having to wait until there is an enforceable judgment against the defaulted obligor. It could be anticipated, however, that there might be some formalities to consider as to how the call on the guarantee is to be made depending on applicable law, the terms of the guarantee or the type of obligations covered by the guarantee.

The reference to these features in the General Documentation is important, as otherwise it would not be clear which types of guarantees could be eligible. The

¹² Articles 114-118 of the General Documentation.

¹³ Article 114(3).

¹⁴ Article 114(1) and (2).

¹⁵ Article 114(5).

speakers on this panel will therefore explain how these features are understood in the context of monetary policy lending operations and the acquisition of asset-backed securities (ABS) under the Eurosystem asset purchase programme, and also share private sector experiences.

3 Relevance of national law

The Eurosystem's collateral framework is not fully detached from legal constructions originating from national law, even if the key requirements for the recognition and enforcement of certain legal constructions are regulated at Union level.¹⁶ As things stand, the concept of a guarantee is basically defined in national law and subject to the specificities of that national law. In Eurosystem monetary policy lending operations, an eligible guarantee may be issued under the law of any EU Member State.¹⁷ As such, the term "guarantee" may include various legal constructions known to that particular legal system, whether they are based on statutory law or possibly just banking practice and case-law, and in particular could include types of guarantees that are somewhat linked to or dependent on the principal obligation. The eligibility analysis would thus need to assess the compliance of such constructions with the characteristics of guarantees required by the Eurosystem. Furthermore, it is not sufficient to ascertain that a guarantee is what it promises (a legal commitment to pay upon demand), as national law may provide for defences through which guarantors could try to avoid a liability. It is therefore essential that the language of the guarantee and any other relevant documentation are carefully reviewed before acceptance.

The use of guarantees also depends on the financial product – it is important to understand the nature of the obligation that the guarantee covers and hence when the guarantee could be invoked. The speakers will therefore explain how the wording of the legal documentation could differ depending on the nature of the financial instruments covered by the guarantee. In this context, one might wonder whether establishing some minimum requirements for guarantees at Union level could help mitigate the uncertainties related to their use.

Eligible guarantors could also be established in various jurisdictions and be subject to specific requirements applicable to them. A guarantor established under public international law or Union law would be subject to the legal framework governing its activities and as such not subject to authorisation or similar requirements pursuant to national law. If a guarantee is invoked, it may need to be enforced against the guarantor. Therefore, one would also need to consider which steps need to be taken if the guarantee is to be enforced. This would include a consideration of the steps required to trigger payment under a guarantee provided by the Government or another public sector body, as there could otherwise be a risk that a transaction

¹⁶ See the types of financial collateral arrangements required to be recognised in Member State law under Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements (OJ L 168, 27.6.2002, p. 43).

¹⁷ Article 114(4) of the General Documentation.

leading to a claim against a public sector body that is not paid promptly could breach the prohibition of credit facilities laid down in Article 123 TFEU.

Guarantees provided by public sector bodies could also be subject to specific requirements concerning their validity. If a state guarantee is found to be in breach of the Treaty provisions on state aid (e.g. due to a failure to notify it), the national courts, acting in accordance with national law, will also need to determine the consequences of such a finding. This could include the cancellation of a guarantee if other measures are assessed as not effective enough to restore the competitive situation which existed before that guarantee was provided.¹⁸ The national law context will therefore be relevant in determining how the guarantee should be enforced and what the possible consequences of a guarantee not complying with the Treaty requirements concerning state aid might be.

4 Overview of the presentations of the panel members

What is clear from all these remarks is that the Eurosystem does not automatically rely on the existence of a guarantee supplementing the relevant collateral asset. The General Documentation requires an assessment of guarantees accepted by the Eurosystem, so does not just rely on the review by credit rating agencies or other credit assessment sources to determine whether a guarantee complies with the Eurosystem requirements.

Our speakers today will shed more light on the legal aspects related to the acceptance of guarantees.

First, let me introduce Olga Stavropoulou, who is Head of the Financial and ESCB Law Section at the Bank of Greece. She works on monetary policy, payment system and other financial law matters and is a member of the Eurosystem's Legal Committee. Olga will outline the principles behind the Eurosystem requirements for guarantees and share some very relevant experiences when accepting guarantees in national emergency liquidity assistance operations.

Our second speaker is Sarah Palmer, who is responsible for ABS and structured finance issues in the ECB's Financial Law Division. Sarah will talk about the types of guarantees in ABS structures and compare European issuances with those in the United States. After her presentation we will know when a guarantee can be called in ABS structures.

The panel is completed by Asmaa Cheikh, who is a director in the banking and financial regulation team within the Legal Department at Société Générale. Asmaa will focus on her experiences of accepting guarantees in private sector transactions and share her perspective on the Eurosystem requirements for guarantees.

¹⁸ See e.g. Case C-275/10 *Residex Capital IV CV v Gemeente Rotterdam*, ECLI:EU:C:2011:814, paras. 29-47.

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The use of guarantees by central banks: the criteria relating to and the limits of relying on guarantees

By Olga Stavropoulou¹

1 Introduction

In the execution of its monetary policy mandate the Eurosystem conducts a number of market oriented liquidity-providing operations. These operations comprise, *inter alia*, liquidity-providing “reverse” transactions, namely transactions which involve the provision of liquidity that Eurosystem counterparties are required to repay at a particular point in time.²

In addition to the operations indicated above, the euro area national central banks (NCBs) grant liquidity as part of their national lender-of-last-resort (LOLR) function. These operations fall outside the perimeter of the single monetary policy. They constitute a national central banking task and are carried out on the basis of the relevant central bank’s national rules and practices.

Guarantees have long played a specific, albeit not uniform, role as regards both monetary policy liquidity-providing reverse transactions and liquidity-providing transactions which euro area NCBs conduct as part of their national LOLR function. The time is ripe to analyse the role that guarantees have played so far in the context of these operations, outline the various aspects related to their current use, and offer some preliminary reflections on whether there is room to further enhance their presence in the above-mentioned central banking activities.

¹ Head of the Financial and ESCB Law Section at the Bank of Greece. The views expressed here are those of the author and do not necessarily reflect those of the Bank of Greece or of any other Eurosystem central bank. This paper was finalised in October 2018.

² Notwithstanding that foreign exchange swaps may also serve liquidity- providing purposes and consist of two transaction legs, they do not fall within the notion of liquidity-providing reverse transactions.

2 The legal framework of central bank liquidity providing operations

2.1 Eurosystem monetary policy operations

The Eurosystem monetary policy operations are carried out on the basis of Articles 127 and 282 of the Treaty on the Functioning of the European Union (TFEU)³, as well as on the basis of Articles 3 and 18 of the Statute of the European System of Central Banks and the European Central Bank (the “Statute”).⁴

Article 18 of the Statute delineates the open market and credit operations which the Eurosystem may conduct in the pursuit of its monetary policy objectives, and, further, empowers the ECB to “establish general principles for open market and credit operations carried out by itself or the national central banks, including for the announcement of conditions under which they stand ready to enter into such transactions.”⁵

The ECB has established the above-mentioned principles and conditions by means of appropriate legal acts, which are binding on euro area NCBs and, ultimately, on their counterparties. These legal acts lay down a comprehensive framework governing the overall implementation of the single monetary policy. The Eurosystem collateral rules form part of this all-encompassing monetary policy framework and, in this context, also regulate the use of guarantees. In the remainder of this paper, the Eurosystem collateral rules will be referred to as the “Eurosystem collateral framework (ESCF)”.

2.1.1 The current ESCF

The ESCF has evolved on the basis of Article 18.1 of the Statute.

Briefly, Article 18.1 of the Statute provides that, in the pursuit of its objectives, the Eurosystem may, among other things, enter into repurchase agreements as well as conduct credit operations “with lending being based on adequate collateral”.⁶

Although the preparatory discussions at the level of the Committee of Governors were not conclusive as to whether this latter aspect should be explicitly included in the Statute, having regard to the fact that, while euro area NCBs used to take collateral in their credit operations, their statutes did not always expressly provide for it, it was finally decided that the public mission which the Eurosystem has been entrusted with under primary European Union law called for a prudent approach;

³ OJ C 326, 26.10.2012, p.47.

⁴ Protocol (No 4) on the Statute of the European System of Central Banks and of the European Central Bank (OJ C 326, 26.10.2012, p. 230).

⁵ Article 18.2 of the Statute.

⁶ Article 18.1 second indent.

accordingly, the requirement that credit operations be conducted only against “adequate collateral” was incorporated in the final version of the Statute.⁷

Still, notwithstanding the express reference to “adequate collateral”, no further guidance is directly available in Article 18.1 of the Statute as to what constitutes “adequate collateral”, including, in this respect, which legal forms collateral should take in order to qualify as “adequate”. A basic premise is that collateral should be broad enough to allow for efficient monetary policy implementation and conservative enough to allow for sufficient risk-mitigation.

Sufficient risk-mitigation requires that collateral is of a sort that will permit the Eurosystem to recover the amounts of liquidity provided to the fullest extent possible and in a timely manner. On this basis, collateral may certainly take the form of a security interest. The term “security interest” is to be understood in its wider sense, encompassing any form of a right *in rem* established for security purposes: it should, accordingly, include pledges, fiduciary transfers, liens or other charges⁸, having also regard to the law applicable to the relevant collateral arrangements.

In fact, this is exactly how the statutory term has invariably been perceived and applied by the Eurosystem since the initial conception of the ESCF back in the late 1990s. Indeed, in implementing Article 18.1 of the Statute, it was from the very outset considered that Eurosystem liquidity-providing reverse transactions can take the form of repos or “collateralised” loans, i.e. loans secured by means of a security interest granted over specific categories of assets fulfilling the prescribed criteria. This decision was taken by the ECB already in 2000 and it has ever since been consistently reflected in the ECB core monetary policy legal act, the General Documentation Guideline.⁹,¹⁰ This approach is firmly rooted in the ESCF. It is noteworthy that, even when the ECB decided, following the onset of the financial crisis, to broaden the collateral framework in order to increase collateral availability, including through a set of additional temporary measures¹¹, with a view to supporting

⁷ See de Tomasi (2005), p. 356; see also Smits (1997), p.272; this approach is in line with the fundamental view that central bank credit is (and should) always be based on collateral – unsecured credit is not suitable for the performance of central banking activities; see Bindseil et al (2017), p.10.

⁸ See Smits (1997), p. 263.

⁹ Guideline ECB/2000/7 of 31 August 2000 on monetary policy instruments and procedures of the Eurosystem (OJ L 310, 11.12.2000, p. 1); Chapter 6.1, first paragraph of the said Guideline was crystal clear on this matter and read as follows: “Article 18.1 of the Statute of the ESCB allows the ECB and the National Central Banks to transact in financial markets by buying and selling underlying assets outright or under repurchase agreements and requires all Eurosystem credit operations to be based on adequate collateral. Consequently, all Eurosystem liquidity-providing operations are based on underlying assets provided by the counterparties either in the form of the transfer of ownership of assets (in the case of outright transactions or repurchase agreements) or in the form of a pledge granted over relevant assets (in the case of collateralised loans).”

¹⁰ Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (recast) (OJ L 91, 2.4.2015, p.3).

¹¹ Guideline (EU) 2014/528 of the European Central Bank of 9 July 2014 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral and amending Guideline ECB/2007/9 (recast) (OJ L 240, 13.8.2014, p.28). These additional temporary measures complement several other measures which the Eurosystem took in order to increase collateral availability, such as the relaxation of the minimum credit quality requirements, which were eventually incorporated into the standard monetary policy framework.

the provision of credit within the euro area, the changes that it effected did not touch upon the legal forms that collateral may take.¹²

In a nutshell: currently, all the liquidity-providing reverse transactions carried out by the Eurosystem, be it in the context of the standard monetary policy framework or of the additional temporary one, be it in euro or, exceptionally, in a foreign currency¹³, take the form of either repos or loans secured by means of a right *in rem* established for security purposes. Guarantees do not constitute a legal form of (adequate) collateral under the current ESCF, nor have they ever been recognised as such so far.¹⁴

The use of guarantees within the current ESCF: a credit quality enhancement mechanism

Although guarantees do not constitute a legal form of (adequate) collateral under the current ESCF, this is not to say that they are not at all relevant for Eurosystem credit operations. For guarantees are used, albeit in a rather specific context: within the current ESCF, guarantees serve *credit (quality) enhancement purposes only*, i.e. they only come into play in the process of assessing the credit quality of an asset which otherwise underlies a secured loan (or a repo) and are employed, under specific conditions, in order to improve the asset's credit quality.¹⁵

The above-referenced credit quality enhancement mechanism may be activated in cases where the credit quality of an asset is determined on the basis of the rating of the issuer or the debtor, depending on whether the asset concerned is a marketable or a non-marketable one. With regard to marketable assets, this occurs where no issue rating is available¹⁶, with the exception of government bonds, as well as bonds issued by agencies/multilateral development banks or international organisations,

¹² From a risk perspective, the expansion of collateral took place having regard to a set of risk management principles that the Eurosystem has consistently applied throughout the years, i.e. the principles of protection, consistency, simplicity and transparency; see Mersch (2018a), p.2; see also ECB (2015), p. 23.

¹³ The Eurosystem may, if the need arises, provide liquidity also in foreign currencies on the basis of foreign liquidity-specific rules; such liquidity has already been provided eg. in US dollars.

¹⁴ See Mersch (2018b), p.3.

¹⁵ Article 59 para 6 of the General Documentation Guideline.

¹⁶ As far as marketable assets are concerned, other than government bonds, and bonds issued by agencies/multilateral development banks or international organisations, the Eurosystem first looks at the credit rating of the issue, which in general terms should at least fall within "credit quality step 3" within the Eurosystem harmonised rating scale, namely it should cover the full investment-grade on the credit rating scale (see also footnote 18 below). If the issue rating is below investment-grade, and unless a specific derogation has been granted, the asset is not eligible; namely, in those cases the Eurosystem will, in principle, not look further into the structure of the transaction, including any existing guarantees. This is so, taking into account that guarantees which are embedded in rated transactions are normally assessed by the rating agencies in the context of the rating assigning process. Having said this, it has to be pointed out that the Eurosystem has reserved itself the right to carry out its own credit assessment also based on any other information it may consider relevant, thus disassociating itself from the assessments performed by rating agencies; see Article 59(5) and (6) of the General Documentation Guideline.

which are always assessed on the basis of the credit rating of the issuer.¹⁷ Likewise, non-marketable assets are assessed on the basis of the credit rating of their debtor.

In those cases where the issuer/debtor credit rating is relevant for credit quality assessment purposes, the guarantor credit rating may substitute for that of the issuer/debtor. Conceivably, this may occur in the following circumstances: (i) when the issuer/debtor credit rating is below the minimum set by the Eurosystem (currently corresponding to a “credit quality step 3” within the Eurosystem’s harmonised rating scale,¹⁸ with certain exceptions) and (ii) when the issuer/debtor credit rating meets the minimum required, but the guarantor’s one is higher, thus potentially resulting in a better asset valuation due to the application of lower haircuts. Relying on the guarantor higher credit ratings could in those cases permit the provision of additional liquidity or, as the case may be, avert the need to trigger margin calls.

In order to allow for the guarantor credit rating to substitute for that of the issuer (or of the debtor), the Eurosystem has laid down a number of conditions, in terms of the guarantor’s financial profile and legal status, as well as in terms of the legal features of the guarantees themselves. Both sets of conditions have been established with the aim of maximising recoveries within a reasonable timeframe if a counterparty defaults.

Conditions for accepting guarantors

Apart from the guarantor’s credit quality, which, similarly to that of the issuer, should as a rule fall within investment grade¹⁹, the ESCF attaches a number of conditions to the guarantor’s type and place of establishment. These conditions have been determined on the basis of the stated dual objective to (i) accept a sufficiently wide range of assets, in order to enable efficient monetary policy implementation on the one hand and (ii) avoid over-exposure to risks, including legal ones, on the other hand.

¹⁷ The underlying reason being that the relevant issuances are of a rather standardised nature, thus credit rating agencies tend to derive their issue ratings directly from the issuer /guarantor ones.

¹⁸ Article 59 of the General Documentation Guideline. The Eurosystem has developed a credit assessment framework, whereby, among other things, the credit assessments from all Eurosystem acceptable credit assessment sources are made comparable. This is achieved through the mapping of each of those credit assessment sources’ rating grades to the proper “credit quality step” in the Eurosystem’s harmonised rating scale; see ECB (2015), p.19. A “credit quality step” reflects a certain level of default probability over a one-year horizon. Within this context, the minimum acceptable credit quality step is, as a rule, “credit quality step 3” (which represents a 0.40% default probability over a one-year horizon). In terms of mapping, a minimum credit rating of BBB- comes within “credit quality step 3”, so that, as a rule, the full investment-grade credit quality (accorded by a Eurosystem ‘eligible’ credit rating agency) is currently acceptable by the Eurosystem (see also footnote 16 above).

¹⁹ See footnotes 16 and 18 above.

In terms of the guarantor's type, the Eurosystem accepts, with certain variations depending on the category of assets (marketable/non-marketable), a wide range of public and private entities as well as international/supranational organisations.²⁰

In terms of location, the guarantor's place of establishment is, as a rule, required to be in the EEA or in the euro area, depending on the asset type, on the guarantor's risk profile and on whether the guarantee is actually relied upon for eligibility purposes.²¹ Setting the wider perimeter in the EEA countries has been considered appropriate having regard to the fact that enforcement of the guarantee would reasonably be expected to take place at the guarantor's place of establishment: the efficiency of the enforcement process calls for the selection of a range of states whose laws are not totally unfamiliar to the Eurosystem. A corollary of the EEA location criterion is that guarantors established in the United Kingdom would be impacted in the case of Brexit, unless the final Brexit-related arrangements were to accord to the United Kingdom the status of an EEA country. The exact point in time when UK-based guarantors would lose eligibility depends on whether a withdrawal agreement would ultimately be reached between the Union and the United Kingdom and whether such withdrawal agreement will provide for a transition period during which the United Kingdom would effectively maintain its status as a member state of the Union.²² Irrespective of envisaged timelines, and provided no other policy decision is taken with regard to the location requirement, counterparties relying on impacted guarantors for eligibility purposes would need to seek substitution of the UK-based guarantor by another entity, which could conceivably belong to the same group of companies or be a third entity, otherwise they would be required to remove the relevant assets from their collateral pools (and replace them if necessary).

Conditions for accepting guarantees

Apart from establishing specific conditions for the acceptance of guarantors, the Eurosystem requires that guarantees as well possess certain key legal features, which are set out in the General Documentation Guideline. It is worth noting that these legal features have not been modified in the context of the additional temporary collateral framework through the introduction of explicit rules specific to guarantees. The additional credit claims (ACCs) temporary framework generally entitles euro area NCBs to accept as collateral for Eurosystem credit operations certain credit claims on the basis of their own eligibility rules, thus, arguably, pointing to a discretion for the NCBs to also accept guarantees whose features deviate from those prescribed in the General Documentation Guideline. Still, there is no

²⁰ These may comprise central banks, public sector entities, agencies, credit institutions, financial/non-financial corporations, multilateral development banks or international organisations; see Articles 69 and 95 of the General Documentation Guideline (for marketable and non-marketable assets respectively).

²¹ Articles 70 and 96 of the General Documentation Guideline.

²² A transition period extending up to end December 2020 was, at the time of writing, foreseen in the draft withdrawal agreement negotiated between the European Commission and the United Kingdom (Draft Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community, dated 19 March 2018, TF50 (2018); see, in particular Article 121 thereof.

automaticity in the application of national ACCs regimes and any ACCs national eligibility rules would have to be submitted to the Governing Council of the ECB for prior approval.

With the aim of adequately addressing the legal risks attached to the provision of guarantees, the General Documentation Guideline establishes the basic requirement that guarantees should be valid, binding and enforceable vis-à-vis the guarantor and, further, sets out a list of other attributes that guarantees should possess in order to be acceptable. These include the requirement that guarantees are payable on first demand, independently of the guaranteed asset; that they are unconditional and irrevocable; that they fully cover payment obligations which have become due; that they rank at least *pari passu* and *rateably* with all other unsecured obligations of the guarantor; and that they are governed by the law of a Union member state.²³

What the General Documentation Guideline essentially seeks to achieve through the above-mentioned conditions is that guarantees are such that, if activated, they would trigger the guarantor's obligation to discharge, fully and promptly, all payment obligations stemming from the assets which have become due (whether on the regular due date or following acceleration). The guarantor's obligation to pay would have to be activated if the principal obligor fails to perform for any reason whatsoever, including for reasons of insolvency. In this context, the guarantor should be obliged to pay the relevant amounts in full, upon the NCB's notice, without being entitled to refuse payment on the basis of a potential dispute as to the primary obligor's default, or on the basis of the fact that the relevant NCB has not exhausted its remedies against him. Conversely, on the basis of the payment on first demand/independent from the guaranteed asset requirement, the NCB concerned would not be obliged to adduce any evidence with regard to the primary obligor's default and the crystallisation of the NCB's losses.²⁴ Rather than focusing on the formal legal characterisation of the type of guarantee that the General Documentation Guideline seeks to establish, namely on whether the guarantees under discussion constitute "performance bonds/performance guarantees" (by contrast to "payment guarantees"), it is material, in the Eurosystem context, to ascertain that the terms of the guarantee, whether or not the latter is embedded in the main transaction documents, are apt to achieve the objectives described above. Hence, the outcome of the review process would depend on the drafting of the actual guarantee terms and on their interpretation, based on the national law governing the guarantee structure. The review process is underpinned by legal confirmations.²⁵ This does not in itself preclude NCBs from seeking further clarifications, if these are deemed necessary in order to finalise the assessment, especially in those cases where the legal confirmation submitted lacks sufficient clarity or does not cover the full range of the requested information.

²³ Articles 113(2), 114 and 115 of the General Documentation Guideline.

²⁴ Bertrams (2013), p.46; Allen & Overy (2013); a demand under the guarantee may have to be supported by such documents as the guarantee terms may specify.

²⁵ Article 114(5) of the General Documentation Guideline (which also clarifies that legal confirmations are not required in the case of public entities entitled to levy taxes).

As already stated, guarantees should be governed by the law of a Union member state. The specific requirement is reasonably dictated by legal efficiency considerations, taking into account, *inter alia*, that the reviewing euro area NCB would in such a case be readily assisted by the NCB of the governing law member state, namely an NCB of the European System of Central Banks (ESCB). Clearly, the governing law requirement, in its current formulation, would result in English law governed guarantees becoming ineligible following an eventual Brexit, as further explained earlier in this paper; accordingly, in the event that an English law governed guarantee is relied upon for eligibility purposes, counterparties would have to either provide for amended/replacement guarantees or remove the guaranteed assets from the collateral pool and replace them if required.

State guarantees – specific aspects

Variation of conditions

State guarantees are also subject to the conditions laid down in the General Documentation Guideline, albeit with a variation. By contrast to other guarantees, State guarantees may either be payable on first demand or “otherwise provide for prompt and punctual payment following any default”.²⁶ The wording differentiates from other guarantees in that the NCB may, in their case, be required to demonstrate that its counterparty has in fact defaulted, an issue which might be under dispute. Still, this element of differentiation has been considered appropriate for State guarantees, taking into account that budgetary, administrative or legal constraints may be applicable to the State, which render a first demand guarantee unsuitable. In an effort to specify the scope of State guarantees as appropriate, the General Documentation Guideline uses the term guarantees of “public entities entitled to levy taxes”, in order not to capture those public entities which may not have material differences with the private sector in this field.

Government guaranteed bank bonds (GGBBs) – State aid

The legal features of guarantees prescribed in the General Documentation Guideline must be fulfilled also in the case of State guarantees provided in favour of Eurosystem counterparties which have issued debt under a national financial support scheme (government guaranteed bank bonds - GGBBs)²⁷. The terms of such State guarantees may vary per jurisdiction and their assessment comes within the scope of the regular review process conducted by euro area NCBs in the context of the General Documentation Guideline.

Beyond pure Eurosystem rules, and similarly to other forms of State guarantees backing Eurosystem collateral, state aid rules are most relevant in the case of GGBBs. Therefore, it is necessary to ascertain that the guarantees so provided are

²⁶ Article 114(2) of the General Documentation Guideline.

²⁷ It is recalled that these national financial support schemes were first launched back in 2008, following a concerted Union response to the global financial crisis; for a detailed presentation of the relevant measures see ECB (2010a), pp.12-13; ECB (2010b), pp.18-28. Several national financial support measures were taken within the Union thereafter, including those recently adopted by the Italian authorities regarding the support of the Italian banks (Decree-Law No 237/23.12.2016 converted into Law No 15/2017 and published in the Italian Official Gazette No 43/21.2.2017).

not in breach of the relevant Treaty provisions, an assessment falling within the exclusive competence of the European Commission (EC). Clearly, this is of practical significance, taking into account that a negative finding on the part of the EC could, on the basis of a subsequent national court ruling, result in the cancellation of the guarantee for the purposes of recovering the unlawful state aid. The EC Banking Communications adopted in this area, the latest being the EC Banking Communication of the year 2013²⁸, which spell out, among other things, common requirements in order for the public support measures to be compatible with the internal market, accompanied by the relevant EC clearances, provide certainty with regard to the compatibility of such national support schemes with Union state aid rules.

The discussion on GGBBs is of interest to counterparties with GGBB holdings: while own-used GGBBs have generally been phased-out since 1 March 2015²⁹, GGBBs other than own-used constitute eligible collateral under the conditions set forth in the ESCF. Provided that the State guarantees backing them fulfil the conditions described earlier, these GGBBs may: (i) be used as collateral irrespective of the limits which the Eurosystem has generally established with regard to unsecured bank bonds (UBBs)³⁰; and (ii) exceptionally remain eligible, under specific conditions, despite their (statutory) subordination to other securities of the same issuer.³¹

2.1.2 Beyond the current ESCF

The use of guarantees as a standalone means of security

Having outlined the supplementary role attributed to guarantees in the context of the ESCF so far, the question that inescapably arises is whether guarantees could be used beyond the existing boundaries, namely whether they could *in and of themselves* constitute an appropriate means to secure Eurosystem credit operations.

²⁸ See “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’)” OJ C216, 30.7.2013, p.1.

²⁹ Consistent with the general policy not to encourage Eurosystem exposure to assets which are closely linked with the issuer/debtor; see ‘The financial risk management of the Eurosystem’s monetary policy operations’, ECB, July 2015, p.26); see also Article 139 paras 1 and 2 (in conjunction with Article 138 of the General Documentation Guideline), which only allows exemptions under specific conditions.

³⁰ Article 141 of the General Documentation Guideline.

³¹ While unsecured bank bonds (UBBs) which are subject to any form of subordination (i.e. statutory, contractual or structural) are ineligible, GGBBs (namely UBBs which are backed by a State guarantee) remain eligible if: (i) they are issued until 31 December 2018 and (ii) they are subject to ‘statutory’ subordination, namely, they are subordinated by virtue of the law; see Article 81a of the General Documentation Guideline.

In rem security vs guarantees

As previously indicated, a fundamental principle underlying the design of the ESCF is that the Eurosystem should be protected in a manner that would allow it to address the likelihood of financial losses by maximising recoveries without undue delays.³² It has, therefore, been considered appropriate to rely on collateral which consists of assets that, in the event of the counterparty's default, can be disposed of in the market.³³

A right *in rem* established for security purposes would be an adequate means of meeting these objectives, in particular having regard to the collateral regime that has long been operative at the Union level which, as a general rule, allows, *inter alia*, for collateral enforcement (by means of a sale or appropriation) based on simplified procedures and, to a significant extent, without interference under the Union member states' insolvency laws.³⁴

Enforcement of such rights would, further, not be inhibited in a resolution context: this is so, taking into account that, pursuant to the BRRD³⁵, a resolution authority's power to restrict the enforcement of "security interests" cannot be exercised, among others, vis-à-vis central banks.³⁶ Additionally, a Eurosystem liquidity providing operation performed by means of a repo and/or a secured loan would fall within the definition of a "secured liability" under the BRRD, thus being exempt from bail-in.³⁷ Irrespective of the fact that, as a matter of practice, Eurosystem credit operations would, in a resolution process, normally be among the transactions transferred to a purchaser or to a bridge institution, so that they would continue to operate as liabilities of the transferee, the afore-mentioned elements essentially provide, by operation of law, an enhanced protection to the Eurosystem as collateral taker having regard to the latter's mandate and functions.

On the other hand, to what extent a Eurosystem claim covered by a guarantee would be satisfied in the case of a counterparty's default, insolvency or resolution, will largely depend on the actual design of the guarantee. By way of indication, in a

³² See Article 99 and Article 181(3) of the General Documentation Guideline. The objective of realising collateral without undue delay and in such a manner as to recover the economic value for the credit provided is also reflected in Article 166 as well as Article 181 of the General Documentation Guideline.

³³ In principle, the Eurosystem would not opt to keep the assets on its balance-sheet; having said this, it would do so, if, having regard to the specific market conditions, a 'prompt' disposal in the market would not result in realising the economic value of the assets.

³⁴ Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements (O.J. L 168, 27.6.2002, p.43), as amended by Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 (O.J. L 146, 10.6.2009, p.37) and Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 (O.J. L 173, 12.6.2014, p. 190) (the 'Financial Collateral Directive'); Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems (O.J. L 166, 11.6.1998, p. 45), as amended by the above-mentioned amending Directives ; See also Yeowart and Parsons (2016).

³⁵ 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 firm and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/ECB, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012 of the European Parliament and of the Council (O.J. L 173, 12.6.2014 p.190).

³⁶ Article 70(2) BRRD.

³⁷ Article 44(2) BRRD.

resolution context the Eurosystem could arguably be confronted with the prospect of a reduction of its claims as a result of the application of the bail-in tool; to what extent the Eurosystem would ultimately be in a position to recover the full amount of the credit granted would, *inter alia*, depend on whether the terms of the guarantee establish a clear and unconditional obligation of the guarantor to discharge the counterparty's payment obligations, in full, also in the scenario mentioned above.³⁸

Should guarantees be excluded altogether as a standalone means of security?

Having said this, it would arguably be overly restrictive to take the *ex ante* blanket position that guarantees may under no circumstances be relied upon on a standalone basis. On the contrary, it would not appear misplaced to suggest that relying on guarantees would be conceivable, at the very least as an exceptional measure. Specific rules and conditions could be put in place, in terms of the guarantor's legal status and risk profile as well as in terms of the overall design of the guarantee, serving as risk mitigating measures. To the extent that a public sector entity may be involved, appropriate steps could be envisaged, in order to ensure that potential state aid considerations are adequately addressed. Other features may be built in the guarantee structure, in order to ensure that the Eurosystem exercises its public function in an independent manner. The in principle positive approach suggested here draws from Article 18.1 of the Statute – which, as mentioned earlier, does not prescribe the legal forms that “adequate collateral” may take – and would allow for the provision of central bank credit in pursuit of the Eurosystem's monetary policy objectives, whilst not disregarding the requirement for reasonable risk-taking.

2.2 National central bank operations (emergency liquidity assistance-ELA)

Eurosystem NCBs may also grant (emergency) liquidity to financial institutions facing liquidity needs but remaining solvent. As indicated earlier, these operations, commonly referred to as “emergency liquidity assistance (ELA)”, are performed as part of the NCBs' national LOLR function. That is to say, they lie within the competence of the NCBs, which also incur the related costs and risks. Accordingly, these operations are carried out on the basis of national rules and practices, as further explained below.

The measure of the ECB's permissible interference in the conduct of such operations is delimited in Article 14.4 of the Statute as well as in Article 123 TFEU. Briefly, Article 14.4 of the Statute exceptionally enables the ECB to *ex ante* restrict the provision of ELA, if it can establish that the latter interferes with the objectives and tasks of the

³⁸ An additional protection for the central bank would in such cases conceivably be the guarantor's acknowledgement that in the case of bail-in he (the guarantor) would not be entitled to have recourse vis-à-vis the counterparty (in accordance with Article 53(3) BRRD), but that his obligations stemming from the guarantee remain intact.

Eurosystem.³⁹ Given that it curtails national competence, the ECB may only exercise its power under Article 14.4 of the Statute on the basis of a qualified majority of the voting Governing Council members. Article 123 TFEU, on the other hand, empowers the ECB to perform an *ex post* monitoring of ELA operations in order to assess their compliance with the prohibition of monetary financing. Both are subtle exercises that warrant a cautious assessment.⁴⁰

2.2.1 Different collateral frameworks applicable - The use of guarantees in the context of ELA

Against the background outlined above, ELA, as stated, is granted on the basis of national rules, including national laws and regulations, the NCBs' statutes and their internal procedures. It is also granted according to NCBs practices. These national frameworks determine such matters as the conditions of access to ELA; the type of collateral accepted, including its legal forms; the categories of assets which may serve as collateral; the valuation of collateral; the applicable risk control measures, including haircuts. Indeed, consistent with the notion that ELA falls within the competence of NCBs, risk management of ELA operations is performed by the NCB concerned, which also carries out its own risk assessment.⁴¹ Within this context, it is conceivable that ELA be granted also against guarantees, serving either as credit quality enhancement tools or, otherwise, as a standalone means of security.⁴² Similarly to other forms of collateral, guarantees should be apt to shield the central bank from potential losses, and it is for the NCB concerned to assess the attendant risks and to determine the terms and conditions under which it would accept the relevant guarantees.

Within the framework described above, ELA may be, and has in fact been, granted also against State guarantees.

³⁹ For a concise analysis on how ELA is apt to affect the tasks of the Eurosystem, see B. Scouteris & Ph. Athanassiou (2016), p.801-802.

⁴⁰ In the context of Article 123 TFEU, the ECB has expressed its scepticism in relation to unsecured or insufficiently secured financing provided in order to safeguard financial stability, especially noting the risk that such lending could result in the provision of solvency support to a credit institution experiencing financial difficulties (see eg. ECB Convergence Report May 2018, p. 198).

⁴¹ See 'The financial risk management of the Eurosystem's monetary policy operations' ECB, July 2015 p.35. It is to be noted, in this respect, that Article 59(3)(e) BRRD implicitly requires that ELA collateral needs to be appropriate to avoid an equity write-down and/or conversion of capital instruments in the credit institution receiving ELA; additionally, according to the EC Banking Communications ELA may constitute state aid if it is not "fully secured by collateral to which appropriate haircuts are applied, in function of its quality and market value".

⁴² This is also reflected in the "Agreement on emergency liquidity assistance" dated 17 May 2017 (the "ELA Agreement") which requires, among other things, that NCBs inform the ECB of the details of their ELA operations, including, in this respect, of the "collateral/guarantees" against which ELA has been/is to be provided; see section 3.2(a)(i) of the ELA Agreement (published on the ECB's website).

2.2.2 State guarantees – specific aspects

State aid

By contrast to monetary policy operations, which do not fall within the scope of State aid rules, ELA, itself a liquidity support “*dedicated to a specific credit institution*”⁴³, may constitute state aid. The EC Banking Communications spell out the conditions to be cumulatively met in order for ELA not to constitute state aid: the beneficiary credit institution must be temporarily illiquid but solvent at the moment of the liquidity provision; ELA must be fully secured by collateral to which appropriate haircuts are applied; a penal rate must be charged; and ELA must be granted at the NCB’s own initiative and must not be “*backed by any counter-guarantee of the State*”⁴⁴. Hence, State-guaranteed ELA is vetted by the EC against State aid rules and has to be notified accordingly. Past experience shows that State-guaranteed ELA was found to constitute state aid pursuant to Article 107(1) TFEU. At the same time, however, the EC concluded that such aid was compatible with the internal market on account of the fact that (i) it was granted in order to remedy a serious disturbance in a member state’s economy pursuant to Article 107(3)(b) TFEU and (ii) it complied with the regular compatibility criteria of appropriateness, necessity and proportionality.⁴⁵

Monetary financing

ELA-relevant State guarantees are also scrutinised by the ECB, on the basis of monetary financing considerations. The ECB is vigilant in terms of monetary financing and seeks to ensure that an NCB does not assume government tasks. In this regard, it has elaborated a number of criteria that need to be met in order for State guaranteed ELA to be in compliance with the prohibition of monetary financing. These criteria also ascertain that NCBs preserve their financial independence. Among other things, a central bank must grant ELA in the exercise of full discretion; ELA should be provided with a view to preserving financial stability; and State guarantees should be valid and enforceable under the applicable national law, as well as economically adequate, i.e. they should cover both ELA principal and interest.⁴⁶

⁴³ See in particular paragraph 62 of the 2013 Banking Communication.

⁴⁴ Ibid.

⁴⁵ This has been the case eg. with regard to the Greek State-guaranteed ELA, which was assessed by reference to each Greek bank as part of a more general assessment against State aid rules of the financial measures that were taken in support of the Greek banking sector at the time.

⁴⁶ See ECB Convergence Report (2018), p.33, also referring to several ECB Opinions on this matter. In the context of evaluating whether an NCB is allowed to independently exercise full discretion with regard to the provision of ELA, the ECB has indicated that it will also assess whether a State guarantee is granted *ex ante* and whether it is provided automatically in favour of the NCB concerned, namely without the need for a prior agreement of the national authority (eg. Ministry of Finance) (see ECB Opinion CON/2008/46).

The use of State guarantees in parallel to other forms of collateral

State guarantees could be used, either fully or partially, in order to secure a NCB's ELA operations in addition to other forms of ELA collateral, such as a security interest established over ELA eligible assets.⁴⁷ In the case where a State guarantee co-exists with such other forms of ELA collateral, the question that may arise is whether the NCB is required to act in a particular manner upon the counterparty's default, i.e. whether it is obliged to enforce its collateral first or whether it should first call on the guarantee. The answer would largely depend on whether the terms of the State guarantee require that the NCB exhaust its remedies vis-à-vis the primary debtor first.⁴⁸ In the absence of such a requirement it would be reasonable to suggest that the NCB will have discretion as to how to proceed. In this respect, a guiding principle would have to be which of the two avenues (realising collateral vs activating the State guarantee) would increase the likelihood of maximum recovery within the best possible timeline. Several factors would need to be weighed up, such as whether there is actually a market for the assets, which is the asset market price, what is the expected timeframe of a market sale, what are the costs and benefits of selling the assets at a potential discount by contrast to keeping them on the NCB's balance-sheet as well as whether the guarantor would be able to pay if the guarantee were to be called on or whether enforcement proceedings would have to be opened against it. Clearly, this is an assessment that the NCB would have to perform on the basis of the precise facts of each particular case.

3 Summary - Concluding remarks

Guarantees are well embedded in the current ESCF as a means of enhancing the credit quality of the assets underlying monetary policy liquidity-providing transactions. In this context, the ESCF comprises a detailed set of rules and conditions, aiming at ensuring that, to the extent that they are employed, guarantees will not expose the Eurosystem to undue risks, including legal ones. No overhaul of the current use of guarantees as a credit quality enhancement mechanism was considered necessary in the context of the implementation by the ECB of a series of temporary measures additional to the standard monetary policy ones. Arguably, there still appears to be room for guarantees to play a more active role in securing Eurosystem monetary policy operations, if the efficient implementation of monetary policy so requires. In legal terms, this is underpinned also by the fact that Article 18.1 of the Statute is not prescriptive as to the forms that adequate collateral may take. In this regard, a series of measures can be envisaged in order to protect the Eurosystem from the risk of incurring financial losses.

The use of guarantees in the context of ELA falls within a different framework, consisting of the relevant NCB's national rules, practices and procedures. In this

⁴⁷ These assets may themselves be backed by a State guarantee, such as in the case of GGGBs (it may indeed be the case that GGGBs are not eligible for monetary policy operations, eg. due to their low credit rating).

⁴⁸ This is for example the case of the State guarantee provided for ELA purposes in the context of the Italian financial support measures referenced in footnote 25 above; see ECB Opinion CON/2017/1.

context, NCBs may determine, based on their own risk assessment, whether and to what extent they may accept guarantees in their ELA operations. On this basis, guarantees may conceivably be used as credit quality enhancement tools or as standalone means of security. National competence is to be seen within the context of Article 14.4 of the Statute and Article 123 TFEU, which empower the ECB to restrict ELA operations, provided it can be established that these interfere with the objectives and the tasks of the Eurosystem and to monitor them *ex post* in order to ensure compliance with the monetary financing prohibition.

State guarantees are also relevant for the purposes of the present discussion. Indeed, State guarantees have been relied upon, albeit in varying degrees, by the Eurosystem counterparties for the purposes of receiving liquidity in a monetary policy and/or in an ELA context. Other aspects aside, it is important to address the State guarantees' likely interference with Union state aid rules, for which the EC has exclusive competence. The Union action that has been taken in this respect so far with regard to national financial support measures has contributed to providing a sufficient degree of certainty in this field.

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Guarantees in true sale ABS structures

By Sarah Palmer¹

The focus of this short paper is on the use of guarantees in true sale asset-backed security (ABS) structures. It considers the conceptual reasons why guarantees in ABS structures usually have specific policy or regulatory purposes (Section 1) and outlines the two broad categories of guarantees used in ABSs (Section 2). It also outlines the Eurosystem's approach to guarantees in ABS structures, including under the ABS purchase programme (ABSPP) (Section 3) and three particular contexts in which they are used to great effect to serve a specific purpose, namely US agency mortgage-backed securities, European Investment Fund (EIF) guarantees and, at a national level, the Italian Garanzia Cartolarizzazione Sofferenze (GACS) scheme (Sections 4-6).

1 Conceptual issues regarding the use of guarantees in ABSs

Guarantees are very commonly used in standard bank lending operations, where a parent company often provides a guarantee in relation to the loan facility or debt repayment obligations of its subsidiaries. In securitisation structures, guarantees are most frequently encountered as a method by which credit institutions seek to achieve capital relief by way of synthetic risk transfer, or on a more granular level as a type of credit-enhancing insurance for individual receivables in true sale securitisations. This paper will not deal with those two types of guarantees in detail, although given the flexible nature of guarantees, it is not always possible to delineate strict boundaries between the various types and purposes of guarantees in true sale and synthetic ABS structures. Indeed, elements of both EIF guarantees and the Italian GACS scheme are relevant to and driven by capital relief. Overall, however, it is possible to say that, beyond synthetic risk transfers and receivables insurance contexts, guarantees in true sale ABS structures are rather less common in Europe than in the United States. The reasons for this are both conceptual and legal.

Conceptually, the unique characteristic of an ABS is the fact that its repayment is primarily and directly dependent on the repayment of principal and interest from the assets underlying it. While it is technically correct that the special purpose vehicle (SPV) issuing an ABS is the legal entity liable to pay the amounts due under the ABS notes, the SPV is structured to be bankruptcy remote, has no employees and no assets other than the underlying pool of mortgages, auto loans, leases, etc. As a matter of economic fact, therefore, an investor in an ABS is, under normal circumstances, wholly reliant on the performance of the underlying assets and not on

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one particular party's creditworthiness in order to receive repayments under the ABS notes at maturity.

This is in line with the original purpose of securitisation, especially true sale-based securitisation, which was conceived as a method of separating the credit risk of revenue-generating assets like mortgage loans, auto loans or credit card receivables from the credit and insolvency risk of the banks that created or originated the assets. Incorporating a guarantee from an unrelated third party for the payment of interest and/or principal under the ABS notes thereby deviates from the conceptually "pure" ABS format, focused solely on the performance of the assets, and introduces the possibility of improving the credit profile or regulatory characteristics of the ABS based on the characteristics of the guarantor and guarantee. The use of guarantees can therefore generally be traced to a specific policy or regulatory purpose, which will be examined in more detail in Sections 4-6.

The second reason for the rarity of guarantees in ABS structures in Europe, particularly when compared to the market in the United States, relates to the legal constraints imposed by the State aid prohibitions in the Treaty on the Functioning of the European Union (the Treaty)². The US Government National Mortgage Association (Ginnie Mae) and the US government-sponsored entities (GSEs), the Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), play an outsized role as guarantors in US securitisations. The benefit to originating banks generated by their guarantees is not always remunerated at a market rate in their guarantee fees when compared to the risk the guarantee covers. European Union Member State governments and agencies are much more constrained in terms of the potential for guarantee activities in ABS structures. Article 107(1) of the Treaty provides that any aid granted by a Member State or through State resources in any form whatsoever that distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market. These general criteria apply to guarantees given directly by the State, namely by central, regional or local authorities, as well as guarantees given through State resources by other State-controlled bodies such as undertakings and imputable to public authorities, all of which may constitute State aid.³ The provision of State guarantees in ABS structures in the Union would therefore generally need to be notified to the European Commission and would be subject to its non-objection.⁴ This rigorous process will be explored in more detail in relation to the Italian GACS scheme (Section 6).

² Articles 107-109 TFEU.

³ Section 2.1, Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees (2008/C 155/02) (20.6.2008).

⁴ Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees (2008/C 155/02) (20.6.2008) sets out guidelines on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to guarantees. Beyond securitisation structures, the Commission's Guidelines on State aid to promote risk finance investments (2014/C 19/04) (22.01.2014) and Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty (OJ L 187, 26.6.2014, p. 1) (the General Block Exemption Regulation).

2 Types of guarantees in true sale ABS structures: embedded and bilateral guarantees

At the outset, it is instructive to distinguish between the two main families of guarantees that are used in cash, true sale ABS structures, namely embedded and bilateral guarantees.

2.1 Embedded guarantees

The key feature of an embedded guarantee is that the guarantee is a part of the ABS itself; it is literally embedded into the terms and conditions of the ABS notes and lattice of contracts that create and support the ABS structure (See Figure 1).

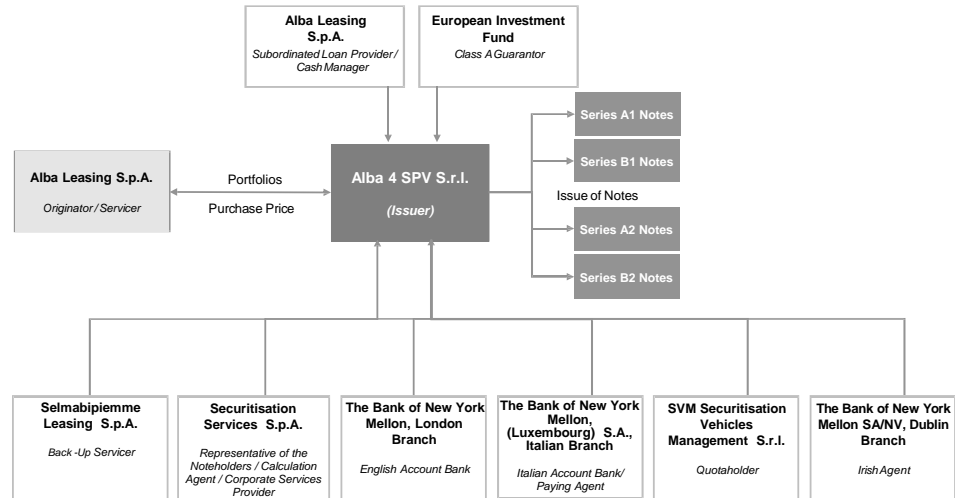
The embedded nature of the guarantee means that the guarantor's role is woven through the fabric of the ABS structure. It is party to all the relevant contractual documentation, not just the guarantee contract, and has direct contractual rights against the issuer SPV. These can include the right to call meetings, to give the issuer instructions or to consent to or veto important developments in the life of the ABS transaction. For the holders of an ABS note benefiting from an embedded guarantee, it implies that, following a sale of the note, the new investor will still benefit from the guarantee, since the guarantee comes with the note.

The full incorporation of the guarantee into the contractual structure means that the guarantor is not just party to various contracts as a silent observer. Rather, the terms and conditions of the notes and supporting contractual documentation expressly refer to the guarantee and the rights and obligations of the guarantor vis-à-vis the issuer and the beneficiaries of the guarantee, namely the ABS noteholders. For example, in the terms and conditions of the notes, the pre- and post-enforcement priorities of payments will make reference to guarantee fees payable by the issuer SPV to the guarantor as well as repayment obligations of the issuer where the guarantee has been drawn (see Excerpt 1). In addition, covenants entered into by the issuer SPV in the terms and conditions of the notes will make reference to the issuer's obligations to seek the noteholders' (or their representative's) and guarantor's consent prior to making amendments which might negatively affect the noteholders' or guarantor's interests. Similarly, the undertakings provided by the issuer SPV will make reference to obligations to notify the noteholders and guarantor of adverse developments and follow their instructions.

Figure 1

Example of an EIF embedded guarantee structure

Alba 4 SPV S.r.l



Source: Alba 4 SPV S.r.l issuance prospectus (26 June 2013).

Excerpt 1

References to the guarantee-related payments in the priority of payments in an EIF embedded guarantee structure (abridged)

Alba 4 SPV S.r.l

6. PRIORITY OF PAYMENTS

6.1 Pre-Enforcement Priority of Payments

On each Quarterly Payment Date prior to the delivery of a Trigger Notice, the Issuer Available Funds shall be applied in making or providing for the following payments in accordance with the following Priority of Payments (in each case, only if and to the extent that payments of a higher priority have been made in full, with the exception of any Advance made under the Subordinated Loan which shall be used exclusively to pay the Expected Maturity Extension Indemnity due and payable to the Senior Noteholders):

- (i) in or towards satisfaction of any and all costs and taxes due and payable by the Issuer required to be paid to maintain the rating of the Senior Notes and in connection with the listing, registration and deposit of the Notes (as the case maybe), or any notice to be given to the Noteholders or the other parties to the Transaction Documents (to the extent that the amount then standing to the balance of the Expenses Account is insufficient to pay such Expenses);
- (v) in or towards satisfaction, *pari passu* and *pro rata* according to the respective amounts thereof,
 - (a) of the Interest Amounts due and payable in respect of the Senior Notes; and
 - (b) of any Class A Guarantee Fee due to the Class A Guarantor, plus any interest (if any) accrued and unpaid thereon;
- (vi) in or towards satisfaction, *pari passu* and *pro rata* according to the respective amounts thereof,
 - (a) of all the Outstanding Guarantor Interest Payment Amounts and any interest accrued but unpaid thereon; and
 - (b) of any Expected Maturity Extension Indemnity due and payable to the Senior Noteholders;

Source: Alba 4 SPV S.r.l issuance prospectus (26 June 2013).

2.2 Bilateral guarantees

When describing bilateral guarantees, it would be remiss not to acknowledge that they are most frequently used in the context of synthetic securitisations. Here, bilateral guarantees are regularly provided directly by the SPV on a bilateral basis to the originator bank holding a reference portfolio of assets. This paper does not explore these types of bilateral guarantees in detail. Nonetheless, the types of bilateral guarantees described in this paper – guarantees used in true sale securitisations – still have several distinguishing features compared to their embedded cousins. The distinguishing characteristics of bilateral guarantees generally stem from the fact that the guarantee is a contract between two parties only, the guarantor and the ABS noteholder. Neither the issuer nor the representative of noteholders or trustee need to be party to the guarantee contract because the guarantor undertakes bilateral obligations only to an identified ABS noteholder and not to a whole class of noteholders.

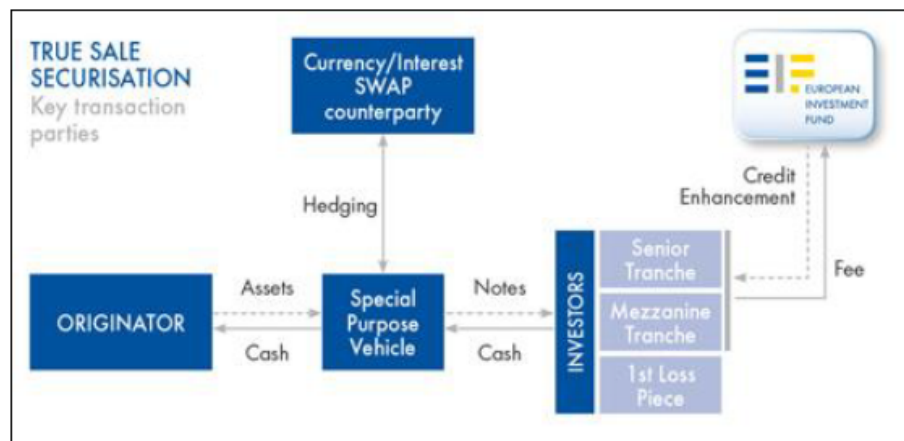
There are a number of legal consequences which flow from this fact. First, unlike in embedded guarantee structures, the guarantor has no direct rights against the issuer SPV under the terms of the guarantee contract. Any such rights of the guarantor against the issuer would ordinarily only arise as a result of the operation of the private law principle of subrogation whereby, after the guarantee is drawn, the guarantor is substituted for the noteholder so that it has a right to recover from the issuer the amounts paid under the guarantee.

Second, the guarantee relationship is separate to the ABS structure. Even if the guarantee were terminated, the ABS structure and notes could continue to exist independently but without the benefit of any guarantee.

Finally, and unlike an embedded guarantee structure, the benefit of a bilateral guarantee will not necessarily pass to an ABS noteholder simply by virtue of their purchase and the transfer of the note from the original beneficiary of the guarantee. Rather, it is likely to be necessary to assign the benefit of the guarantee to any note purchaser separately, subject to any particular requirements of the laws governing and applicable to the guarantee and its transfer.

Figure 2
Example of an EIF bilateral guarantee structure

Alba 4 SPV S.r.l



Source: EIF

Source: SME Securitisation – at a crossroads? EIF Working Paper 2015/31.⁵

2.3 Hybrid guarantee formats

Finally, as mentioned above, the flexibility of guarantees means that it is also possible to create guarantees which mix features of both embedded and bilateral guarantees or which do not have all the features enunciated. For example, the Italian state guarantees that can be provided for securitisations of non-performing loans under the GACS scheme combines elements of both types (see also Section 6).

Under the GACS scheme, the Italian Ministry of Economy and Finance may provide a guarantee to all holders of the most senior class of ABS notes by reference to its ISIN, and subject to a number of structural conditions which must be fulfilled by the transaction. These include that the priority of payments already pre-emptively foresees a certain position in the waterfall for guarantee fee payments in relation to other payment obligations of the issuer SPV. To this end, the contractual documentation incorporates references to the guarantee in a similar manner to embedded guarantees. Similarly, once the guarantee has been issued, subsequent noteholders will still benefit from the guarantee if the ABS is sold. As such, it has the same effect as an embedded guarantee. Unlike an embedded guarantee, however, the Ministry of Economy and Finance is not party to the ABS contracts itself, rather the guarantee is published in the Italian Official Gazette with a reference to its ISIN code.

⁵ EIF SME Securitisation – at a crossroads?, Working Paper 2015/31, EIF Research and Market Analysis.

Excerpt 2

Example of an Italian GACS scheme guarantee notice referring to note ISIN

Popolare Bari NPLS 2017 S.R.L.

23-11-2017

GAZZETTA UFFICIALE DELLA REPUBBLICA ITALIANA

Foglio delle inserzioni - n. 138

POPOLARE BARI NPLS 2017 S.R.L.
Società a responsabilità limitata con socio unico
Costituita ai sensi dell'articolo 3 della legge 130/99, in
corso di iscrizione nell'elenco delle società veicolo tenuto
dalla Banca d'Italia ai sensi del provvedimento della Banca
d'Italia del 7 giugno 2017
Sede legale: via V. Alfieri, 1 - Conegliano (TV)
Capitale sociale: Euro 10.000,00 i.v.
Registro delle imprese: Treviso-Belluno 04905460269
Codice Fiscale: 04905460269

Avviso di cessione di crediti pro soluto ai sensi della Legge
n. 130 del 30 aprile 1999 (la "Legge sulla Cartolariz-
zazione") e dell'articolo 58 del Decreto Legislativo
n. 385 del 1° settembre 1993, come successivamente
modificato e integrato (il "Testo Unico Bancario") - ed
informativa ai debitori ceduti sul trattamento dei dati
personali, ai sensi dell'articolo 13 del Decreto Legisla-
tivo 30 giugno 2003, n. 196 (il "Codice della Privacy").

Popolare Bari NPLs 2017 S.r.l. (la "Società") comunica
che in data 16 novembre 2017 (la "Data di Stipulazione") ha
concluso con Banca Popolare di Bari S.c.p.a. ("Banca Popo-
lare di Bari") e Cassa di Risparmio di Orvieto S.p.a. ("Cassa
di Risparmio di Orvieto" e, insieme a Banca Popolare di
Bari, le "Banche Cedenti" e, ciascuna una "Banca Cedente")

garantiscono i Crediti od altrimenti ad essi inerenti, senza
bisogno di alcuna ulteriore formalità o annotazione, come
previsto dall'articolo 7.1, comma 6, della Legge sulla Car-
tolarizzazione.

La Società ha conferito incarico a Prelios Credit Servicing
S.p.A. (il "Servicer") affinché in suo nome e per suo conto
in qualità di soggetto incaricato della riscossione dei Crediti
proceda all'incasso ed al recupero delle somme dovute in
relazione ai portafogli di Crediti ceduti dalle Banche Cedenti
e delle garanzie e dei privilegi che li assistono e garanti-
scono. A seguito della cessione tutte le somme dovute alle
Banche Cedenti in relazione ai Crediti dovranno essere ver-
sate alla Società sul seguente conto corrente avente IBAN
IT 72 X 03479 01600 000802172100, intestato alla Società
ed aperto presso BNP Paribas Securities Services, succur-
sale di Milano, e/o in conformità con le eventuali ulteriori
indicazioni che potranno essere comunicate ai debitori ceduti
ed ai garanti. A seguito della cessione, inoltre, la Società è
divenuta esclusiva titolare dei Crediti e, di conseguenza, ai
sensi del decreto legislativo 196/03 ("Codice della Privacy"),
titolare autonomo del trattamento dei dati personali, anagra-
fici, patrimoniali e reddituali contenuti nei documenti e nelle
evidenze informatiche connesse ai Crediti, relativi ai debitori
ceduti ed ai rispettivi eventuali garanti, successori ed aventi
causa (i "Dati"), e con la presente intende fornire ai debitori

Source: Italian Official Gazette.⁶

3 The Eurosystem's approach to guaranteed ABS structures in its monetary policy framework

3.1 Collateral framework

The Eurosystem's approach to guarantees used in true sale ABS structures in its monetary policy function depends on the context in which they are considered. The first context is the usage of a guaranteed ABS as collateral for liquidity-providing monetary policy operations.

Guideline ECB/2014/60⁷ sets out the single framework that applies in the Eurosystem for assets that may be submitted as eligible collateral for the purpose of participating in Eurosystem monetary operations (the "general framework"). In addition, Guideline ECB/2014/31⁸ also includes additional temporary measures regarding the eligibility of collateral, which includes specific measures for ABS (the "temporary framework"). In order to be eligible as collateral for Eurosystem monetary

⁶ Italian Official Gazette, 21 November 2017.

⁷ Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (ECB/2014/60) (OJ L 91, 2.4.2015, p. 3).

⁸ Guideline (EU) 2014/528 of the European Central Bank of 9 July 2014 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral and amending Guideline ECB/2007/9 (recast) (ECB/2014/31), 18.7.2014 (OJ L 240, 13.8.2014, p. 28).

operations, an ABS must fulfil the eligibility criteria laid down in the general framework or, if the ABS's rating is below the required rating set out in the general framework, it must fulfil the rating requirement set out in the temporary framework as well as the additional structural requirements contained therein.⁹ The Eurosystem's credit quality requirements under Article 82(1)(b) of the general framework require ABSs to have credit assessments provided by at least two different accepted external credit assessment institutions (ECAIs) with a minimum rating of credit quality step 2 in the Eurosystem's harmonised rating scale. Under Article 3(1) of the temporary framework, ABSs may be eligible as collateral provided they have two ratings of at least "BBB" from any accepted ECAI for the issue and fulfil the further requirements in the temporary framework, e.g. that the cash-flow generating assets backing the ABSs do not contain any loans which are non-performing at the time of issuance or incorporated in the ABSs during the life of the ABSs.¹⁰

On this basis, one may summarise that the monetary policy collateral rules for ABSs consider the rating of the ABS notes as the key proxy for an ABS's credit quality. Neither the general nor temporary framework address whether an ABS benefits from a guarantee which influences the rating. Instead, the collateral framework is effectively neutral with regard to the existence or non-existence of a guarantee in the ABS structure. The main advantage of this approach is its simplicity: the collateral framework looks to the overall credit outcome of structural features in ABSs, expressed in the form of the rating, without laying down more complex rules than necessary. Conversely, the main disadvantage of not addressing the potential existence of a guarantee in an ABS structure is that the potential effect of the guarantee on the credit quality of the notes is not addressed: the framework does not include any requirements to ensure the robustness of a guarantee that supports the rating. Nonetheless, it is arguable that the Eurosystem's straightforward approach can be justified on the basis that its collateral framework is designed to accommodate a wide range of standard marketable assets (as well as non-marketable assets), and it is arguably unnecessary to include rules for a structural feature that is as rare as ABS guarantees in the European ABS market. In the balancing act between simple, transparent collateral rules and more nuanced provisions, this pragmatic approach therefore seems appropriate.

3.2 ABS purchase programme

The second context in which the Eurosystem's monetary policy is relevant for guaranteed ABSs is the ABS purchase programme (ABSPP). The ABSPP was one of the first asset purchase programmes established by the Eurosystem as part of its non-standard monetary policy measures to "enhance the transmission of monetary policy, facilitate credit provision to the euro area economy, generate positive spillovers to other markets and, as a result, ease the ECB's monetary policy stance, and

⁹ Recital 13 of Guideline ECB/2014/31 clarifies that the temporary framework supplements the general framework.

¹⁰ Article 3(1)(c) of Guideline ECB/2014/31.

contribute to a return of inflation rates to levels closer to 2%”.¹¹ Unlike the Eurosystem collateral framework, the ABSPP does contain specific rules on guarantees in ABS structures: the ECB may purchase mezzanine tranches of notes, but only if they benefit from a guarantee that complies with the specified provisions on guarantees set out in the general framework.¹² For the purpose of the ABSPP, a mezzanine tranche is defined as “a tranche of an ABS issue that ... (a) ranks below the non-subordinated tranche or sub-tranches of the same ABS issue ... and (b) ranks above the most subordinated tranche or sub-tranches that are the first to bear losses incurred on the securitised exposures and which thereby provide protection to the second loss and, where relevant, higher ranking tranches or sub-tranches.”¹³ A mezzanine tranche is therefore any note tranche which is neither the most senior nor the most junior in the ABS.

The eligibility of guaranteed mezzanine ABS tranches for purchases under the ABSPP is a departure from the approach of the Eurosystem collateral framework in two ways. First, the Eurosystem only accepts senior tranches of ABSs as collateral for Eurosystem liquidity-providing operations.¹⁴ This seniority requirement is therefore deactivated in relation to mezzanine guaranteed ABS tranches for the ABSPP. Second, the ABSPP looks through the credit rating of the mezzanine tranche to focus on the specific characteristics required of a guarantee on that tranche. In all other respects, a guaranteed mezzanine ABS tranche should comply with the other eligibility criteria for purchase under the ABSPP.

With regard to the approach to a mezzanine guarantee, Decision ECB/2014/45 clarifies that such a guarantee must (i) meet the requirements for guarantees of marketable assets as set out in Articles 114, 115, 117 and 118 of the general framework; and (ii) be issued by a guarantor rated at least at the level of credit quality step 3 by at least one accepted ECAI. The core, substantive requirements for the guarantee therefore include certain key elements. The guarantee must be (i) an unconditional and irrevocable first-demand guarantee in respect of the issuer’s obligation to pay principal, interest and any other amounts due under the mezzanine ABS tranche, until the tranche is discharged in full; (ii) payable on first demand independently of the guaranteed tranche; (iii) legally valid, binding and enforceable against the guarantor; (iv) governed by the law of a Member State; (v) confirmed by a legal confirmation with regard to its legal validity, binding effect and enforceability (if the guarantor is not a public sector entity with the right to levy taxes); (vi) ranked equally, *pari passu*, and rateably, *pro rata*, with all other unsecured obligations of the guarantor.

Consequently, it can be observed that no adjustments were made to the eligibility criteria for guarantees in the collateral general framework to adapt to the particular nature of ABSs or to accommodate the particular features of actual examples of ABS

¹¹ Recital (2) of Decision (EU) 2015/5 of the European Central Bank of 19 November 2014 on the implementation of the asset-backed securities purchase programme (ECB/2014/45) (OJ L 1, 6.1.2015, p. 4).

¹² Article 2(9) of Decision ECB/2014/45.

¹³ Article 2(9) of Decision ECB/2014/45.

¹⁴ Article 77 of Guideline ECB/2014/60.

guarantees issued by certain guarantors (such as the EIF) in the past. As will be outlined in Section 5, this means that many existing examples of ABS mezzanine guarantees in the European market, including those of the EIF, are not currently compatible with the ABSPP requirements.

4 US agency mortgage-backed securities

Turning away from the Eurosystem and its approach to true sale ABS guarantees, it is useful to consider some real-life examples of guarantees used in true sale ABS structures, to demonstrate how these guarantees operate and how they have a specific purpose in each case. By far the most prominent example of guaranteed ABSs is to be found in the United States, where mortgage-backed securities (MBSs) are guaranteed by the US government agency Ginnie Mae and both issued and guaranteed by the government-sponsored agencies Freddie Mac and Fannie Mae.

4.1 Statutory purpose of US agency guarantees: home ownership

In the case of the US agencies, the clear policy purpose of their securitisation guarantee activities to support home ownership in the United States is closely linked to the country's historical economic context¹⁵ and is built into their legal mandate in their founding charters. These include the goals to support the secondary market for residential mortgages in the United States “to provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing ...[and to] promote access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing”.¹⁶

Thus, by pursuing their legal mandate by issuing guarantees on MBSs, the agencies support the secondary market for US mortgages and bolster the price mortgage lenders can obtain for their mortgage loans in the secondary mortgage market. This increases the flow of liquidity to banks originating mortgage loans, thereby enhancing the ability of banks to grant new mortgage loans and thus increasing the ease with which US consumers can access credit to buy and ultimately own a home.

¹⁵ See Ginnie Mae website, “[Our History](#)”; Fannie Mae website, “[The path of progress](#)”.

¹⁶ [Sec. 301 of Federal National Mortgage Association Charter Act](#), Title III of National Housing Act, 12 U.S.C. 1716 et seq. (as amended through May 24, 2018); and [Sec. 301 of Federal Home Loan Mortgage Corporation Act](#), Public Law No. 91-351, 84 Stat. 450, Approved July 24, 1970 (as amended through July 21, 2010).

4.2 Technical operation of agencies' guarantees

The US agencies' guarantees operate slightly differently in each case. Ginnie Mae does not buy or sell loans or issue MBSs itself, rather it guarantees the timely payment of principal and interest on MBSs backed by a defined set of federally insured or guaranteed loans, mainly loans insured by the Federal Housing Administration (FHA) or guaranteed by the Department of Veterans Affairs (VA), but also loans guaranteed or issued by the Department of Agriculture's Office of Rural Development (RD) and the Department of Housing and Urban Development's Office of Public and Indian Housing (PIH).¹⁷ Issuers of MBSs may apply to become issuers of Ginnie Mae guaranteed MBSs subject to their compliance with applicable eligibility criteria.¹⁸ As Ginnie Mae is fully owned by the US government, MBSs guaranteed by it benefit from the "full faith and credit guaranty of the United States government".

In contrast, Fannie Mae and Freddie Mac actually purchase single or multifamily mortgages (conforming to designated size and underwriting criteria) themselves. They then package them into MBS structures which they issue and guarantee. They provide a guarantee relating to timely payment of interest and principal on the MBSs they issue, irrespective of whether or not the underlying mortgages pay on time or in full.¹⁹ In contrast to Ginnie Mae, Fannie Mae and Freddie Mac are private corporations (albeit serving a public purpose), but they are perceived by the market to benefit from an implicit guarantee of US government backing. This implicit understanding was made somewhat more explicit, but not technically explicit, by actions taken in 2008 at the beginning of the financial crisis.²⁰ In September 2008, Fannie Mae and Freddie Mac agreed to be placed in voluntary conservatorship, which permitted the Federal Government to run them, and the Federal Housing Finance Agency became their conservator.²¹ They also entered into a senior preferred stock purchase agreement with the U.S. Department of the Treasury. Pursuant to the agreement, the US Treasury committed to provide funding to the agencies under specified circumstances.²²

Notwithstanding the difficulties faced by Fannie Mae and Freddie Mac in 2008, the US agencies have been enormously successful in their MBS guarantee activities, at least when measured by issuance volumes. The US agency MBS market is the second-largest fixed income debt market in the world, behind only US Treasuries. As mentioned in Section 1, Europe in particular has no comparable scheme of true sale guarantees on the scale of US agency MBSs, because State aid rules hinder large-scale engagement in private markets. This issue was evident in the level of scrutiny applied to the establishment of the Italian GACS scheme by the European Commission (Section 6).

¹⁷ See "[Funding Government Lending](#)".

¹⁸ See "[Becoming an Issuer](#)" and the "Ginnie Mae MBS Guide".

¹⁹ See Fannie Mae website on [single-family](#) and [multifamily](#) MBS products; and Freddie Mac website, [FAQs](#).

²⁰ See Fannie Mae website "[Investor Relations](#)"; [SIFMA MBS Factsheet 2011](#).

²¹ See Weiss, N. Eric and Jones, Katie, (2017), *An Overview of the Housing Finance System in the United States*, [Congressional Research Service](#), (7-5700, R42995).

²² See Fannie Mae website, "[Investor Relations](#)"; [SIFMA MBS Factsheet 2011](#).

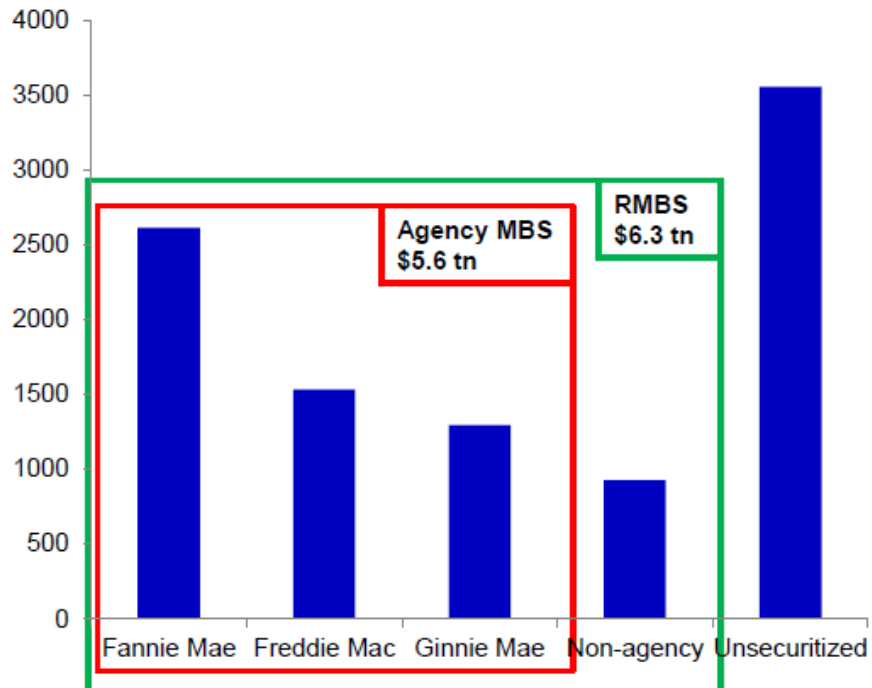
Chart 1

Agency MBS share of home mortgage credit in the United States

2015 Mortgage Statistical Annual, Federal Reserve Bank of New York analysis

Outstanding 1-4 Family Mortgage Credit, Total = \$9.9 trillion

Q4 2014, \$ billions



Source: MBS Market and Operations, Federal Reserve Bank of New York, 30 September 2015²³.

5 EIF guarantees

In the European context, the EIF is one of the best-established and most active market participants in SME securitisations in Europe. The EIF is active in many different areas, but when providing credit enhancement to mezzanine and senior tranches of SME transactions, it engages in three main types of activity: (i) it provides guarantees of timely payment of interest and principal on ABS tranches, (ii) it provides synthetic guarantees on tranching portfolios (facilitating regulatory capital relief for the beneficiary), and (iii) it can also make direct purchases of ABS tranches. This section focuses on the true sale guarantees referred to in (i).

5.1 Policy purpose of EIF guarantees: SME financing

As outlined in Section 2, these EIF guarantees can take the form of either embedded or bilateral guarantees. In addition, like the US agencies, the EIF's guarantees are issued for the specific purpose laid down in its legal mandate. Under its Statutes, the

²³ [MBS Market and Operations](#).

task of the EIF is to “to contribute to the pursuit of the objectives of the European Union ... through ... the provision of guarantees as well as of other comparable instruments for loans and other financial obligations in whatever form is legally permissible...”.²⁴ In interpreting this mandate, the EIF has become a specialist provider of risk finance to small and medium-sized enterprises (SMEs) across Europe, developing and offering targeted financial products to intermediaries, such as banks, guarantee and leasing companies, micro-credit providers and private equity funds, to enhance SMEs’ access to finance.²⁵ The overriding objective of financing SMEs in Europe is therefore clearly visible in the EIF’s ABS guarantees, which are always related to SME securitisations.

The key advantages of an EIF guarantee stem from the fact that the EIF qualifies as a multilateral development bank in the Capital Requirements Regulation (CRR). This means that banks investing in an ABS tranche guaranteed by the EIF can apply a 0% risk weighting to the tranche asset when calculating their regulatory capital requirements, which is a great deal more attractive than the higher capital requirements for exposures to “ordinary” ABS tranches.²⁶ In addition, the rating of the guaranteed tranche is enhanced from its intrinsic credit level to triple-A status, reflecting the EIF’s AAA credit rating. These regulatory and credit advantages of EIF guarantees underpin the EIF’s ability to achieve its policy goal of enhancing SME access to finance in several ways. An EIF guarantee can make it easier to sell ABS tranches to investors, thereby supporting the ability of originators to access capital market funding and liquidity, and ultimately making it easier for SMEs to access funding at the next stage of capital intermediation. In addition, an EIF guarantee can help an originator achieve regulatory capital relief. This frees up funds on the originator’s balance sheet to permit it to provide fresh financing to SMEs.²⁷

5.2 Features of EIF guarantees

Even though there are several formats in which EIF guarantees can be issued, they have certain core features. They are irrevocable and unconditional, payable on first demand (subject to conditions and formalities, e.g. receipt of a duly completed and executed payment demand). The scope of the guarantee covers interest when due,

²⁴ See [EIF Statutes](#), as amended.

²⁵ See [Who we are: our mission, our objectives](#), EIF website.

²⁶ See Kraemer-Eis, Helmut, Passaris, George and Tappi, Alessandro, (2013), “SME Loan Securitisation 2.0 Market Assessment and Policy Options”, [Working Paper 2013/19](#), EIF Research & Market Analysis, October, p. 32.

²⁷ EIF involvement in SME securitisations has several other more practical upsides: “In addition to the direct benefits of its guarantees, other factors of EIF’s involvement can play an important role in facilitating the execution of a securitisation transaction: EIF’s involvement can facilitate placement of tranches with investors. From the originator’s point of view, EIF reduces uncertainty and supports the marketing of a deal through its ‘anchor’ investor status. Smaller banks profit from EIF’s experience and knowledge of the SME securitisation process (support and spread of best market practise). Usually, EIF is involved very early in the transaction and can assist the originator. The EIF facilitates (on average) overall lower transaction costs. EIF acts in the ‘traditional’ securitisation markets and with “traditional” key players, but expands the idea of SMESec into non-core market countries (e.g. Central and Eastern Europe), and to new originators. In general, EIF facilitates standardisation, requires high transparency levels, and spreads best securitisation market practice.” Kraemer-Eis, Helmut, Passaris, George and Tappi, Alessandro, (2013), “SME Loan Securitisation 2.0 Market Assessment and Policy Options”, [Working Paper 2013/19](#), EIF Research & Market Analysis, October, p. 32.

i.e. on interest payment dates, as well as the ultimate repayment of principal on the legal final maturity date.²⁸

In addition, since the effect of the EIF's guarantee is that it assumes the core credit risk for payments under the guaranteed ABS notes, its guarantees are issued subject to its ability to exercise an appropriate level of control over important developments occurring during the lifetime of the transaction by retaining certain entrenched rights over "reserved matters". These entrenched rights are therefore also characteristic of the EIF's ABS guarantees and typically give the EIF consent or veto rights over matters which could increase or adversely affect the EIF's obligations or liabilities under the guarantee or which would, or could reasonably be expected to, otherwise be materially prejudicial to the EIF's interests.²⁹ These types of matters can include amendments, modifications, derogations or waivers in respect of (a) the EIF's voting rights under the ABS transaction; (b) the interest rate, the currency or the legal final maturity of the notes it guarantees; (c) events of default, termination events or other material terms of any swap agreement; (d) the contractual waterfall if it would affect the seniority of amounts due to the EIF as guarantor; (e) the release of the security for the notes; occurrence of an event of default under the ABS notes; (f) the EIF's entitlement to receive any information in its role as guarantor under the contractual documentation.

EIF guarantees also usually contain a prepayment option whereby the EIF may opt to pay the beneficiaries of the guarantee the full amount of principal outstanding and interest accrued under the guaranteed notes if the beneficiary has delivered a duly completed payment demand and/or following the delivery by the noteholder representative or trustee of a notice of default under the ABS notes.³⁰ Crucially for the holders of the guaranteed ABS notes, the notes could then be fully redeemed earlier than the expected or legal final maturity date, even if the EIF guarantee had only been drawn with regard to interest payments. The benefit of this prepayment option for the EIF is that it has the legal effect of subrogating the EIF to any rights of the repaid ABS noteholders against the issuer SPV. This allows it to take control of an ABS transaction to better protect its interests and exercise influence when there are concrete indications of adverse developments, i.e. a draw on the guarantee or trigger of an event of default, but without having to share control with noteholders over a period of time until the guarantee has been fully drawn.

5.3 Comparison of EIF guarantees with Eurosystem requirements on guarantees for the ABSPP

As outlined in Section 3, the Eurosystem may purchase mezzanine ABS tranches where they benefit from a guarantee complying with the requirements of the

²⁸ See Prospectus, Alba 4 SPV S.r.l, (26 June 2013), pp. 56-59; Prospectus, Sandown Gold Plc (16 July 2010) pp. 72-73.

²⁹ See Prospectus, Alba 4 SPV S.r.l, (26 June 2013), p. 142.

³⁰ See Prospectus, Alba 4 SPV S.r.l, (26 June 2013), p. 131; Prospectus, Sandown Gold Plc (16 July 2010) p. 73.

collateral general framework. However, existing EIF guarantees of ABSs would not meet these requirements for a number of reasons.

First, Article 114(1) of the general framework requires the guarantor to provide an “unconditional and irrevocable first-demand guarantee in respect of the obligations of the issuer or debtor in relation to the payment of the principal, interest and any other amounts due under the marketable asset ... to the holders or creditor thereof, until the marketable asset or credit claim is discharged in full”. Crucially, the scope of the guarantee must extend to “other amounts due”, not just interest and principal amounts. These other amounts are not defined further, but might conceivably comprise default interest and principal, broken funding indemnities, other increased costs or amounts unpaid due to withholding tax. In contrast, EIF guarantees cover interest when due and the ultimate repayment of principal, but no additional amounts. There is therefore a discrepancy in the scope of coverage required for a guarantee on a mezzanine tranche for purchase under the ABSPP and EIF guarantees issued thus far.

Second, Article 114(1) requires a guarantee to cover “amounts due under the marketable asset”. ABS structures are pass-through structures, which act as conduits for the cash flows generated from the underlying assets to reach the investors in the ABS notes. For this reason, there is usually an important distinction made in the terms and conditions of the notes between amounts which are “payable” and amounts which are “due”. When an amount is “payable” this means that when funds are actually received by the issuer SPV from the underlying assets and available, they should be paid on to the noteholders. If no funds are received or available, however, then the absence of any payment will not entitle the noteholders (or their representative) to any remedy, i.e. it will not entitle them to deliver a notice of default. In contrast, if an amount is “due and payable”, then non-payment of that amount on the relevant due date, for whatever reason and irrespective of whether the funds are available or not, will entitle the noteholders (or their representative) to deliver a notice of default.

In ABS structures, interest amounts are both due and payable on each payment date, which usually occurs on a monthly or quarterly basis. Principal amounts, however, are merely payable on the periodic payment dates and only become both due and payable at the legal final maturity date of the ABS note. This date usually corresponds to the longest maturity of the underlying asset pool (plus a defined period to permit any work out to be completed). It is submitted, however, that it is possible for an event of default to occur prior to the legal final maturity date of the ABS.

Events of default in ABS structures are generally limited to non-payment of amounts due under the notes, insolvency or similar procedures relating to the issuer SPV and non-performance by the issuer SPV of material obligations under the transaction documents. If an enforcement notice is delivered on foot of an event of default, then this accelerates the obligations of the issuer SPV to render all amounts under the notes due immediately. It is highly unlikely that an issuer SPV, as an insolvency remote vehicle, would enter into insolvency proceedings. Similarly, it is unlikely that the issuer SPV’s corporate servicer and various other service providers would

default in their obligations and therefore indirectly trigger a material non-performance default by the issuer SPV. Nonetheless, they are each a factual possibility, which is reflected in their standard inclusion in the majority of ABS transactions as note events of default. If these events of default occurred prior to the legal final maturity of the notes, and the notes were accelerated, then the principal of the notes would become due at that earlier point in time. For this reason, the Eurosystem collateral framework would require a mezzanine guarantee of an ABS tranche to cover amounts of principal whenever it was possible for it to become due, even if it was unlikely that principal would actually become due prior to the legal final maturity of the notes. In contrast, EIF guarantees only cover principal at the legal final maturity date of the guaranteed ABS notes.

The EIF has also highlighted that it is uncertain whether its guarantees would comply with the need for the mezzanine guarantee to be “on first demand”. “[T]he ECB’s requirement of a guarantee on demand (‘The guarantee shall be payable on first demand independently of the guaranteed marketable asset or credit claim’) leads for guarantors to a gap between their payment obligation to ECB (on demand) and the receipt of payment from the mezzanine ABS tranches ... This feature limits the number of potential guarantors significantly since a wrap of this sort would not be a market standard.”³¹ In this context it is important to note that the law applicable to guarantees is highly specific to national law context. Consequently, a “first-demand” guarantee may have different legal implications in different jurisdictions. These types of national law specificities are not addressed by the Eurosystem ABSPP or its requirements on guarantees.

While recognising the possibility for legal variations in interpretation of a “first-demand” guarantee, the accounting implications of one particular interpretation are of particular note. If “payable on first demand” is interpreted as meaning that the beneficiary may demand full payment without proof of default (subject to the possibility to litigate subsequently whether the demand was justified), then it may be argued that the guarantee can be drawn independent of actual loss incurred. In that case, it is also arguable that the guarantee acts more like a credit default swap, or derivative, rather than a (financial) guarantee. For guarantors, this has implications for how they account for the guarantee. Financial guarantees are exempt from fair value (mark to market) accounting under Statements of Financial Accounting Standards No. 133 (Accounting for Derivative Instruments and Hedging Activities) or International Accounting Standard No. 39 (Financial Instruments: Recognition and Measurement)³², while derivatives are not. The ability of ABS guarantors to account for their guarantees as financial guarantees, and not derivatives, is therefore highly relevant to their ability to provide the guarantee in the first place.

³¹ See Kraemer-Eis, Helmut, Passaris, George and Tappi, Alessandro, (2013), “SME Loan Securitisation 2.0 Market Assessment and Policy Options”, [Working Paper 2013/19](#), EIF Research & Market Analysis, October, p. 40.

³² See also Ng, Leonard (2010), “Credit default swaps, guarantees and insurance policies: same effect, different treatment?”, JIBFL, December, p. 664.

6 Italian GACS scheme

The final example of a true sale ABS guarantee comes from the national context, namely the Italian GACS scheme. As briefly mentioned in Section 2.3, the scheme, established by decree in February 2016³³ (the Decree), permits the Italian Treasury, through the Ministry of Economy and Finance, to provide a guarantee to all holders of the most senior class of notes in a securitisation of non-performing loan (NPL) portfolios.

6.1 GACS' statutory purpose: support Italian banks' transfer of non-performing loans and balance sheet relief

Like the US agency MBS and EIF guarantees, the GACS scheme guarantee also has a very clear policy purpose. It is designed to “facilitate the removal of bad loans from the books of commercial banks ... [by] funding transfers of bad loans. This is an additional step in the series of measures taken ... to help strengthening the banking sector ... With this additional step, this whole set of measures will ensure effective and gradual elimination of the residual weakness still present in Italy's banking sector, i.e. the high levels of bad loans”.³⁴

The availability of a state guarantee for NPL securitisations aims to help Italian banks dispose of NPLs weighing down their balance sheets by way of securitisation.³⁵ Although, under current conditions, the Italian state guarantee would not provide any rating uplift (compared to the required rating of the senior tranche of notes without the guarantee), the guarantee nonetheless facilitates the transfer of NPLs because it improves the transfer prices available (for originators) and therefore reduces the potential loss versus book value.³⁶ This, combined with other reforms of banking sector and insolvency laws, is part of a concerted policy drive by Italian authorities to address NPL issues facing Italian banks.

6.2 Conditions for issuing the GACS guarantee

There are a series of conditions which must be met by an NPL securitisation before the Italian Ministry of Economy and Finance will issue a guarantee. The rationale for these conditions can be traced to two main issues: first, the policy purpose of facilitating a genuine transfer of risk from Italian banks' balance sheets while minimising the burden on the Italian state's coffers and moral hazard, and second,

³³ See Law Decree no. 18 of 14 February 2016, Italian [Official Gazette](#).

³⁴ See “Scheme introduced to facilitate the disposal of banks' bad loans GACS (Garanzia Cartolarizzazione Sofferenze – Guarantee on Securitization of bad loans) to be introduced shortly”, Ministry of Economy and Finance, [Press release N° 20](#), 27 January 2016.

³⁵ See also ECB opinion of 24 March 2016 on the reform of cooperative banks, a guarantee scheme for securitisations of non-performing loans and the lending capacity of alternative investment funds (CON/2016/17).

³⁶ See Bergman, D. (2018), “Scope raises Italian NPL securitisation forecast amid acceleration in asset disposals, Structured Finance”, [Scope Ratings](#), 29 May; and Bergman, D. (2017), “NPL Securitisations: Italy Continues to be the Main Market”, [Scope Ratings](#), 18 December.

the overriding need to structure the guarantee in line with the requirements of the Treaty on state aid.

6.2.1 Deconsolidation of risk

With regard to the transfer of receivables, the Decree stipulates that the transfer price for the NPL portfolio may not exceed the aggregate net book value of the receivables as recorded in the originators' accounts – there is no floor on the sale price, in recognition of the need for a large discount in many cases.³⁷ Most importantly, however, the guarantee may only be issued if, in accordance with Article 8(1) of the Decree, the originator bank has managed to transfer more than 50% of the junior notes, i.e. a sufficient amount to attain balance sheet deconsolidation of the securitised NPL portfolio. This core requirement is the one most closely linked to the overall policy goal of the scheme to facilitate a true transfer of risk from the balance sheets of Italian banks to address their issues with NPLs.

Figure 3
Simplified graphical presentation of an Italian GACS securitisation

Structure showing purchase price, provisioning and note structure

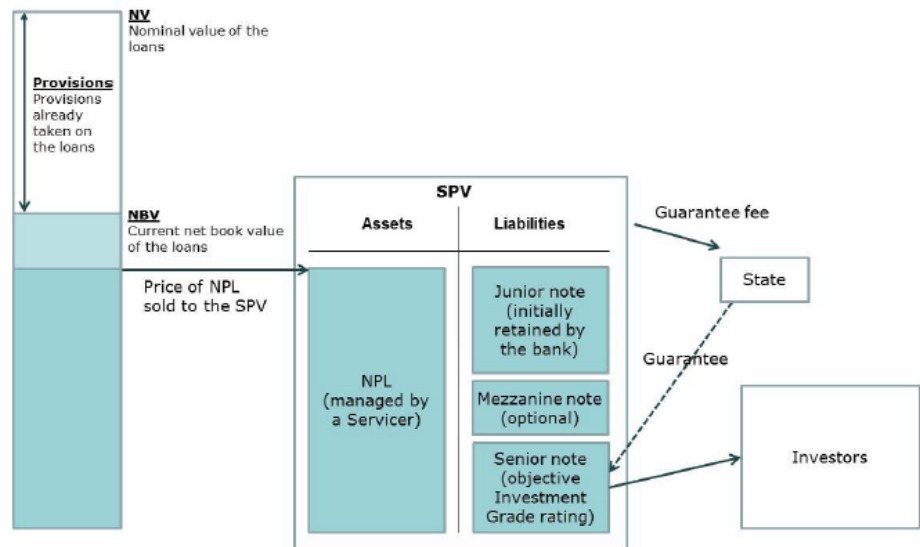


Figure 1 – Securitisation structure

Source: European Commission Decision on Case SA.43390 (2016/N) – Italy – Italian securitisation scheme.³⁸

³⁷ See also Article 2 of the GACS Ministerial Decree.

³⁸ Commission Decision, 10.02.2016 C(2016) 873 final, as set out in the Official Journal 'Authorisation for State aid pursuant to Articles 107 and 108 of the Treaty on the Functioning of the European Union — Cases where the Commission raises no objections (OJ C 161, 4.5.2016, p. 1).

6.2.2 Requirements regarding the transaction structure and the senior notes

In relation to the senior notes on which the guarantee would be issued, these must first, and independently of the guarantee, achieve a rating equal to or higher than investment grade (BBB-) from an independent rating agency included in the list of credit rating agencies accepted by the Eurosystem. “The rating will be issued on the basis of the strict standards which the agencies are required to abide by, including: an analytical estimate of cash flows associated with the guaranteed security, a check on the credit quality of all underlying loans, the percentage invested in the tranches that will absorb the first losses, the operating capacity of the servicer which will be entrusted with recovery of the credit.”³⁹

Payments of interest and principal under the senior notes must be unsubordinated to payments of any other tranche under the post-enforcement or post-acceleration priority of payments⁴⁰, and there must be at least two classes of notes in the structure. In this way, the Decree requires a certain priority of payments to be incorporated in the terms and conditions of the notes even before the guarantee is issued. The “usual senior costs, expenses and fees due to the NPL servicer and other agents are followed by the payment of interest due on any permitted credit facility, fees due under the guarantee and any hedging payments, and interest on the senior notes rank in priority to other interest payments under the mezzanine notes, and principal payments on the senior notes rank prior to any other payment on the mezzanine notes and/or junior notes”⁴¹.

In addition, the Italian Ministry of Economy and Finance has a consent right in relation to certain material issues, e.g. the amendment of the nominal amounts of the guaranteed senior notes, an increase in the senior note interest rate, a change to the legal final maturity date, an amendment of the note events of default or any other amendment to the transaction documents leading to a downgrade of the senior notes. The Ministry of Economy and Finance is also entitled to receive ongoing information on the performance of the transaction.⁴²

Finally, the Decree requires banks “to entrust credit recovery to an external independent servicer. The latter shall prevent any conflict of interest from hampering debt recovery.”⁴³

³⁹ See “Scheme introduced to facilitate the disposal of banks' bad loans GACS (Garanzia Cartolarizzazione Sofferenze – Guarantee on Securitization of bad loans) to be introduced shortly”, Ministry of Economy and Finance, [Press release N° 20](#), 27 January 2016.

⁴⁰ See Article 4 of the translation of the GACS Ministerial Decree by Chiomenti Studio Legale in “[Implementation of the Italian Non-Performing Loan \(NPL\) State Guarantee Scheme \('GACS'\)](#)” (3 August 2016).

⁴¹ See “Public State guarantee to secure securitisations of non-performing loan receivables: the Italian “bad bank” solution? ('GACS')”, [Clifford Chance Briefing note](#), February 2016.

⁴² See Article 5 of the GACS Ministerial Decree.

⁴³ See “Scheme introduced to facilitate the disposal of banks' bad loans GACS (Garanzia Cartolarizzazione Sofferenze – Guarantee on Securitization of bad loans) to be introduced shortly”, Ministry of Economy and Finance, [Press release N° 20](#), 27 January 2016.

The collective effect of these structural requirements is to maximise the security and quality of the senior notes, retain some control by the Ministry of Economy and Finance over developments in the transaction and thereby include minimum safeguards for the Italian Treasury prior to assuming the credit risk of the guarantee.

6.2.3 State aid: market-based guarantee fee

Given the involvement of the Italian state in the issuance of the GACS guarantee and the potential advantage it provided to Italian banks under the scheme, resolving potential state aid issues in cooperation with the European Commission was of key importance before the scheme was established.

The GACS guarantee is subject to the payment of a fee paid by the issuer SPV which has priority over interest on the most senior class of notes. The fee is designed to be based on market prices in order to remove potential state aid issues. As explained by the Italian Ministry of Economy and Finance, “[t]he price [of the fee] shall be calculated on the basis of single name CDS related to Italian issuers with a risk level equal to that of the guaranteed securities. The price will increase in time, both to cover for the higher risk associated with longer duration of the bonds and to incorporate into the scheme a strong incentive to an early recovery of the credit. The price for the first three years is calculated as an average of the mid-price of three-year benchmark CDSs for issuers with a rating equal to that of the guaranteed tranches. In the fourth and fifth year the price will increase after the first step up (5-year CDS) and an incentivizing premium will be paid to offset the lower rate paid for the first three years. From the sixth year onwards the guarantee will be fully priced (7-year CDS). In the sixth and seventh year an additional incentivizing premium will be paid to offset the lower rate paid for the first 5 years.”⁴⁴

On this basis, the European Commission assessed that the GACS guarantees would be “remunerated at market terms according to the risk taken, i.e. in a manner acceptable for a private operator under market conditions” and that the measure is free of state aid within the meaning of Union State aid rules. The Commission viewed three elements as critical to this assessment, namely the market-based pricing of the guarantee, the fact that the risk was limited to the senior notes and the predetermined priority of payments and mezzanine risk transfer to third-party investors.⁴⁵

⁴⁴ See “Scheme introduced to facilitate the disposal of banks' bad loans GACS (Garanzia Cartolarizzazione Sofferenze – Guarantee on Securitization of bad loans) to be introduced shortly”, Ministry of Economy and Finance, [Press release N° 20](#), 27 January 2016.

⁴⁵ See European Commission [press release](#) “State aid: Commission approves impaired asset management measures for banks in Hungary and Italy”, 10 February 2016. For the sake of completeness it is worthwhile noting that EIF guarantees are not subject to state aid rules when deploying its own resources (from the EIB group) or acting under a mandate from the European Commission and managing Union funds – see Commissioner Almunia and Hoyer, Werner, “[State aid matters in relation to the activities of the EIB Group](#)”, 21 January 2014; see also Nicolaidis, P., “[State Aid and EU funding: Are they compatible?](#)”, PE 621.778 – April 2018.

6.3 GACS issuance so far

Since the establishment of the scheme, several guarantees have been issued in relation to Italian NPL securitisations by, among others, Banca Popolare di Bari S.c.p.a. and Banca Monte dei Paschi di Siena. Indeed, the measure of its success and continued relevance is probably the fact that the scheme has been extended several times since February 2016, most recently to September 2018⁴⁶. At the same time, however, the GACS guarantee is only one tool of many available to the Italian authorities and financial institutions when addressing NPLs.

7 Conclusion

As we have seen, the use of guarantees in true sale ABS structures is both context and purpose-driven. US agency MBS guarantees have been highly successful in the United States, while true sale guarantees are less common but more focused in Europe, primarily due to state aid restrictions. Taking a pragmatic but less nuanced approach, the Eurosystem monetary policy framework reflects the relative rarity of guaranteed ABS structures. Nonetheless, guarantees provided by the EIF and the Italian state under the GACS scheme show that, with a targeted approach, guarantees in true sale ABS structures can play a useful role in achieving specific policy goals, whether financing SMEs or assisting banks in offloading NPLs from their stressed balance sheets.

⁴⁶ [Italian Official Gazette](#), 21 November 2017.

Panel 7

The role of central banks as benchmark administrators



Introduction to the panel on the role of central banks as benchmark administrators

By Bram van der Eem¹

Without always being aware of their intricacies, few people these days are unfamiliar with “benchmark” or “reference” rates. They are usually referred to by their well-known acronyms such as LIBOR, EURIBOR or EONIA.² Benchmark rates have become essential for the smooth functioning and efficiency of financial markets for several reasons. First, they are used as a reference in many financial contracts such as mortgages, money market contracts, floating rate securities and derivative instruments. This reduces their complexity and permits standardisation. Second, benchmark rates are used to value balance sheet items. The value of the outstanding stock of contracts referencing benchmark rates is high. For EURIBOR alone, for instance, the European Commission has estimated that the nominal value of the contracts which use it as a reference rate is about €180 trillion.³

Benchmark rates are also important for central banks. This is because they are used for the operationalisation and monitoring of the transmission of their monetary policy. Monetary policy transmission starts with changes in money market benchmarks as a response to, notably, changes in the policy interest rates of central banks. The existence of proper benchmark rates is also considered to be of key relevance for financial stability. The absence of robust and reliable benchmarks might trigger financial market disruptions with, in turn, a possible significant adverse impact on the transmission of monetary policy decisions and the ability of central banks to contribute to the smooth conduct of policies relating to the stability of the financial system.⁴

Sadly, while the relevance of benchmark rates is widely acknowledged, as you are all aware they owe their current reputation among the general public mostly to several rigging scandals in the recent past. These cases of manipulation of benchmarks such as LIBOR and EURIBOR underlined both their importance and their vulnerabilities. Doubts about the integrity of benchmark rates can undermine market confidence, distort the real economy and cause losses to consumers and investors. Unsurprisingly, these cases led to claims, litigation and corrective action by public authorities, raising many interesting questions from a legal perspective.

¹ Head of Section, Directorate General Legal Services, European Central Bank.

² “London interbank offered rate”, “euro interbank offered rate” and “euro overnight index average” respectively.

³ See [ECB](#), Why are benchmark rates so important? September 2017.

⁴ Ibid. See also Bank for International Settlements, [Towards better reference rate practices: a central bank perspective](#), March 2013.

This is not what the current panel will cover, however. Many others have done so already.⁵

Instead, this panel will discuss the policy response to address the shortcomings of existing benchmark rates and, more precisely, the legal aspects of central bank involvement in such benchmark reform.

This introduction merely aims to provide some context in that respect. Substantial work has been done by public authorities and the private sector to address the shortcomings of existing benchmark rates. Several investigations have been conducted at both national⁶ and global level,⁷ leading to recommendations on how to address weaknesses. Work is still in progress to fully deliver on these recommendations. In Europe, one example of this follow-up is the work of the working group on euro risk-free rates. This is a private sector-led working group, with the Belgian Financial Services and Markets Authority (FSMA), the European Securities and Markets Authority (ESMA) and the European Commission acting as observers and the ECB providing the secretariat. The working group was established to identify and recommend risk-free rates that could serve as a basis for an alternative to current benchmarks used in the euro area.⁸

Another important step was the publication by the Board of the International Organization of Securities Commissions (IOSCO) of a 2013 report entitled Principles for Financial Benchmarks (IOSCO principles).⁹ The IOSCO principles are intended as a set of best practices for benchmark administrators and contributors of data for the production of benchmarks. While they are non-binding, their aim is to promote the reliability of benchmark determinations and address benchmark governance, quality and accountability mechanisms. IOSCO has recommended that administrators of benchmarks publicly disclose the extent of their compliance with the IOSCO principles. The application and implementation of the IOSCO principles should be proportional to the size and risks posed by each benchmark and/or administrator and the benchmark-setting process.¹⁰ At the same time, the IOSCO principles constitute a global standard which has been used by local legislators and regulators when adopting binding regulations for their jurisdictions.

⁵ For a recent contribution to the debate on this topic, with further references, see Lejot, P., "Misconceptions of interest benchmark misconduct", *Capital Markets Law Journal*, 2018, Vol. 13, No. 2, pp. 275-292.

⁶ See most notably in the United Kingdom: The Wheatley Review of LIBOR: [final report](#), September 2012.

⁷ In 2013 the G20 asked the Financial Stability Board (FSB) to undertake a fundamental review of major interest rate benchmarks and plans for their reform. This led to the [FSB report: Reforming Major Interest Rate Benchmarks](#), July 2014.

⁸ See [ECB](#), Working group on euro risk-free rates.

⁹ See [Principles for Financial Benchmarks](#), July 2013.

¹⁰ *Ibid.*

The EU legislator, having taken due account of the IOSCO principles, adopted the Benchmark Regulation¹¹ in 2016, thus introducing a binding regulatory framework for benchmarks applicable across the European Union. The Benchmark Regulation aims, first, to improve the governance of the benchmark process. This includes managing potential conflicts of interest at the level of the administrator and data contributors and ensuring transparency. Second, it sets rules aimed at enhancing the quality of input data and methodologies used by administrators. Third, it establishes a regime for the authorisation, registration and supervision of benchmark administrators, as well as a third-country regime. Finally, the Benchmark Regulation distinguishes different types of benchmarks in terms of their importance, with critical benchmarks being subject to the most stringent regulatory regime.¹²

Only administrators compliant with the Benchmark Regulation can be authorised and/or included in a register maintained for that purpose by ESMA. In turn, financial markets may in principle only use benchmarks provided by registered administrators. While the requirements of the Benchmark Regulation have been in force since 1 January 2018, in the case of existing benchmarks the regulation currently provides that their administrators must be authorised and/or registered by 1 January 2020 in order for the continued use of these benchmarks to be allowed going forward.

As will be further outlined in the subsequent contributions to this book, central banks — including the ECB — have contributed to most of the aforementioned initiatives. They did so in view of their specific expertise and to fulfil their respective mandates, and also as it had become clear that the private sector alone would not provide the solution for all the issues faced by existing benchmarks. In addition to contributing to these initiatives, however, central banks also developed and took over responsibility as administrators of their own benchmark rates. These rates, which are intended to complement existing benchmarks and serve as a backstop, were deemed necessary as the future of some of the current major benchmark rates became uncertain.

The viability of LIBOR as a benchmark rate, for instance, will not be guaranteed as of 1 January 2022 after the UK Financial Conduct Authority announced it would no longer require banks to submit LIBOR quotes after 2021.¹³ EONIA, in turn, may not be recognised as compliant with the requirements introduced by the Benchmark Regulation, which under the currently applicable transition rules would be needed by

¹¹ Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation IEU No 596/2014 (OJ L 171, 29.6.2016, pp. 1–65). Ten [Commission Delegated Regulations](#) setting out regulatory technical standards (RTS) under the Benchmark Regulation were published in early November 2018 and will apply from 25 January 2019. Finally, with a view to promoting convergence of supervisory practices, ESMA publishes regularly updated Q&As on the Benchmark Regulation. See [ESMA, Benchmarks](#). See also [ECB Opinion CON/2014/2](#) on the initial proposal for the Benchmark Regulation.

¹² The European Commission has so far designated three benchmark rates as critical benchmarks: EURIBOR and EONIA, both having as administrator the Brussels-based European Money Markets Institute (EMMI), and LIBOR, having as administrator the London-based ICE Benchmark Administration (IBA); see Commission Implementing Regulation (EU) 2016/1368 of 11 August 2016 establishing a list of critical benchmarks used in financial markets pursuant to Regulation (EU) 2016/1011 of the European Parliament and of the Council.

¹³ For further details see Bailey, A., [The future of LIBOR](#), 27 July 2017.

1 January 2020.¹⁴ As a result, it is possible that reference to neither of these benchmark rates will be permitted or possible in financial instruments or contracts in the future.

Therefore, in April 2016 the Bank of England became administrator of the Sterling Overnight Index Average (SONIA), a widely used interest rate benchmark and the reference rate for sterling Overnight Indexed Swaps.¹⁵ In turn, the ECB decided to develop a euro short-term rate (ESTER) based on data already available to the Eurosystem. ESTER will reflect the wholesale euro unsecured overnight borrowing costs of euro area banks and will complement existing benchmark rates produced by the private sector, serving as a backstop reference rate. The ECB has announced that it will start publishing ESTER by October 2019.¹⁶

The Federal Reserve Bank of New York, meanwhile, was ahead of these European central banks and has long experience of producing benchmark rates. Over the past few years it has gone from producing one benchmark rate to now producing five such rates on a daily basis.¹⁷

All this raises some very interesting legal questions, which will be now discussed in the following contributions by Sarah Jane Hlášková Murphy, David Geen, James Bergin and Fernando Conlledo Lantero. Sarah will reflect on the role of the Eurosystem in central bank reform in Europe and give an insight into the ESTER project. David will enlighten us on the Bank of England's experiences regarding benchmark reform and SONIA in particular. James will contribute a view from across the Atlantic, bringing the New York Fed's experience with benchmark reform into the equation. Finally, Fernando will complete the picture and provide us with the private sector perspective on the topic, as well as adding some critical and thoughtful footnotes from this angle.

¹⁴ The administrator of EONIA, EMMI, has announced that it will no longer pursue the review of EONIA it had engaged in; see EMMI, [State of play of the EONIA review](#).

¹⁵ See on this Bank of England web page, [SONIA Benchmark](#).

¹⁶ See ECB, [Euro short-term rate](#) (ESTER).

¹⁷ These rates are: Effective Federal Funds Rate (EFFR), Overnight Bank Funding Rate (OBFR), Secured Overnight Financing Rate (SOFR), Broad General Collateral Rate (BGCR), and Tri-Party General Collateral Rate (TGCR); Comp. Federal Reserve Bank of New York, [Reference Rates](#).

The ESTER project – a lawyer’s view of the role of the Eurosystem in benchmark reform

By Sarah Jane Hlásková Murphy¹

In the years following the commencement of investigations and enforcement actions regarding serious cases of benchmark manipulation, we have seen a dramatic expansion in the guidance from public authorities on benchmark-related activities, seeking to address conflicts of interest in the benchmark-setting process, as well as on issues relating to changes to and cessation of benchmarks. The Board of the International Organization of Securities Commissions (IOSCO) published its Final Report on Principles for Financial Benchmarks (IOSCO principles) in July 2013.² The Financial Stability Board (FSB) published findings on reforms to major interest rate benchmarks, supported by a report of the Market Participants Group.³ This work has been accompanied by the enactment by the European Parliament and Council of the Benchmarks Regulation,⁴ together with the preparation of a range of implementing and delegated acts⁵ based on the Benchmarks Regulation.

Against this background, central banks have stepped in to provide interest rate benchmarks. The European Central Bank (ECB) is the latest to start work on developing its own risk-free rate – provisionally named ESTER – following action taken by the Federal Reserve Bank of New York, the Bank of England and the Swiss National Bank, among others. This article explores a number of important legal issues that arise from the interaction between the action taken by the ECB to provide ESTER and the new landscape which regulates and provides guidance on benchmark-related activities. While it is clear that the Benchmarks Regulation does

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² See [Principles for Financial Benchmarks](#).

³ See [Financial Stability Board](#).

⁴ Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation IEU No 596/2014 (OJ L 171, 29.6.2016, pp. 1–65).

⁵ Commission Delegated Regulation (EU) 2018/67 of 3 October 2017 supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council with regard to the establishment of the conditions to assess the impact resulting from the cessation of or change to existing benchmarks C/2017/6537 (OJ L 12, 17.1.2018, pp. 14–15); Commission Delegated Regulation (EU) 2018/64 of 29 September 2017 supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council with regard to specifying how the criteria of Article 20(1)(c)(iii) are to be applied for assessing whether certain events would result in significant and adverse impacts on market integrity, financial stability, consumers, the real economy or the financing of households and businesses in one or more Member States, C/2017/6469 (OJ L 12, 17.1.2018, pp. 5–8); Commission Delegated Regulation (EU) 2018/65 of 29 September 2017 supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council specifying technical elements of the definitions laid down in paragraph 1 of Article 3 of the Regulation, OJ L 12, 17.1.2018, pp. 9–10; Commission Delegated Regulation (EU) 2018/66 of 29 September 2017 supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council specifying how the nominal amount of financial instruments other than derivatives, the notional amount of derivatives and the net asset value of investment funds are to be assessed, C/2017/6464 (OJ L 12, 17.1.2018, pp. 11–13).

not apply to the ECB as a central bank, the regulatory framework and related guidance pose a number of important questions concerning the manner in which a central bank should carry out its role as administrator of a benchmark. Given the unique institutional legal framework that applies to the ECB and the Eurosystem, some of the answers to these questions are also unique.

1 The development of ESTER by the ECB

Before turning to the legal analysis, it is important to take account of the key steps that have been taken by the Eurosystem to develop ESTER and to participate in the reform of benchmarks in the Union.

1.1 The rationale for the ECB's decision to develop ESTER

In September 2017, the Governing Council announced that it would develop a euro unsecured overnight interest rate based on money market statistical data already available to the Eurosystem.⁶ This action took place against the background of the ECB's long-running work in support of efforts to reform the euro overnight index average (EONIA) and the euro interbank offered rate (EURIBOR), including participation in the FSB's Official Sector Steering Group working on reforms to major interest rate benchmarks.⁷ It had become clear, however, that the European Money Markets Institute (EMMI) faced significant challenges to ensure the compliance of EONIA and EURIBOR with the requirements of the Benchmarks Regulation. There was also ongoing uncertainty over whether the contributors of input data would continue to make submissions in the future. The ECB's decision to develop ESTER was therefore expressly linked to the need to "complement existing benchmark rates produced by the private sector and serve as a backstop reference rate" in the event that those rates were found to be not compliant with the requirements of the Benchmarks Regulation.⁸ The decision clearly indicated that the rationale for the ECB's intervention was to carry out the basic task of defining and implementing the Union's monetary policy, given the pivotal role that the interest rate benchmarks for the euro play in the transmission and implementation of the ECB's monetary policy.⁹

In other policy documents, the ECB has referred to the potential repercussions that the absence of a reliable private benchmark could have for the stability of the financial system.¹⁰ This is consistent with the ECB's role to contribute to the smooth

⁶ See the [decision of 20 September 2017](#) regarding provision by the Eurosystem of a new unsecured overnight interest rate and the [press release](#) of the ECB of 21 September 2017.

⁷ See further the discussion of the role of the ECB in the topic of benchmarks in the document "[Why are benchmark rates so important](#)" of 21 September 2017.

⁸ See the press release of the ECB of 21 September 2017 at footnote 5 above.

⁹ See the press release of the ECB of 21 September 2017 at footnote 5 above, which stated that "[t]he ECB decided to take action as benchmark rates have an important anchoring role for contracts in financial markets. Monetary policy is transmitted through financial markets and benchmark rates play a pivotal role in the operationalisation and monitoring of the transmission of the ECB's monetary policy."

¹⁰ For example, see [First ECB public consultation](#) on developing a euro unsecured overnight interest rate, p. 2.

conduct of policies pursued by the competent authorities relating to the stability of the financial system.¹¹ However, it is important to note that the Governing Council's decision emphasises the ECB's monetary policy task as providing a mandate for its development of ESTER, in line with the view that financial stability plays a more limited, contributory role.¹²

1.2 Follow-up work of the ECB to develop ESTER

The ECB's decision has been followed up by a number of different work streams to support the development of ESTER. In November 2017, the ECB launched a first public consultation on developing a euro unsecured overnight interest rate,¹³ seeking feedback on the high-level features of the rate. A large majority of respondents agreed with the suggested definition and indicated that they expected the rate to be accepted as providing a meaningful reference in financial contracts.¹⁴ This was followed by a second public consultation in March 2018 which invited comments on the proposed methodology for the new rate, as well as on key operational and technical parameters.¹⁵ The respondents again broadly supported the proposed methodology and provided constructive feedback on the proposed data sufficiency policy and contingency procedure.¹⁶

Taking account of the responses received in the public consultations, the Governing Council decided in June 2018 to adopt the methodology¹⁷ for calculating ESTER and indicated that it would be published by October 2019.¹⁸ In addition, it was decided to release a "Pre-ESTER" to help market participants assess the suitability of ESTER and make arrangements to support a possible transition to the new rate. This is a "mock-up" of ESTER calculated using the same methodology. However, it is published with a time delay which allows revisions to the input data received from reporting agents to be taken into account.¹⁹ The ECB does not, however, purport to provide Pre-ESTER in a manner which accords with the recommended practices for administrators set out in the IOSCO principles. As such, the ECB has made it clear that Pre-ESTER is for information purposes only and is not intended for use as a benchmark in any market transaction.

¹¹ See also the express objective of the Bank of England to protect and enhance the stability of the financial system of the United Kingdom: Bank of England Act 1998, Article 21.

¹² [Speech by Yves Mersch](#), Member of the Executive Board of the ECB, ESCB Legal Conference, Frankfurt, 6 September 2018.

¹³ [Consultation document](#).

¹⁴ [Summary of responses](#) to the ECB's first public consultation on developing a euro unsecured overnight interest rate, February 2018.

¹⁵ [Consultation document](#).

¹⁶ [Summary of responses](#) to the ECB's second public consultation on developing a euro unsecured overnight interest rate, May 2018.

¹⁷ [ESTER methodology and policies](#).

¹⁸ ECB press release "[ECB announces methodology for calculating Euro Short-Term Rate \(ESTER\)](#)", 28 June 2018.

¹⁹ [Pre-Ester](#).

1.3 Involvement of the ECB in the working group on euro risk-free rates

Lastly, it is important to draw attention to the ECB's involvement in the working group on euro risk-free rates, which commenced its work in February 2018. This is a private sector working group whose core mandate has been to identify and adopt a recommended risk-free rate²⁰ in line with the recommendations of the FSB.²¹ The initiative to establish the working group was taken by four public sector bodies, the Belgian Financial Services and Markets Authority (FSMA), the European Securities and Markets Authority (ESMA), the European Commission and the ECB.²² However, the core purpose of the working group is to reach decisions on the mandate that are supported by the private sector, including contributors and users of interest rate benchmarks. As such, the working group is chaired by a private sector representative and made up of 21 credit institutions from the euro area as voting members, five industry associations as non-voting members (EMMI, European Fund and Asset Management Association, International Capital Market Association, International Swaps and Derivative Association and the Loan Market Association) and the European Investment Bank as an invited institution. The four public sector bodies continue to participate as observers in the working group and the ECB provides the secretariat.

The working group delivered on its core mandate on 13 September 2018, publishing its recommendation that ESTER should serve as an alternative euro risk-free rate and as a replacement for EONIA.²³ The work of the three sub-groups is ongoing.²⁴ The first sub-group focuses on term rates. Its work involves determining and recommending a term structure methodology on recommended risk-free rates as a fallback for EURIBOR-linked contracts in particular. The second sub-group focuses on contract robustness. It is involved in analysing the legal risks of implementing fallback or replacement provisions in legacy contracts and suggesting measures to mitigate these risks. It is also examining measures to enhance the legal soundness of references to newly defined risk-free rates in new contracts. The third sub-group focuses on EONIA transition and is analysing the available paths for transition from EONIA to alternative risk-free rates.²⁵ The output of the working group is clearly important and warrants attention, as it depicts the challenges brought about by changes in the regulatory landscape, not only for administrators and contributors of input data but also for the large community of users of interest rate benchmarks, which will be explored in the following sections.

²⁰ [Terms of reference for the working group on euro risk-free rates](#).

²¹ Financial Stability Board, Reforming major interest rate benchmarks, 22 July 2014, p. 59.

²² Speech by Jean-Paul Servais, chair of the Belgian Financial Services and Markets Authority on "Introducing the mandate of the working group", 26 February 2018.

²³ ECB press release, "[Private sector working group on euro risk-free rates recommends ESTER as euro risk-free rate](#)", 13 September 2018.

²⁴ See the [terms of reference](#) of the working group and sub-groups and the records of meetings.

²⁵ See [further information](#) on the activities of the working group on risk-free rates.

2 Implications of the Benchmarks Regulation for ESTER

2.1 The exclusion of central banks from the application of the Benchmarks Regulation

It is trite law that central banks are not subject to the Benchmarks Regulation.²⁶ The recitals make clear that they “already meet principles, standards and procedures which ensure that they exercise their activities with integrity and in an independent manner”. This is in line with the recognition by the legislature that the degree of risk of conflicts of interest arising, with the accompanying opportunities and incentives to manipulate benchmarks, will vary and that the approach to be adopted to address these risk factors should be tailored to the particular circumstances.²⁷ To the extent, therefore, that the ECB or Eurosystem central banks are involved in the provision of benchmarks, the Benchmarks Regulation does not apply to this activity.

However, the scope of the Benchmarks Regulation is not restricted to the provision of benchmarks but extends widely to cover other activities, namely the contribution of input data to a benchmark and the use of a benchmark within the Union. This gives rise to an important question as to whether the Benchmarks Regulation applies to financial institutions when they contribute input data for use in the determination of a benchmark provided by the ECB or a Eurosystem central bank, and when they use such benchmarks.

2.2 How are contributors of input data to a benchmark provided by a Eurosystem central bank regulated?

In the case of ESTER, the answer must be that the Benchmarks Regulation does not apply to the contribution of input data. Contribution of input data is defined in Article 3(1)(8) as “providing any input data *not readily available* to an administrator, or to another person for the purposes of passing to an administrator, that is required in connection with the determination of a benchmark, *and is provided for that purpose*” (emphasis added).

Taking the first element of the definition, it is clear that the input data required in connection with the determination of ESTER are readily available to the ECB as administrator. The input data are based exclusively on statistical information that the ECB collects from certain banks in accordance with Regulation (EU) No 1333/2014²⁸

²⁶ Benchmarks Regulation, Article 2(2)(a).

²⁷ Benchmarks Regulation, Recital 8.

²⁸ Regulation (EU) No 1333/2014 of the European Central Bank of 26 November 2014 concerning statistics on the money markets (ECB/2014/48) (OJ L 359, 16.12.2014, p. 97).

(the MMSR Regulation).²⁹ Specifically, the relevant statistical information is specified in Annex II of the MMSR Regulation which sets out the reporting scheme for money market statistics relating to unsecured transactions. In the author's view, where – as in the case of ESTER – the ECB has a statutory entitlement to collect data directly from economic agents in order to undertake its tasks, and these data are the primary or exclusive source of input data for a benchmark provided in pursuit of those tasks, such data should be viewed as readily available to the ECB.³⁰ Indeed, the MMSR data on the unsecured sector have in practice been available to the Eurosystem since 2016.³¹ This interpretation is in line with the ordinary meaning of the term “readily available”, i.e. it is available easily, without delay or difficulty.

With respect to the second element of the definition, it is also clear that the MMSR data are not provided for the purpose of determining ESTER. Credit institutions report money market statistics to the ECB because they have a legal obligation to do so under the MMSR Regulation. This obligation applies regardless of whether the ECB will use the data for the determination of ESTER or in order to carry out other tasks. They are not voluntary contributors to ESTER and have no right to cease contributing input data to the ECB.

For these reasons, it is clear that credit institutions which report MMSR data to the ECB are not contributors of input data required in connection with the determination of ESTER. It is submitted that this is also consistent with a teleological interpretation of the Benchmarks Regulation. As noted above, the Union legislators clearly intended that the approach to regulating the provision of benchmarks should be tailored to the degree of risk of conflicts of interest arising; where the input data are based on a scheme for the compulsory reporting of observable transactions, it is recognised that the opportunities and incentives for manipulation of such data are correspondingly low.

The issue of whether contributors of input data to a central bank administered benchmark are regulated by the Benchmarks Regulation has also drawn the attention of ESMA. In its “Questions and Answers On the Benchmarks Regulation (BMR)”,³² it has elaborated on the question of “Does the BMR apply to EU and third country central banks and the benchmarks they provide?” In response, ESMA states that it “considers that Article 16 of the BMR is to be applied to EU supervised

²⁹ Even to the extent that the input data may be enriched by data from other sources (e.g. reference data stored in a different database and collected on a different legal basis), this does not undermine the argument that MMSR data would be the primary or exclusive source of the data, as they are the only source of information on transactions used to reflect the core underlying interest represented by ESTER, namely the wholesale euro unsecured overnight borrowing costs of banks in the euro area.

³⁰ The statutory entitlement to collect statistical data derives from Article 5 of Protocol (No 4) on the Statute of the European System of Central Banks and of the European Central Bank and the provisions of the TFEU specifying the tasks of the ESCB. Articles 5(1) and 6(4) of Council Regulation (EC) No 2533/98 of 23 November 1998 concerning the collection of statistical information by the European Central Bank (OJ L 318, 27.11.1998, p. 8) provide that the ECB may adopt regulations for the definition and imposition of its statistical reporting requirements on the actual reporting population of participating Member States and to specify the conditions under which the right to verify or to carry out the compulsory collection of statistical information may be exercised.

³¹ Article 10, MMSR Regulation.

³² ESMA, [Questions and Answers on the Benchmarks Regulation \(BMR\)](#), Version 8, last updated on 17 July 2018.

contributors contributing input data (according to Article 3(1)(8)) to a central bank". It follows that Article 16 does not apply to EU supervised contributors if they are not contributing input data according to Article 3(1)(8), because the data are readily available to the central bank and are not provided for the purpose of determining a benchmark.

It is important to note, however, that a different set of circumstances could apply. For example, if a contributor provided input data or submissions to a central bank on the basis of a voluntary agreement for the purpose of determining a benchmark, ESMA's interpretation would suggest that Article 16 would apply to a central bank administered benchmark based on the voluntary submission of input data.³³

2.3 How is use of a benchmark provided by a Eurosystem central bank regulated?

ESMA's guidance also addresses the scope of application of the Benchmarks Regulation to the use of benchmarks provided by central banks. In this respect, questions have arisen regarding the meaning of Article 29 of the Benchmarks Regulation, which provides that a supervised entity may use a benchmark if either the benchmark or its administrator is included in ESMA's public register. However, as central banks are not required to apply for authorisation or registration, they will not be listed in the register, hence a literal reading of Article 29 would suggest that the benchmarks they provide are not permitted for use. ESMA has adopted a practical approach to the interpretation of this Article and considers that supervised entities are nevertheless allowed to use such benchmarks. It has also made it clear that supervised entities should produce and maintain robust written plans setting out the actions that they would take in the event that a benchmark materially changes or ceases to be provided, in accordance with Article 28(2) of the Benchmarks Regulation. This requirement applies regardless of whether or not the benchmark used is administered by a central bank.

2.4 Conclusions on the scope of application of the Benchmarks Regulation to benchmarks provided by a Eurosystem central bank

To draw some conclusions, it is clear that in the case of ESTER, MMSR reporting agents are not regulated as supervised contributors of input data. This means they are not required, for example, to comply with a code of conduct or other governance and control requirements set out in the Benchmarks Regulation. Instead, they are subject to and required to comply with the statistical reporting obligations that apply to their contribution of input data. These requirements can be enforced in

³³ This does give rise to some interpretative difficulties, however, as Article 16 requires supervised contributors to implement certain governance and control requirements that are in accordance with the code of conduct referred to in Article 15. Article 15, however, imposes an obligation on the administrator to develop a code of conduct specifying contributors' responsibilities and be satisfied that contributors adhere to it. As the Benchmarks Regulation does not apply to a central bank as an administrator, however, there is no legally binding obligation to develop the said code of conduct.

accordance with the legal framework that governs non-compliance with statistical reporting obligations.³⁴ Indeed, heavy reliance will need to be placed on the efficacy of this framework to ensure a high standard of compliance with the minimum standards for reporting, in particular, to support the quality of ESTER and the sufficiency of the input data to accurately and reliably represent the interest it measures.

3 Compliance by ESTER with best practice under international standards

3.1 The aim of ensuring compliance with best practice

Although the Union legislators have recognised that it is not necessary for central banks to be subject to the Benchmarks Regulation, they have nevertheless made it clear that “[w]hen central banks provide benchmarks, especially where those benchmarks are intended for transaction purposes, it is their responsibility to set appropriate internal procedures in order to ensure the accuracy, integrity, reliability and independence of those benchmarks, in particular with respect to transparency in governance and computation methodology”.³⁵

The ECB has indicated that, like other central banks, it takes this responsibility very seriously, confirming that it aims to ensure that the design and implementation of ESTER is consistent with the international best practice recommended in the IOSCO Principles for Financial Benchmarks.³⁶ It follows that the core legal act that the ECB is expected to implement – the Guideline on ESTER – will provide a high-level roadmap setting out how the ECB and euro area national central banks (euro area NCBs) will ensure compliance with the IOSCO principles, insofar as they are relevant to the provision of ESTER by the ECB. This will stand alongside other legal acts – for example ECB Guideline ECB/2015/11³⁷ – as well as policy or operational documents that demonstrate compliance with the principles. It can be expected that

³⁴ This means the Eurosystem’s general statistical collection and non-compliance framework comprising Council Regulation (EC) No 2533/98 of 23 November 1998 concerning the collection of statistical information by the European Central Bank (OJ L 318, 27.11.1998, p. 8), Council Regulation (EC) No 2532/98 of 23 November 1998 concerning the powers of the European Central Bank to impose sanctions (OJ L 318, 27.11.1998, p. 4), Regulation (EC) No 2157/1999 of the European Central Bank of 23 September 1999 on the powers of the European Central Bank to impose sanctions (ECB/1999/4) (OJ L 264, 12.10.1999, p. 21) and Decision ECB/2010/10 of the European Central Bank of 19 August 2010 on non-compliance with statistical reporting requirements (OJ L 226, 28.8.2010, p. 48).

³⁵ Recital 14, Benchmarks Regulation.

³⁶ See ESTER methodology and policies.

³⁷ Guideline (EU) 2015/855 of the ECB of 12 March 2015 laying down the principles of a Eurosystem Ethics Framework and repealing Guideline ECB/2002/6 on minimum standards for the ECB and national central banks when conducting monetary policy operations, foreign exchange operations with the ECB’s foreign reserves and managing the ECB’s foreign reserve assets (ECB/2015/11) (OJ L 135, 2.6.2015, p. 23).

the ECB will prepare and publish an assessment of its compliance with the IOSCO principles after ESTER has been published.³⁸

3.2 Issues arising from the institutional legal framework of the ESCB

While exercising the legislative power of the ECB is one of the ways in which ESTER's compliance with the IOSCO principles can be implemented, there are certain features of the institutional legal framework of the European System of Central Banks (ESCB) which raise interesting issues from a legal perspective.

To take one example, when establishing appropriate governance arrangements the IOSCO principles recommend that the administrator should retain primary responsibility for all aspects of the benchmark determination process. In the case of ESTER, the methodology clearly specifies that the ECB is the administrator of ESTER and has overall responsibility for providing the rate. It adopts the same definition of the term "administrator" that is used in the IOSCO principles, namely an organisation or legal person that controls the creation and operation of the benchmark administration process.³⁹

However, there are certain stages or processes involved in the provision of ESTER which, out of necessity, require the participation of euro area NCBs. For example, the statistical information that is used as input data is collected in accordance with Article 5 of the Statute of the ESCB and of the ECB. Article 5.1 empowers the ECB, assisted by the national central banks (NCBs), to collect the necessary statistical information in order to undertake the tasks of the ESCB. Article 5.2 provides that NCBs shall carry out, to the extent possible, the tasks described in Article 5.1. The MMSR Regulation, in line with the provisions of the Statute, requires reporting agents to report to the NCB of the Member State where they are resident⁴⁰ and for NCBs to transmit the information to the ECB. It may also be implied that NCBs are responsible for verifying and correcting the reported information and preparing it for transmission, as these are necessary for the collection of statistical data. Although there is an option for an NCB to decide that reporting agents resident in its Member State shall report directly to the ECB, Article 3.3 of the MMSR Regulation confirms that this can only be implemented by decision of the NCB.

In summary, although the methodology envisages that the ECB will have overall responsibility for providing the rate, the stage or process involving collection of the data, and certain ancillary aspects of collection such as verifying and correcting data, is the responsibility of euro area NCBs with reporting agents in their Member States, unless they decide that reporting agents shall report directly to the ECB. The collection processes are also underpinned by IT infrastructure that is established and

³⁸ [Statements of compliance](#) with the IOSCO principles have been published by the Bank of England concerning SONIA and the Federal Reserve of New York concerning its [benchmarks](#).

³⁹ The administrator is further defined as having responsibility for all stages of the benchmark administration process, including: (a) the calculation of the benchmark; (b) determining and applying the benchmark methodology; and (c) disseminating the benchmark: IOSCO principles, p. 35.

⁴⁰ MMSR Regulation, Article 3(1).

operated by NCBs. These arrangements are unique to the ESCB and clearly distinguish the role of the ECB as administrator from the role played by other central banks such as the Bank of England or the Federal Reserve Bank of New York. They point to the importance of ensuring that the tasks and responsibilities of the ECB and euro area NCBs which participate in the collection of input data – or possibly in other stages or processes involved in the provision of ESTER – are clearly defined in the legal framework that is being developed, including not only the Guideline but also any contractual arrangements that govern their involvement.

4 Addressing market expectations regarding transition

4.1 The difficulties arising from changes to or cessation of existing benchmarks

The last issue which this article addresses concerns some of the legal challenges which arise by reason of changes to or cessation of existing benchmarks, namely EONIA and EURIBOR.

The current state of play is that EMMI, the administrator of EONIA, considers that “should market conditions and dynamics remain unchanged, EONIA’s compliance with the EU BMR by January 2020 cannot be warranted, as long as its definition and calculation methodology remain in its current format”.⁴¹ In this context, it has decided that it is no longer appropriate to pursue a thorough review of EONIA with the objective of ensuring compliance. EONIA may therefore be used until 31 December 2019, but after 1 January 2020 it may not be used in new financial instruments or contracts and may only be used in existing instruments or contracts where permitted by the FSMA in accordance with the conditions currently set out in the Benchmarks Regulation.⁴²

EMMI is in the process of reforming the EURIBOR benchmark, however. Having concluded that it would not be feasible under current market conditions to develop a transaction-based methodology, it is focusing on developing a hybrid methodology.⁴³ It has published a first consultation paper on this and a summary of the responses, and has undertaken in-depth testing of the proposed methodology.⁴⁴ A second consultation on the parameters was launched in October 2018.⁴⁵ This process is ongoing, however, and it is not yet clear if and by when EMMI would be able to

⁴¹ State of Play of the [EONIA Review](#).

⁴² Benchmarks Regulation, Article 51(4). Use of a benchmark shall be permitted by the competent authority of the Member State where the index provider is located, where an existing benchmark does not meet the requirements of the Benchmarks Regulation, but ceasing or changing that benchmark to fulfil the requirements of the Regulation would result in a force majeure event, frustrate or otherwise breach the terms of any financial contract or financial instrument or the rules of any investment fund which references that benchmark.

⁴³ EMMI, EURIBOR [pre-live verification program](#) outcome, 4 May 2017.

⁴⁴ See EMMI, “[Feedback of consultation on hybrid methodology for EURIBOR](#)”.

⁴⁵ See EMMI, “[Second public consultation on hybrid methodology for EURIBOR](#)”.

secure authorisation in order to ensure the compliance of EURIBOR with the requirements of the Benchmarks Regulation.

The difficulties posed by these changes are clearly of high importance to the proper functioning of financial markets. This is indicated by the mapping exercise in which the ECB sought to gauge the maximum amounts of outstanding financial instruments linked to reference EONIA and EURIBOR reference rates. Preliminary results indicated that there are €2.9 trillion of EONIA-linked and €3.4 trillion of EURIBOR-linked financial transactions which will remain outstanding on 1 January 2020.⁴⁶ Finding solutions to the legal challenges that arise from changes to or cessation of existing benchmarks is of corresponding importance, but as explained in the following sections, the direction in which the pendulum will swing when it comes to private sector or public sector action to address these challenges remains unclear.

4.2 Competition law issues

The primary action that the ECB has taken to date to address issues concerning the transition to new interest rate benchmarks is, as outlined in Section 1.3 above, the establishment of the working group on risk-free rates.

The establishment of the group itself has given rise to legal issues, in particular concerning the competition law implications of establishing a forum in which undertakings that are actual or potential competitors (or non-competitors engaged in the same product markets but in different geographic markets) could be viewed as engaging in a form of horizontal cooperation. As the title of the working group clearly indicates, its mandate relates to pricing, as risk-free rates are indices by reference to which the amount payable under or the value of a financial instrument or contract is determined. Exchanging information on undertakings' individualised intentions concerning future conduct regarding prices is viewed as particularly likely to lead to a collusive outcome.⁴⁷ Although public authorities have been actively involved in the establishment of the working group and continue to participate as observers, this does not affect the position that the undertakings involved in the working group are subject to competition law and any anticompetitive conduct would not be permissible.

Consistent with the view that the working group is industry-led, the terms of reference afford voting and decision-making powers to member firms and confirm that it is their responsibility to ensure they understand their responsibilities under all applicable competition laws, including EU competition law. For this reason, the working group member firms have commissioned and published competition law compliance guidelines to ensure they are aware of the constraints that competition

⁴⁶ Presentation on "[Update on quantitative mapping exercise](#)" at the working group on euro risk-free rates of 20 April 2018. See also Presentation of 17 May 2018 for [further detail on the derivatives and debt securities markets](#).

⁴⁷ Communication from the Commission, Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements (2011/C11/01) (OJ C 11, 14.1.2011, p. 1. para 73).

law may impose and are aware of certain safeguards, particularly where they may be exposed to sensitive non-public information in the course of their work. The guidelines also confirm – in line with the terms of reference of the working group – that the purpose of the work conducted is to make recommendations, which will not commit individual firms or public authorities to specific actions. This points to the importance of ensuring that the output of the working group is not to establish an arrangement by which the members would mutually accept a limitation of their freedom of action. Instead, their recommendations should be consistent with the stance that they continue to independently determine their future conduct in the market.

4.3 Transition: a private law or public law solution?

The ongoing task of the working group concerns the need to ensure new financial instruments or contracts are robust and resilient to the cessation or change of benchmarks they reference, as well as to develop transition plans for legacy contracts which reference existing benchmarks.

This need is very pressing, as the Benchmarks Regulation already requires supervised entities to produce and maintain robust written plans setting out the actions they would take in the event that a benchmark they use materially changes or ceases to be provided and to reflect them in contractual arrangements with clients. This obligation, set out in Article 28(2), already applied as of 1 January 2018. ESMA has made it clear that such plans should be reflected in contracts entered into after 1 January 2018, and that amendments should be made to legacy contracts entered into prior to 1 January 2018 where practicable and on a best-effort basis.⁴⁸

The difficulty, however, is that the lead time for implementing such plans is very short, given that the ECB has indicated that ESTER will be delivered by October 2019 and it is not yet clear if a reformed EURIBOR will be compliant with the requirements of the Benchmarks Regulation by the end of 2019.

This gives rise to an important question, namely whether there is a case for amending the transitional arrangements in the Benchmarks Regulation to provide a better opportunity for market players to develop and implement plans relating to critical benchmarks.

A number of options would be possible in theory. First, the period during which an index provider may apply for authorisation or registration beyond 1 January 2020 could be extended.⁴⁹ This would be accompanied by an amendment permitting such benchmarks to be used for this extended period.⁵⁰ This could be expected to allow EMMI greater leeway to secure authorisation and ensure a reformed EURIBOR is compliant with the requirements of the Benchmarks Regulation. It may also allow a

⁴⁸ See A8.1 of ESMA, Question and Answers On the Benchmarks Regulation (BMR), Version 9, Last updated on 27 September 2018.

⁴⁹ Amendment of Article 51(1) of the Benchmarks Regulation.

⁵⁰ Amendment of Article 51(3) of the Benchmarks Regulation.

longer period in which EONIA and ESTER could coexist. This would in turn provide a longer opportunity for market participants to develop and implement plans for changes to or cessation of critical benchmarks in new and legacy financial instruments and contracts. It would need to be determined whether such changes would be general in application, affecting benchmarks other than those which have been recognised as critical, or whether their application would be confined to critical benchmarks.

A second option would be to extend the period of time during which a competent authority could compel the administrator of a critical benchmark to continue publishing a benchmark (currently limited to a maximum of 24 months in total).⁵¹ This would be accompanied by an extension of the period during which the competent authority could require mandatory contribution of input data.⁵² However, this solution would only address the risk of an administrator ceasing to provide a critical benchmark or supervised entities ceasing to contribute input data. It does not address the risk that a critical benchmark would not be compliant with the requirements of the Benchmark Regulation, and it is difficult to envisage that a competent authority would compel the ongoing provision of a benchmark if the administrator has not applied for authorisation or it is not yet clear if authorisation will be granted.

Ultimately, however, it is not yet sufficiently clear if amendments to the Benchmarks Regulation to extend the application of transitional provisions would be implemented in law in the course of 2019.

Similar questions also arise as to whether a wider legislative initiative – for example to redenominate benchmarks in private contracts – would be required.

My own assessment is that there would be many hurdles to overcome to implement a legislative initiative of this kind. It would clearly require a sound legal basis to justify the interference in contractual rights and obligations, a field which is anchored in national competence. It would raise fundamental questions as to why the extensive efforts involved in developing the Benchmarks Regulation have not been sufficient to address and remedy the risks to the proper functioning of financial markets that existing benchmarks have caused. It would also require Union legislators to depart from the approaches taken in other jurisdictions, such as the United Kingdom and the United States, which have fallen in line with the FSB's recommendation that authorities should encourage industry and work with administrators to support reform initiatives in the private sector.⁵³ It would be necessary to present a clear and persuasive case that additional legislative intervention relating to interest rate benchmarks is required to support the proper functioning of the Internal Market and to ensure a high level of consumer and investor protection.

To draw a very short conclusion to this article, if we look towards the horizon of the new regulatory landscape, it is not yet possible to discern a clear path ahead.

⁵¹ Amendment of Article 21(3) of the Benchmarks Regulation.

⁵² Amendment of Article 23(6) and 23(10) of the Benchmarks Regulation.

⁵³ Financial Stability Board, Reforming major interest rate benchmarks, 22 July 2014, p. 59.

Role of the central bank in relation to benchmarks: the experience of the Bank of England in benchmark reform

By David Geen¹

1 Background

High profile incidents of benchmark manipulation and false reporting have caused concern over continued use of Inter-bank Offered Rates (IBORs) in derivatives and other financial contracts. At the same time, a structural decline in unsecured interbank money markets following the financial crisis means that there are insufficient transactions underlying those benchmarks, undermining confidence in their robustness and sustainability.

Regulators have responded to these concerns both domestically and at a global level. In the UK, for example, the [Wheatley Review](#)² in 2012 led to major changes in London Interbank Offered Rate (LIBOR)'s governance and methodology.

The Financial Stability Board (FSB) and the International Organisation of Securities Commissions (IOSCO) have led international initiatives. In February 2013 the G20 asked the FSB to undertake a "fundamental review of major interest rate benchmarks". In response, the FSB, supported by the Official Sector Steering Group (OSSG) of regulators and central banks, and drawing on reviews of benchmark administrators by IOSCO and the work of a Market Participants Group, published a report in July 2014 on "[Reforming Major Interest Rate Benchmarks](#)".³ Its focus was on IBORS: LIBOR, the Euro Interbank Offered Rate (EURIBOR) and the Tokyo Interbank Offer Rate (TIBOR).

The FSB report endorsed IOSCO's [Principles for Financial Benchmarks](#)⁴ (the IOSCO Principles, discussed further below) and the "multi-rate" approach. As regards the latter, the Report encouraged the private sector to identify additional benchmark rates and proposed that robust risk free reference rates should be developed in order to serve as alternatives to the most widely used IBORs.

¹ Deputy General Counsel – Central Banking, Bank of England. This paper represents the personal views of the author and not necessarily those of the Bank of England.

² See the [Wheatley Review of LIBOR: final report](#), September 2012.

³ See the [Financial Stability Board, Reforming Major Interest Rate Benchmarks](#), July 2014.

⁴ See the [Board of the International Organisation of Securities Commissions, Principles for Financial Benchmarks, Final Report](#), July 2013.

The European Union legislator published the Benchmark Regulation⁵ (BMR). The BMR, which entered into force on 30 June 2016, introduces a common framework for benchmark regulation across the Union. It aims to ensure that benchmarks are robust and reliable, and to minimise conflicts of interest in benchmark-setting processes⁶.

The overall goal of benchmark reform efforts, being led by the authorities, is broadly to remove dependence on IBORs. To this end, these efforts are focused on promoting risk free rates (RFRs) as an alternative and ensuring a smooth transition to them in derivatives, bond, loan and other relevant markets. This translates, broadly, into ensuring that new contracts reference RFRs not IBORs and that legacy contracts are converted to RFRs. At the same time, it is important to ensure that existing contracts contain robust fallbacks that will operate if LIBOR ceases to be available before transition is complete.

In the United Kingdom (UK), the Financial Conduct Authority (FCA) is the benchmark regulator. It is responsible for market conduct and market functioning. The FCA has been designated as the National Competent Authority (i.e. the national regulator) for benchmarks in the UK. Crucially, the FCA has stated publicly that it will not compel or persuade banks to submit data to LIBOR after 2021⁷.

2 Role of the Bank of England

The Bank of England (the Bank)'s role in relation to benchmark transition reflects its financial stability remit. The Bank's mission is to promote the good of the people of the UK by maintaining monetary and financial stability.

The Bank has been concerned with the risks that reliance on LIBOR raises to financial stability. The Bank's Financial Policy Committee (FPC) identified the risks in March 2017. The FPC judged at that time that reliance of financial markets on term LIBOR benchmarks created a risk to financial stability⁸.

The concern has continued: in the June 2018 Financial Stability Report⁹ the FPC said: "Continued reliance of financial markets on LIBOR poses a risk to financial stability that can be reduced only through a transition to alternative rates." The FPC note that the medium-term risks can be reduced only through a substantial and lasting transition away from reliance on LIBOR, and that ongoing work to develop and implement more robust fallback clauses in existing contracts will be critical in mitigating these risks.

⁵ [Regulation \(EU\) 2016/1011](#) of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 (Text with EEA relevance).

⁶ See the [FCA's summary](#).

⁷ [The future of LIBOR](#), speech by FCA Chief Executive, Andrew Bailey on 27 July 2017.

⁸ [Record of the Financial Policy Committee Meeting, 27 March 2017](#), at paragraph 55.

⁹ See the [Financial Stability Report](#), Issue No. 43, June 2018, page 52.

The Bank has been active in seeking to drive this transition. Transition requires market participants to agree on which alternative rate they will use. That in turn requires the availability of credible alternative rates.

3 A credible alternative rate: SONIA

In April 2016 the Bank took over as administrator of the Sterling Overnight Index Average (SONIA) benchmark from the Wholesale Market Brokers Association (WMBA). SONIA is a Sterling Risk Free Rate.

At that time the Bank sub-contracted the calculation and publication of the rate to WMBA. In April 2018 the Bank assumed the full end-to-end production process, including calculation and publication of the rate. Crucially, the Bank enhanced SONIA's governance and robustness. In particular, inputs to SONIA were broadened to include overnight unsecured transactions negotiated bilaterally as well as those arranged through brokers. This boosted the volume of transactions captured by a factor of three to £ 50 billion per day. These data are collected using the Bank's information gathering power under the Bank's monetary policy powers, specifically Section 17(1) of the Bank of England Act 1998. (This is relevant for the impact of the BMR, discussed later.)

The SONIA rate for a given London business day is now published at 9am on the following London business day to allow time to process the larger volume of transactions it will capture. Previously it was 6pm on the same day.

In relation to governance, the Bank's SONIA Oversight Committee reviews and provides challenge on all aspects of the benchmark determination process and provides scrutiny of the administration of SONIA. The Bank's administration of SONIA and the Oversight Committee's oversight of it are supported by the SONIA Stakeholder Advisory Group.

These changes were made following public consultations, to ensure market acceptability of the rate, in July 2015, October 2016, and February 2017.

As part of the changes to SONIA, the Bank considered the best way to define the rate. The definition that the Bank arrived at has two elements¹⁰:

First, a "statement of underlying interest". This describes what SONIA is intended to measure. It is intended to be enduring. This states: "SONIA is a measure of the rate at which interest is paid on sterling short-term wholesale funds in circumstances where credit, liquidity and other risks are minimal."

The second element of the definition is a "statement of methodology". This will be periodically reviewed and can (subject to governance and consultation) evolve to ensure that it continues adequately to measure the underlying interest.

¹⁰ See [SONIA: key features and policies](#).

The Bank considered it to be important that SONIA was compliant – to the extent appropriate – with the IOSCO Principles. These principles relate to benchmark governance, benchmark quality, calculation methodology quality, and accountability mechanisms. As a national central bank, the Bank is not subject to these principles. Nevertheless, the Bank's intent is to be consistent with international best practice for benchmark administration, as encapsulated by the IOSCO Principles. The Bank therefore committed to producing an assessment of its compliance with IOSCO's Principles. The Bank's assessment is that it is compliant with the IOSCO Principles that are applicable to the Bank as SONIA's administrator. It has published a [Compliance Statement](#), which includes independent assurance statement from Ernst & Young¹¹.

4 The market's choice of alternative rate

As noted above, the other necessary element for transition is for the market to select a credible alternative rate. SONIA was such a rate, but it was not the only one. It was for the market to select the one it wanted to use. Therefore, in March 2015, the Bank established the [Sterling Risk-Free Rate Working Group \(RFR Working Group\)](#), which was tasked with recommending a risk-free rate. This group was market led, encouraged and facilitated by the Bank. It consisted of experts from major swap dealers. The International Swaps and Derivatives Association (ISDA), the Bank and the FCA were non-voting members). Similar processes were established at around the same time in the United States (US), Japan and Switzerland.

After discussion of a range of alternatives, and consultation with market participants, in April 2017 the RFR Working Group recommended SONIA as their preferred risk-free rate for Sterling. As mentioned, SONIA is an unsecured overnight rate. Other possibilities were secured rates based on repo rates (the US Alternative Reference Rates Committee has chosen a repo rate).

In 2018, reflecting the needs of the next stage of the process, the RFR Working Group was broadened out. Its membership has been expanded to include investment managers, non-financial corporates and other sterling issuers, infrastructure firms and trade associations, alongside the existing banks and dealers. A number of sub-groups have been constituted to address specific issues/areas of the market, including a loans sub-group and a bonds sub-group.

The RFR Working Group is making a valuable contribution to supporting a broad-based transition from sterling LIBOR to SONIA. Among other things, in July 2018 it launched a [consultation on term SONIA reference rates](#) and in September 2018 it published a note of [considerations around credit spread adjustment options in ISDA's consultation on fallback rates](#).

¹¹ See [SONIA: Statement of compliance with the IOSCO principles for financial benchmarks](#).

The New York Fed's experience with reference rates: a legal perspective

By James P. Bergin, Raymond Check and Justine Hansen¹

A central bank can be a surprisingly interesting place to work. While the core missions of a central bank do not change very often, the nature of the work needed to attain those missions does indeed change. This can lead to interesting challenges for central bankers and the lawyers that advise them.

In this short paper, we describe a few of the challenges that we at the Federal Reserve Bank of New York (New York Fed) Legal Department confronted in the wake of the New York Fed's recently expanded role in producing reference rates for financial contracts, in the hope that other central banks' legal departments can learn from them.

Over the past several years, the New York Fed has gone from producing one benchmark rate to now producing five on a daily basis. What's more, we now produce all of those rates in alignment with the Principles for Financial Market Benchmarks published by the International Organization of Securities Commissions (IOSCO)², and with the specific intention that market participants use them in their financial contracts. This has led us lawyers to grapple with a number of issues, and to work closely together with our operations specialists and fellow control functions to ensure that we produce those rates in a safe and sound manner.

1 The Problem and the Policy Response

The difficulties of the London Interbank Offered Rate (LIBOR) are, at this point, relatively well-known. As former New York Fed president Bill Dudley described: "At its core, the problem we face today is that the financial system has built a tremendously large edifice on a structurally impaired foundation."³ It is estimated that US dollar LIBOR serves as the basis for nearly US dollar 200 trillion of financial contracts, including loans, interest rate swaps, and mortgage-backed securities.⁴ And yet, this foundation has flaws. LIBOR is based on estimates and subjective submissions, and, coupled with its significant influence on market pricing, has been prone to attempted manipulation that led to the enforcement activity of the last decade.

¹ James P. Bergin, Deputy General Counsel and Senior Vice President, with assistance from Raymond Check, Senior Counsel and Vice President, and Justine Hansen, Counsel, Federal Reserve Bank of New York.

² See [Principles for Financial Benchmarks](#).

³ Dudley, William C., "[The Transition to a Robust Reference Rate Regime](#)," Bank of England's Markets Forum, London, England (24 May 2018).

⁴ See The Alternative Reference Rates Committee's [Second Report](#), at 2 (March, 2018).



Moreover, while new regulation and conduct monitoring have bolstered the integrity of the submission process, another problem remains: the statistical rigor of LIBOR has diminished with the corresponding decline in unsecured bank borrowing. As a result, there is an unhealthy disparity between the massive volumes of contracts based on LIBOR, relative to the increasingly thin volume of transactions underlying this benchmark.⁵ Policymakers decided this risk needed addressing. In the words of the Chairman of the Board of Governors of the Federal Reserve System (Board) Jerome Powell: "If the publication of LIBOR were to become untenable because the number of transactions that underlie it decline further, then untangling the outstanding LIBOR contracts would entail a legal mess that could endanger our financial stability."⁶

Policymakers have pursued a range of initiatives to tackle this issue. IOSCO, in July 2013, published principles for the design, management, and oversight of benchmarks. Subsequently, the Financial Stability Board (FSB), at the behest of the G20, and building on IOSCO's work, undertook a broad review of existing interest rate benchmarks and spearheaded plans to develop alternatives. An important outcome of the FSB's work was to create a pathway for a multiple-rate approach.

These international efforts, in turn, led the Board and the New York Fed to jointly convene the Alternative Reference Rates Committee (ARRC) in 2014. The ARRC is comprised of a group of private-market participants in cooperation with the Bureau of Consumer Financial Protection, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, the Office of Financial Research, the Office of the Comptroller of the Currency, the Commodity Futures Trading Commission, the Securities and Exchange Commission and the U.S. Treasury Department. The ARRC's priorities are to identify alternative US dollar reference rates, consider best practices for robust contract design (to mitigate against cessation of a benchmark), and develop adoption plans. The ARRC is promoting a timely and orderly transition from US dollar LIBOR, an objective which has some urgency given the United Kingdom Financial Conduct Authority's (UK FCA) warning that panel banks will no longer be compelled to submit to LIBOR after 2021.⁷

1.1 The New York Fed Expands and Enhances its Reference Rate Production Practices

The New York Fed stepped into this breach by starting to produce reference rates that might be suitable for use as alternatives to LIBOR in financial contracts. Reference rate production is not an entirely novel business for the institution. The New York Fed has calculated and published the daily effective federal funds rate (the rate at which institutions with New York Fed accounts make unsecured loans to each

⁵ Powell, Jerome H., "Introductory Remarks," Roundtable of the Alternative Reference Rates Committee, Federal Reserve Bank of New York, New York, New York (2 November 2017).

⁶ Powell, Jerome H., "Reforming U.S. Dollar LIBOR: The Path Forward," Money Marketeters of New York University, New York, New York (4 September 2014).

⁷ Bailey, Andrew, "The Future of LIBOR," Bloomberg, London, England (27 July 2017).

other) since at least the 1950s as part of its monetary policy mission. That said, while we were aware that the federal funds rate was referred to in financial contracts, it is a different thing to produce rates with the expectation that they will be used in this way, and in volumes large enough to have systemic significance.⁸

The New York Fed now regularly publishes five reference rates: the Effective Federal Funds Rate (EFFR), the Overnight Bank Funding Rate (OBFR), the Secured Overnight Financing Rate (SOFR), the Broad General Collateral Rate (BGCR), and the Tri-Party General Collateral Rate (TGCR). EFFR is an enhanced version of the effective federal funds rate that we have published for over 60 years and has undergone significant changes to make it more robust in light of the recommendations in the FSB benchmarks report. OBFR builds on EFFR by supplementing it with certain overnight Eurodollar transaction data.

SOFR, BGCR, and TGCR are three rates designed to describe activity in the Treasury financing market. Of these three, SOFR is designed to describe the general costs of financing Treasury securities overnight. And, importantly, SOFR is the rate that the ARRC has recommended as its preferred alternative to US dollar LIBOR: in part because SOFR is fully based on observable transactions, anchored in a robust and reliable underlying repo market, closely reflects overnight risk free rates, and is adaptable to future repo market evolution.

2 New challenges for the institution and its lawyers

Producing benchmark rates raises new challenges for the institution and its lawyers. As an institution, we needed to take a look at our rate production processes and controls in light of the new standards for benchmarks. And as lawyers for the institution, there were many considerations needed as part of that analysis – both in legal terms, and perhaps more significantly, in those reputational terms that sometimes fall within the province of the central bank lawyer.

Below, I describe briefly two parts of that analysis: How we came into conformance with IOSCO standards, and what that means. And how we developed our terms of use, and what users of our rates should know as a result.

2.1 IOSCO compliance

As an institution, the New York Fed feels it important to hold ourselves to the highest standards. We want the public to have confidence in the rates that we publish, and we want to support the market's move to the highest standards.

As a result we have affirmed publicly that the rates we produce will be IOSCO compliant.⁹ This required the institutionalization of a thorough internal process to

⁸ Logan, Lorie K., "The Role of the New York Fed as Administrator and Producer of Reference Rates," Federal Reserve Bank of New York, New York, New York (9 January, 2018).

⁹ See [Statement of Compliance with the IOSCO Principles for Financial Benchmarks](#) (28 June 2018).

ensure compliance – involving new staff on the business side and the involvement of internal controls and audit. Lawyers have been partners, advisors and stewards in this process – working closely with our colleagues to make sure that what we say about what we are and will do is accurate, and that we are capable of carrying through with those things in practice.

Together, we settled on a form of affirmation that is something more than just a simple assertion. Our affirmation describes each of the recommendations in the IOSCO report and then applies it to our particular situation as a producer and administrator.

Excerpt 1

<p>5. Internal Oversight</p>	<p>Administrators should establish an oversight function to review and provide challenge on all aspects of the Benchmark determination process. This should include consideration of the features and intended, expected or known usage of the Benchmark and the materiality of existing or potential conflicts of interest identified.</p> <p>The oversight function should be carried out either by a separate committee, or other appropriate governance arrangements. The oversight function and its composition should be appropriate to provide effective scrutiny of the Administrator. Such oversight function could consider groups of Benchmarks by type or asset class, provided that it otherwise complies with this Principle.</p>	<p>Compliant</p>	<p>Consistent with Principle 4-9, the benchmarks are based entirely on observable transactions, as opposed to submissions or calculations.</p> <p>An Oversight Committee reviews and provides challenge on the Benchmark production process. Internal policies are in place defining the responsibilities of the Committee and the details of its membership. The Committee consists of members from across the Federal Reserve Bank of New York organizational structure who are not involved in the daily production of the Benchmarks, and includes the Chief Risk Officer and other senior staff from various control areas of the Federal Reserve Bank of New York. For the Repo Benchmarks only, the Committee also includes a representative of the U.S. Office of Financial Research (OFR).</p> <p>The Oversight Committee meets on at least a quarterly basis to provide effective oversight and challenge to the Federal</p>
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The idea is to discuss what we are and are not doing, with the intention of providing transparency while at the same time mitigating potential damage to our reputation.

Because the IOSCO standards were developed to address shortcomings in privately produced rates based on voluntary submissions with an element of expert judgment – basically, LIBOR as it existed pre-reform – there are parts of the standards that do not fit naturally with rates produced by a central bank based solely on observable transactions. In some places, we have interpreted the standards to make sense as applied in a central bank context, and in other places we decided we needed to adapt our internal processes to meet the new standards.

Our benchmark administration process is designed to meet the IOSCO standards in many crucial respects. For example, we have established an Oversight Committee, comprised of senior staff including our Chief Risk Officer, that is responsible for the review and challenge of the production process, including benchmark design, control framework, and conflict of interest policies. As another example, we have developed policies for applying discretion in benchmark production, in order to ensure that any staff adjustments to the data (e.g., exclusion of outliers, correction of errors) are made only when necessary and in a rigorous, transparent, and controlled manner. We have also established formal accountability procedures, including mechanisms for addressing potential complaints.

By contrast, there were other standards that we decided did not exactly fit our situation. In these situations, we thought it was important to explain why they did not fit what we were doing, and to explain what we were doing instead to accomplish the purpose of the standard.

For example, with respect to IOSCO's recommendations for stakeholder consultation in the event of proposed material changes to our methodologies, we needed to take account of the possibility that the Board may be required to engage in a formal notice-and-comment process in certain circumstances. Another example is that submitter codes of conduct may not be necessary when the rate is based on observable, real-world transactions, as is the case with the benchmarks we administer. At the same time, we meet the objectives of a submitter code of conduct through alternative means, including mandatory reporting to an administrator that also has regulatory authority over the reporting firms and the availability of federal governmental enforcement powers. For the majority of our rates, there is regulatory authority to collect the underlying transaction data, either through formal regulatory reporting or supervisory authority over the financial institutions providing the data. In some situations, as with SOFR, a portion of data is collected pursuant to contract, but is expected to be collected pursuant to regulatory authority in the relatively near term. Given these mitigating factors, it seemed unnecessary to require the submitter codes developed for voluntary submissions of other rates.

As another example, some of a central bank's activities are, by design, not open to review from external participants, especially those functions that are involved in monetary statistics and policy that are the natural home for rate production. We are, however, subject to a host of internal oversight mechanisms, including internal audit and internal Federal Reserve oversight authorities.

2.2 Terms of use

As part of producing new benchmark rates, we lawyers also needed to ensure that the public knew what these rates were and what they were not. That is to say, we needed to devise and implement appropriate terms of use.

The policymakers needed to address a gap in the market, and the urgent requirement of creating a near risk-free rate that could serve as a replacement for LIBOR if need be. With a dearth of willing and trusted producers in the private sector, central banks agreed to step into that new role. At the same time, it is not appropriate that the public sector take on undue risk, including legal risk, as part of its production of this new public good.

Accordingly, we developed and adopted appropriate disclaimers in our new terms of use.¹⁰ These disclaimers say, essentially, that the rates are what they are and that it is the responsibility of parties using them to decide whether they are appropriate for any specific use. This is consistent with the position of the FSB and the Federal Reserve that different rates may be suitable for different purposes and it is up to market participants to decide what rate to use in a given situation, as long as that rate is robust and fit to the purpose.

¹⁰ See [Terms of Use for Select Rate Data](#) (last modified 2 April 2018).

Our terms of use provide that the rates are used by market participants at their own risk. We explicitly disclaim liability, so people should understand what they are using. To this end, we provide sufficient information about the design, methodology, and administration of the rates, so that users can make an informed choice. The terms of use are prominently displayed where the rates are posted by the New York Fed.

3 Conclusion

The two mechanisms that I describe in this paper – the affirmation of IOSCO compliance and the terms of use – go together, in some sense. Even as the terms of use disclaim legal liability and put market participants on notice of what they are and are not getting, the statement of compliance provides those market participants with enough information so that they can make an informed choice when they use our rates. The statement of compliance, together with the painstaking internal work that leads to its publication, allows the public to have knowledge and trust in our processes. All the while protecting the New York Fed's reputation and liability, so we can continue to provide this public good.

Views of the private banks on benchmark reform – issues and possible solutions

By Fernando Conlledo Lantero¹

1 Introduction

As its title infers, this paper discusses the private banking sector's opinion on benchmark reform. In the present context, that view might well be interpreted to conflict with the public sector's thoughts on the matter. Despite the insinuation inherent in the title, I am not in fact able to voice the views of private banks as a whole, as I am not authorised to speak on their behalf. It is no secret that the sector has not adopted a single position on the subject, given the complexity involved, not to mention its sensitivity for its impact on business and interests. The implications of reform also differ from one entity to the next, as some are both contributors and users of a number of benchmarks, while most are only users. Views also depend on entities' business profile: wholesale or retail, international or domestic, as well as the jurisdiction in which they are located.

The sole view I can defend here, then, is my own, largely wrought in national and international fora and as a legal expert at a bank with seats on both the panels on the euro interbank offered rate (EURIBOR) and the euro overnight index average (EONIA). Moreover, in the light of process dynamics, what I say today may soon be dated, for meaningful work on the matter is ongoing. Types of approach and the degree of progress also appear to vary according to the jurisdiction. I shall logically focus on the particular characteristics of benchmarks in the euro area. The scenario under discussion entails (i) maintaining the EURIBOR with its new hybrid methodology, which in my opinion is wholly desirable; (ii) creating a risk-free overnight rate, presumably the euro short-term rate (ESTER), on very firm foundations; and (iii) discontinuing the EONIA for new contracts after 1 January 2020, if this date is to be maintained.

The primary task is to analyse how these changes can be introduced while ensuring the continuity of, rather than disrupting, markets or contracts. What follows are my personal views of the roles of the various actors and the major issues at stake.

I will cover the following areas: Section 2 assesses the role of the public sector, central banks in particular, and whether these institutions are taking sufficiently active part in the process; Section 3 questions whether present regulations suffice as they stand or whether they need to be amended to favour benchmark reform;

¹ General Counsel, Cecabank. This paper represents the author's personal views.

Section 4 highlights the roles of benchmark administrators; Section 5 discusses banks' roles, distinguishing between benchmark contributors and users and reviewing the advantages and drawbacks of panel membership, along with user obligations and difficulties; Section 6 deals with financial sector trade organisations and banking associations; Section 7 analyses contractual matters, including alternative and replacement benchmarks and their application to legacy contracts. By way of conclusion, I will analyse whether there is sufficient time to do all that needs doing in these respects, such as rendering the EURIBOR rule-compliant, generating new benchmarks (ESTER) for new transactions and as suitable replacements for those in place, and generating a new term structure.

2 Is the role of the public sector what it should be?

The public sector's initiatives in response to cases of benchmark manipulation are widely known. Although neither frequent nor pervasive, such instances were serious and intolerable, revealed a certain vulnerability and had indisputable and potentially adverse effects on the stability of the financial system. For that reason the G20 mandated the Financial Stability Board (FSB)² to investigate the issue thoroughly. As early as 2013, however, the International Organization of Securities Commissions (IOSCO) published its Principles for Financial Benchmarks³. The European Securities and Markets Authority (ESMA) and the European Banking Authority also took significant part in identifying the principles that subsequently informed the Benchmarks Regulation (BMR)⁴, which regulates the matter in the European Union⁵. If asked to define the key elements of the issue, even at the expense of simplifying such a significant corpus of work, I would highlight three areas:

- A drastic improvement is sought in governance both for benchmark administrators and contributors, with special importance attached to preventing conflicts of interest. That calls for establishing protocols and codes of conduct and implementing organisational and internal control measures, all duly subject to verification via internal and external audits.
- The golden rule to be established is that benchmarks must be based on actual transactions, eliminating expert judgement-based inputs, which can only be resorted to sporadically and when no other feasible alternative is in place.
- Risk-free alternative benchmarks must be created that will coexist with the so-called IBORs (the euro, London and Tokyo interbank offered rates: the

² See FSB Official Sector Steering Group (OSSG) report (2014) on "[Reforming Major Interest Rate Benchmarks](#)". See also "[Interest rate benchmark reform: overnight risk free rates and term rates](#)" (2018).

³ See IOSCO (2013), "[Principles for Financial Benchmarks](#)". It presently monitors the process by issuing statements on the subject.

⁴ Regulation (EU) No 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014.

⁵ See María José Gómez Yubero (2016), "La regulación de los índices de referencia y la reforma del Euribor", *Revista de Estabilidad Financiera*, Banco de España.

EURIBOR, LIBOR and TIBOR), thereby reducing what is deemed to be undesirable recourse to those reference rates on a major scale⁶.

I believe dramatic progress has been made in the first area. There is a desire not only to comply with supervisors' justified recommendations, but also, on the part of administrators, to ensure their own and their benchmarks' survival, and on that of contributing entities, to avoid compliance and reputational risks. I believe we can assume that before the BMR was approved, governance and control measures had been universally designed and applied by administrators and contributors.

The other two areas mentioned – establishing benchmarks based on actual transactions and formulating risk-free alternative benchmarks – are more complex and call for technical studies, public consultations and a consensus between banks and stakeholders. They also require the consent of supervisors and central banks, as well as reflection on the legal issues, in the light of the transition problems posed, some traditional and others entirely new. Where a benchmark methodology is to be adapted, the implications of change from one method to another must be analysed. Where benchmarks cease to be provided and new ones are created in their place, the question is how to ensure a smooth transition. Obviously, the millions of very long-term legacy contracts, in which interests may clash and where securing contract continuity is imperative, constitute the thorniest issue in this respect.

As mentioned earlier, the public sector initiated the movement to improve and reform benchmark operation, and consequently administrator and contributor functions, by establishing standards and good practice guidelines. The question that has arisen in the interim is whether that endeavour, focused primarily on good practice, has sufficed or whether fuller engagement is needed.

I believe that three stages in the reform of benchmarks can be distinguished in the Union, although defining precise beginning and end dates for each may not be possible. The first entailed identifying the situation, analysing the issues and establishing standards. The second involved adopting directly applicable legislation (the BMR) and consequently implementing supervisory mechanisms. The third and present stage is characterised by the launch of new, risk-free alternative benchmarks and the adoption of a new hybrid methodology to secure a BMR-compliant EURIBOR.

Public sector involvement has become most perceptible in the present stage, further to its collaboration since 2017 with the private sector in a working group on euro risk-free rates⁷, in which the European Central Bank (ECB) is exercising veritable leadership. The creation of ESTER as a risk-free rate after public consultation is a prime example of such engagement.

⁶ The British authorities' latest stance would seem to advocate for the total disappearance of LIBOR. See "Interest rate benchmark reform: transition to a world without LIBOR", speech by Andrew Bailey at Bloomberg London, 12 July 2018.

⁷ In September 2017, the ECB, the Financial Services and Markets Authority (FSMA), ESMA and the European Commission announced the launch of the working group on euro risk-free rates.

Central bank involvement merits specific consideration. In my opinion, central banks are characterised by a series of unique features that qualify them as key players in the benchmark issue. They have (i) the necessary expertise, stemming from their role in monetary policy and thorough understanding of money and financial markets; (ii) an incomparably sound reputation; and (iii) either the authority to request the input data needed to formulate or calculate benchmarks or the data themselves. Certainly, any discussion of intervention by central banks, including the ECB in particular, must distinguish among the various roles at issue, which vary in intensity and complexity: monitoring the progress made on benchmark reform in the Union, together with other European authorities, and occasionally providing guidance on this topic; catalysing and providing technical support for reform of the EURIBOR; acting as the calculation agent for the EONIA on behalf of its administrator; and performing the role of administrator for the future overnight risk-free rate (ESTER)⁸. I find that building ESTER within the framework of the ECB's monetary policy functions is an especially sound approach. Applying the data presently available by virtue of statistical reporting requirements is particularly useful, as it will help to overcome the problems posed by the contributor figure to which I will refer later.

In conclusion, I find this third stage of benchmark reform to be most promising and I believe we are indisputably much better served by a higher degree of public intervention, which I feel is absolutely necessary. The particulars around the amendment of EURIBOR methodology and the institution of risk-free alternatives are, in my opinion, operations with major implications that call for a joint and coordinated effort on the part of public entities and the private banking sector, not for a single-handed response from the latter.

3 Does benchmark legislation do enough to bring about reform?

The question is whether Union legislation should regulate mechanisms envisaging transition-related issues to avoid market disruption and ensure financial stability.

The argument against regulating such instances might broadly suggest that benchmarks are essentially a private matter, “from the market for the market”, and that public intervention would not be justified because lawmakers cannot interfere in contracts concluded between private parties. In addition, if such an approach risks raising suspicions that the legislation aims to “save” banks from a problem, the immediate conclusion is that the matter should not be regulated, particularly if it addresses issues that may affect consumers. The position in favour of regulation holds, first, that the BMR itself – as well as Union legislation on enforcement, which establishes obligations and sanctions for both administrators and the participating credit institutions – entails significant intervention. Moreover, such intervention is especially intense in connection with a new concept, critical benchmarks (Articles 20 to 23 of the BMR), a status presently assigned to the EURIBOR, the

⁸ ECB (2018), “[Why are benchmark rates so important?](#)”.

EONIA and the LIBOR⁹. Singling out critical benchmarks, which are the most prominent instruments in the light of the sums and hence the impact involved, has a number of implications, including: (i) earlier applicability of the BMR; (ii) implementation of a supervisory mechanism via the creation of a supranational college; and (iii) vestment of competent authorities with extraordinary supervisory powers to require credit institutions to contribute to a given benchmark, albeit for a limited time. Added to all the aforementioned implications is the power afforded competent authorities to prohibit the use of a given benchmark (BMR, Articles 51 to 55).

The question thus posed is whether the degree of intervention in critical benchmarks envisaged in the BMR would suffice to regulate the transition-related issues mentioned earlier. General or even supplementary regulation might be in order to stop the gaps in contracts containing no provision in this regard. The public interests protected by such intervention would be financial stability and the common currency, ultimately to prevent market disruption. Such regulation would be clearly beneficial for the public at large, as well as for parties to contracts using such benchmarks. A number of options might be adopted when formulating the procedures to be followed. Where a change in critical benchmark methodology is involved, a validation scheme could be envisaged to conclude, as appropriate, that benchmark identity remains unchanged. In all or certain types of contracts, solutions to the lack of contractual provisions would need to be established.

This is not a new idea by any means. In its debates on the draft BMR, the European Financial Market Lawyers Group (EFMLG)¹⁰ discussed the need for the text to address methodological change, or even the replacement of certain benchmarks with others. The aims pursued would be to ensure financial stability and to favour a Union-wide solution with a view to guaranteeing a level playing field and preventing national solutions that would contribute to euro and single market fragmentation from being adopted.

4 Benchmark administrators

Benchmark administrators play a very important role in the operation of these indicators, although the structure may differ from one to another and some are profit-oriented whereas others are not. The BMR defines their functions in detail and subjects their authorisation to act as administrators to strict public authority supervision.

In the current context of benchmark reform, their main task is to review the design and methodology of their respective benchmarks, which is within the European

⁹ Commission Implementing Regulation (EU) No 2017/2446 of 19 December 2017 amending Implementing Regulation (EU) No 2016/1368 establishing a list of critical benchmarks used in financial markets pursuant to Regulation (EU) No 2016/1011.

¹⁰ The EFMLG, comprising senior legal experts from the Union banking sector, conducts analyses and undertakes initiatives intended to foster the harmonisation of laws and market practices and to further financial market integration in Europe. The Group is hosted by the ECB. [More information](#) about the EFMLG and its activities is available online.

Money Markets Institute's (EMMI) remit in connection with the EURIBOR. Another significant challenge is to have adaptation up and running by the 1 January 2020 deadline.

The EMMI is presently engaged in a task of immense responsibility. It therefore needs the loyal collaboration of financial institutions, especially the contributing banks, which must cooperate both in the design and testing phases to ensure that the outcome is none other than a new, BMR-compliant EURIBOR methodology.

The task must also benefit from the guidance and support of the public sector. Technical support has in fact been received from the ECB, especially at key moments involving the new EURIBOR methodology. Supervisory authorities also have a prominent part to play in the process. Pursuant to the BMR, the competent authorities are expected to grant the authorisation to the administrator of the EURIBOR. The college of supervisors formed as a result of its recognition as a critical benchmark will undoubtedly be involved in this process.

5 Private banks' roles: contributors and/or final users

Credit institutions are presently an essential element in benchmark operation. The tendency, based on routine practice and the BMR, is to divide them into two groups, depending on whether they act as contributors or users. A swift overview reveals that contributors play a more specific and even selective role, whereas users' function is more universal: all entities tend to be end users. As the communities of contributors and users do not overlap fully, the issues and concerns afforded greatest weight may also differ from one institution to the next within the sector, or carry different nuances when one or the other role is involved.

5.1 Contributors

Contributors and their responsibilities are addressed at length in the BMR¹¹. Their role is essential, for they are the entities that, further to the methodology in place, submit the data used by the benchmark administrator to calculate the rate published for the information of end users. In some cases, contributing entities form part of a community, a panel, which must have a large enough membership to ensure (particularly geographic) diversity and balance. This is especially significant in monetary unions such as the euro area, which, while aspiring to banking union, is made up of different Union Member States and therefore different banking systems, each with its own particular characteristics.

Preserving panel stability, most importantly in the case of critical benchmarks, is one of the keys to the satisfactory operation of a reference rate. The BMR therefore vests extraordinary powers in competent authorities by enabling them to require

¹¹ BMR, Articles 3, 15, 16 and 23.

contributors to retain their membership even after having notified their intention to withdraw.

The number of members on the EURIBOR panel is publicly known to have declined from the original 45 to the present 20 entities¹². It is true that membership on the panel gives rise to burdensome obligations, as noted earlier, such as being subject to and defraying the cost of strict internal and external audit-based control. Being a member of the panel also involves assuming compliance- and reputation-related risks, among others. Today, however, contributing entities reap no benefit from their participation, which nonetheless contributes to the smooth operation of the financial system as a whole. In my opinion these entities are therefore providing what is indisputably a public service. The importance of the EURIBOR's continuity for financial stability, and consequently of entities' ongoing presence on the panel, is a notion conveyed by Union authorities to the entities concerned, even before the BMR was adopted. I would like to take this opportunity to acknowledge the positive role such entities are playing in the preservation of financial stability.

The lack of symmetry between EURIBOR contributors and end users is nonetheless a subject of interest that was recently highlighted on the occasion of the creation of the public-private working group on euro risk-free rates¹³. The following question may be raised in the present context: what measures, other than requiring the mandatory contributions set out in Article 23 of the BMR, can the public sector adopt to build a much more broadly based panel of banks?

Benchmarks can exist without formal contributors, of course, such as in the ESTER proposal. I deem that to be a very intelligent design that would help to avoid problems associated with the contributor system (risks, codes of conduct, methodologies and costs).

5.2 Users

As stated earlier, contributors are not the only entities with obligations in the Union's new legal framework. Benchmark legislation also provides that end users must apply them responsibly. Financial institutions must make provision for the major contingency that may arise, i.e. their inability to continue to use a benchmark provided for in their contracts or financial instruments, due to it disappearing or its calculation being suspended. That situation is envisaged in Article 28 of the BMR, which establishes the need to produce "robust" written plans to deal with such circumstances. In our view that obligation would translate, internally, into policies targeting the units concerned, such as operations, legal counsel, compliance or others, and the definition of criteria foreseeing and serving as a guide for those situations. From a more practical, day-to-day perspective, contracts and financial instruments would make provision for replacement benchmarks or mechanisms to

¹² See EMMI's [website](#).

¹³ See [Minutes of the first meeting](#), Jean-Paul Servais (Belgian FSMA) "Mr Servais [...]: also warned about certain dynamics around the Euribor, whereby banks would rather use the benchmark without contributing to it." 26 February 2018.

calculate an alternative price. A debate is presently underway on the need for suitable alternative benchmarks. The efforts of the public-private working group, along with the formulation of a risk-free overnight rate (presumably ESTER) and a term structure, may contribute to raising entity confidence and providing a sound alternative to the existing benchmarks. Alternative systems consisting in calculating interest rates from the ones charged by a series of entities might also be used. However, these systems seem inadvisable in my view as they may pose problems related to effectiveness and practicality if they had to be resorted to on any major scale. The second issue debated in this regard is the inclusion of alternative benchmarks in existing or legacy contracts. Outside of new transactions, that approach could obviously only be applied where practical. There are, after all, millions of contracts that cannot be readily amended without agreement between the parties or that could generate enormous costs (in millions of mortgages, for instance). Further to IOSCO guidance in this respect, such alternatives should be envisaged wherever possible¹⁴.

One last issue that I would like to address is the responsibility incurred by entities when they conclude contracts that contain a critical benchmark or a benchmark published by a central bank. My belief is that such benchmarks should constitute a safe environment for entities. In other words, litigation in that respect, which aims only to enable debtors to cease to honour their obligations under cover of the need for borrowers to fully understand all the contractual conditions, should not prosper.

6 The role of financial sector trade organisations and banking associations

In Section 2 of this article we identified three stages in the evolution of the benchmark issue. There we noted that the present stage is characterised by substantially more intense engagement on the part of the public sector. Central banks, in particular, have risen to the challenge of creating risk-free rates. Much the same may be said of financial sector trade associations; organisations with significance meriting attention. These associations are in fact drafting very suggestive and practical documents on how to implement benchmark reform¹⁵. A comparison of the state of play in different jurisdictions gleaned from their output shows that advances have been most significant in the United Kingdom. Work in the euro area may well benefit from that country's experience, despite the differences in the situations prevailing in the two jurisdictions and the greater difficulties stemming from the Union's heterogeneity and complexity. The specific product analyses also underway reveal the complexity of the circumstances to be confronted. While these associations' scope of action is normally confined to wholesale banking, with

¹⁴ See IOSCO (2018), "[Statement on Matters to Consider in the Use of Financial Benchmarks](#)".

¹⁵ See International Swaps and Derivatives Association (ISDA), the Association of Financial Markets in Europe (AFME), International Capital Market Association (ICMA), the Securities Industry and Financial Markets Association (SIFMA) and its asset management group (SIFMA AMG) (2018), "[Global Benchmark Report](#)" (2018) and "[IBOR Global Benchmark Survey 2018 Transition Roadmap](#)".

particular intensity in the derivatives market, retail banks may also draw from the results of the work performed for their market products.

On the grounds of their credibility and technical capacity, trade associations have earned the confidence of both public and private actors in their pursuit of solutions for including benchmark reform-related features in contracts¹⁶. They are expected to generate clauses that will further the use of the new benchmarks, both as the option of choice and as fall-back rates in contracts stipulating benchmarks liable to be maintained, such as the EURIBOR. These actors trust that the so-called protocols will ensure smooth transition from the EONIA to ESTER, for instance.

Certain obstacles to the success of that endeavour can be identified, however, as the trade associations themselves openly admit. On the one hand, not all types of contracts, particularly bespoke contracts such as customer loans, are covered. The same can be said for bond issues. On the other hand, while the success of these transitional operations ultimately depends on the parties' consent, even in the case of the protocols, the existence of incentives for some to refuse to conform to change cannot be denied. That means, as noted, that public sector support may be necessary or advisable in the end, either in the form of regulation or of endorsement of the procedures adopted.

Lastly, general banking associations, representatives of Europe-wide and national sector interests, are also playing a significant role, not least by raising awareness among their members. For some benchmarks such as the EURIBOR and the EONIA, contributors are known to understand the reforms perfectly. Involvement by user entities of different sizes may be more shallow, however. Banking associations also participate in all public consultations, organising fora and meetings to disseminate initiatives, taking part in working groups and maintaining standing contact with supervisors. An identical role may be attributed to associations representing the interests of other stakeholders.

Consequently, while transparency has been the norm throughout thanks to public consultations, as well as to the publication of the minutes of working group meetings and of information on their membership and other matters, banking associations must intensify their engagement in this stage of the project.

7 Contracts and risks

Satisfactory contract performance, i.e. in keeping with terms and conditions and the absence of risks stemming from unforeseen events, is vital for banks. By law, a number of mechanisms ensure that they are minimally affected by contingencies (force majeure in continental legal systems and frustration of purpose in English law). The idea is to conserve the validity of these contracts either in whole or with the deletion of only some parts if necessary. From that perspective, changes in the

¹⁶ Primarily, standardised documents such as derivatives contracts and bonds, but not bespoke contracts such as loans and mortgages. See ISDA (2018), "[Consultation on certain aspects of fallbacks for derivatives referencing GBP LIBOR, CHF LIBOR, SAY LIBOR, TIBOR, Euroyen TIBOR and BSSW](#)".

methodology of a benchmark used in a contract to establish the price of the parties' benefits and obligations should not alter the fundamental elements of the purpose under discussion. On the contrary, changing the methodology should be intrinsic to a benchmark if the aim is to effectively and continuously measure the same market reality. Moreover, when benchmarks are implemented they are intended to last and their success is dependent upon their longevity.

Methodological change is applied to all manner of references, from consumer price indices to housing prices and others, without giving rise to controversy. Financial market indices command a good deal of respect, however, for they are applied the world over to millions of transactions involving enormous sums. They are used in all manner of contracts, some of which, such as mortgages, entail very long terms. Those factors seem to imbue the matter with systemic importance, even when the issues involved are common to other indices. Nonetheless, certain factors should afford a sense of perspective and a certain peace of mind. First of all, the changes in methodology for critical benchmarks, such as the EURIBOR, are driven by the public sector and reflected in new Union legislation, where the BMR has established the principle that benchmarks should be based on actual transactions (Article 11.1(a))¹⁷ as far as possible. In addition, adaptation of the methodology to a point where it is BMR compliant is subject to supervision by public authorities, which will ultimately render the verdict on such adaptation. The presence of supervisors in all these proceedings should afford peace of mind and suitable coverage for benchmark changes. Another item to be assessed in the process is whether a benchmark retains its identity after the change. For all the foregoing, it hardly seems reasonable that the use by entities of a benchmark subject to all these guarantees could be the object of possibly successful lawsuits brought on the occasion of such change. Constructs such as seamless transition are appropriate but not the only ones that can be resorted to in the various legal systems as support for trouble-free change in the reference rates used in contracts. The changes in both LIBOR and Sterling Overnight Index Average (SONIA) methodology, which have been introduced with no perceptible mishaps from the perspective of contract continuity, constitute valuable experience and a precedent to be borne in mind for the the EURIBOR and EONIA benchmarks.

Methodological change in a benchmark (the EURIBOR) is one thing, while the disappearance or discontinuity of a benchmark (as may be the case with the EONIA¹⁸) is another. The decision to refrain from adapting the EONIA to the BMR will mean that from the date set for that event, initially 1 January 2020 according to Article 51(4) of the BMR, it may not be used in new contracts. Whereas non-applicability to new contracts is clear, the ongoing calculation and publication of the benchmark for existing contracts has yet to be decided by the relevant

¹⁷ Article 11(1)(a) of Regulation (EU) No 2016/1011 reads: "The input data shall be sufficient to represent accurately and reliably the market or economic reality that the benchmark is intended to measure. The input data shall be transaction data, if available and appropriate. If transaction data is not sufficient or is not appropriate to represent accurately and reliably the market or economic reality that the benchmark is intended to measure, input data which is not transaction data may be used, including committed quotes, indicative quotes and estimates."

¹⁸ The European Money Markets Institute (EMMI), the EONIA's administrator, has already announced that it will not attempt to secure BMR compliance for the benchmark.

supervisory authority. Banks consequently face multiple scenarios and variables. The operational existence of alternative benchmarks (ESTER, for instance) and the possible simple and cost-free amendment of the existing contracts are the two most relevant questions¹⁹. Both are presently being analysed by the public-private working group. Having sufficient time to formulate viable alternatives is essential.

To that end, entities must receive daily information on ESTER behavioural patterns to understand the potential of this new benchmark and how it works. The development of a term structure based on a new overnight reference rate, which may be required for cash transactions, will also take time. In my view, the 1 January 2020 deadline for benchmark compliance with the BMR seems overly tight and merits a review by regulators and the public sector.

In any event, I see no alternative to the coexistence, after 1 January 2020, of the EURIBOR and the new benchmarks generated by the public-private working group. Any other scenario could be absolutely fragile, as the working group on euro risk-free rates has shown.

8 Conclusions

A number of conclusions can be drawn from the foregoing observations.

We are facing an operation of historic dimensions that calls for the contribution of all the actors involved: regulators and benchmark supervisors, central banks, administrators, credit institutions, financial sector trade organisations, banking associations and stakeholders in general.

Regulators and authorities should consider whether amendments to the BMR are necessary or at least advisable to regulate transition-related issues, with a view to protecting financial stability and responding with a single European voice to the problems raised with regard to this operation.

Lastly, time would seem to be an essential factor in the replacement of certain benchmarks such as the EONIA and the formulation of suitable substitutes. As the 1 January 2020 deadline envisaged in the BMR seems too tight, the respective Union and other authorities concerned should consider an extension.

¹⁹ The launch of ESTER is foreseen for the second half of 2019.



Concluding remarks

By Chiara Zilioli¹

Ladies and Gentlemen,

We have come to the end of our ESCB Legal Conference 2018. It has been an intense programme, and I hope you have enjoyed it and will leave Frankfurt better informed, but also, hopefully, **inspired**.

Let me conclude by summarising what we learned over the past two days.

We jumped into the Conference at the deep end. Both the keynote speech and the first panel looked at considerations that go to the core of the legal framework of Economic and Monetary Union and the rule of law. We were reminded that when it comes to clarifying the scope of the mandate and actions of central banks, monetary union cannot be based on men of good will. In Jean Monnet's words, **rules are indispensable**.

We started with the keynote speech, in which Yves Mersch opened the Conference with an essential question. What role does Union law ascribe to the ECB in maintaining financial stability? In exploring this question, our attention was drawn to Article 127(5) of the Treaty and to the reference to the contributory role of the ECB. He reminded us of some of the core principles of Union law: the principle of conferral; the principles of subsidiarity and proportionality; the principle of institutional balance; and, most importantly, the rule of law.

Mr Mersch's position is that the ECB's mandate in contributing to financial stability is primarily discharged through its advisory role. Beyond that, the ECB's role with regard to financial stability should be viewed as embedded within both its basic monetary policy tasks and its microprudential supervisory tasks.

The first panel dealt with the yet little studied **relationship between the objective of price stability and the principle of an open market economy**. In the case of conflict, which should prevail? We heard that objectives and principles should be viewed as different cards in the deck of Union law. We learned that principles, by their nature, may either need to trump, or be balanced with, the pursuit of the objectives of Union institutions. We heard that, in the same way the principle of proportionality can be applied to actions in pursuit of the ECB's objectives, so too can the principle of an open market economy. However, we also learned that the principle of an open market economy is not absolute, and sometimes departing from that principle can be justified as legitimate and proportionate. In other words, proportionality can limit the application of the open market economy principle. Indeed, the Treaty itself is not naive when it comes to the fact that markets cannot

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always deliver the necessary outcomes. In some instances, public authorities, including central banks, should be able to intervene to address market distortions.

We also considered the justiciability of the principle of an open market economy. Even though the principle is not itself directly applicable, this does not mean it is merely a garnish on the Treaty. It has meaning and effect in a legal sense. Our colleague from the Commission drew from the doctrine of the Court of Justice and from the decisional practice of the institutions in the field of economic policy to help us understand the principle. He explained that an open market needs to be nurtured and protected by the Union and by its Member States – and again, the rule of law and an independent judiciary play a crucial role here.

The second panel reminded us that rules are also indispensable when it comes to **the delegation or assignment of Union and ECB tasks**: 60 years after the judgment was handed down, the *Meroni* doctrine and the limits to delegation remain of fundamental importance. Union agencies play an increasingly important role, particularly bodies such as the three European Supervisory Authorities and the Single Resolution Board, which form part of a complex system straddling the Union and national level. External delegation from the Commission to these bodies must comply with the principle of institutional balance and the limitations outlined in *Meroni*, in particular that only powers of an executive nature can be delegated, not policy choices.

Similarly, for the Single Supervisory Mechanism (SSM), internal delegation and external assignment of tasks are challenging topics that require us to balance, on the one hand, accountability and the principle of conferral and, on the other hand, efficiency, by leveraging on the technical expertise and resources of national authorities. Any solutions in this context can only apply within the confines of the Treaties and case-law. Legal concerns stem from the fact that a complete outsourcing of the substance of the decision might, first, go explicitly against the political decision to move certain supervisory competences to Union level and, second, go beyond the concept and scope of the assistance that national competent authorities (NCAs) can be requested to provide to the ECB, thereby de facto outsourcing the decision and jeopardising the level playing field in these cases.

The next panel considered **how technology can be used to increase and improve the output of lawyers**, supporting their work. It was underlined that the issue is not one of substitution but of complementarity of lawyers and technology: lawyers perform better if supported by technology but must learn to “talk” to the technology to ask the right questions and get the right support. Smart technology will have a more and more decisive impact on the legislative process and on the task of providing legal advice. The key point I took from this panel is that lawyers not only need to be aware of these innovations, but they also need to actively contribute to shaping these new tools to suit their needs if they are to fully benefit from technological developments.

In that respect, I am proud to say that the ECB’s Directorate General Legal Services is already engaging with the tools and processes offered by new technology. These include knowledge management tools, the use of portals, and the use of metadata to

build effective search functions. One of the panellists referred to the ECB as having the “Ferrari” of technology. If I may be so bold, forget the Ferrari – I am looking forward to the self-flying drone.

The fourth panel, on the **inviolability of the ECB’s archives**, reminded us of the reality that while technology brings with it great advances, it also brings new risks. The ECB’s archives are not stored in cardboard boxes and protected in a locked basement in Frankfurt. They comprise data which can be accessed in any one of the Eurosystem national central banks (NCBs) or the NCAs that are part of the SSM. The Eurosystem and SSM governance is based on decisions taken by bodies – the Governing Council and the Supervisory Board – composed of members from across the 19 Member States and is built on information-sharing. This poses challenges for the ECB in protecting the inviolability of its archives, particularly if we are confronted with politically motivated investigations.

We heard that the inviolability of ECB archives needs to be interpreted broadly – after all, these archives are held in a decentralised manner and in an electronic, and mobile, format. Protecting these documents cannot be a matter for the ECB alone, and we must work together with NCBs and NCAs to give effect to the Treaty protection afforded to the archives. In preparation for future possible cases, we need to apply the lessons learned from our first experiences: we need to ensure a careful and clear separation of documents, and we need to establish appropriate procedures for investigations.

No post-crisis central bank conference would be complete without considering the safety and soundness of banks, both from a monetary policy and a supervisory perspective.

Yesterday, we looked at the scenario where a **bank is deemed to be failing or likely to fail, but is not put under resolution owing to the absence of public interest**. This gave us insights into some of the unexpected results of the new bank resolution rules where the national insolvency triggers are not necessarily fully aligned with the Union resolution triggers under the Union framework. The bank finds itself in limbo – being failing or likely to fail but in neither a resolution nor an insolvency procedure, something that is difficult to withstand with no loss of value. Even though efforts to harmonise national insolvency law and the trigger points might be one of the solutions to this dilemma, we were reminded that European integration has not developed quite far enough to achieve such harmonisation.

Today, we looked at **the use of guarantees in different Eurosystem operations to enhance credit quality and – less typically, in asset-backed security (ABS) structures**. Detailed rules apply to both Eurosystem operations and emergency liquidity assistance (ELA) operations in respect of guarantees used by banks. We learned about the private sector’s experience and perspective on Eurosystem requirements. We also learned that the Eurosystem’s collateral framework, taking a pragmatic approach, does not fully reflect the benefit of guarantees in respect of ABSs although these can substantially improve the credit quality. We also heard about the features of guarantees provided by the European Investment Fund and their policy goal.

Two other panels today dealt with respectively the future of the European Master Agreement and the central banks' role as benchmark administrators, showing us the creativity of legal minds in coming up with solutions to pressing issues for financial markets.

The discussion on the **European Master Agreement** (EMA) is a timely one. First, there is a diversity of master agreements on offer, mostly governed by the law of Anglo-Saxon jurisdictions. Second, in the context of Brexit, market participants will be looking to secure a viable alternative to the existing master agreements which are governed by English law and subject to the jurisdiction of the courts of England and Wales. The European Banking Federation will use this momentum to drive the EMA forward. The update and modernisation of this private-sector initiative – in order to fully realise its potential – is supported by central banks. Central banks see the advantages of the EMA as a multi-product, multilingual and multi-jurisdictional means of facilitating ESCB transactions. We heard that the cross-product netting and margining provisions make the EMA unique and highly advantageous.

This project will not be without its challenges: Rome wasn't built in a day, and we saw examples of the extensive changes that are proposed. We need to ensure not only that the future parties to the updated EMA are engaged, but also that national banking associations and law firms are brought on board to contribute. Likewise, setting up a functioning system of dispute resolution will be a very important issue going forward.

Without doubt, this project shows that innovation and pragmatism can turn every challenge into an opportunity.

Likewise, I see innovation at the heart of the **ESTER project** to develop a euro short-term rate. The role that central banks can play in **administering transaction-based benchmarks** is novel, but not unprecedented. We heard about the ECB's project and how the ECB is in fact following in the footsteps of other major central banks. We benefited greatly from the presentation on the Bank of England's role in respect of the Sterling Overnight Index Average (SONIA); from the observations of our colleague from the Federal Reserve on the Secured Overnight Financing Rate (SOFR); and we also heard about the perspective of the private sector.

To conclude, I would like to thank all our panellists for their insightful contributions and lively discussion on the topics. I would like to thank the Chairs of each panel for leading us through each of the complex legal issues. **And I would like to thank you, the participants, for engaging so proactively with the panels**, which made this year's Conference a truly collaborative event.

I would also like to thank our guest speaker, Síofra O'Leary, who spoke with such eloquence at our dinner yesterday. It has been a great honour to benefit from the wisdom of a learned authority from the European Court of Human Rights, which seeks to uphold the fundamental principles that underpin the concept of Europe in the 21st century.

Last but not least, I would also like to say a very special thanks to the colleagues at the ECB's Directorate General Legal Services who have worked so hard to organise this Conference. First, I would like to thank Michael Rötting. Michael is an excellent lawyer in our Institutional Law Division, who has worked hard to prepare, coordinate and execute the Conference. Michael was supported by two dedicated colleagues in the Legal Groups Team, Tončica Radovčić and Germán Gomez Ventura. After spending a lot of time during the year to organise the Conference, I think that in the last three days they have not slept much, and they have been constantly available to resolve or prevent problems. I would like to thank them wholeheartedly for their excellent organisation of the Conference, which has run like clockwork.

They were also supported by a number of other colleagues in Legal services and in administration who I cannot name individually (they are too numerous) but whose contribution I would also like to recognise.

Let me now conclude these two days with a sentence: **in the same way that rules are indispensable to the Union, the lawyers that interpret and apply them are equally indispensable to their institutions.**

On that note, I wish you a safe journey home.



Programme

Thursday, 6 September 2018

08:00 **Registration**

09:00 **Welcome address**

Chiara Zilioli, Director General Legal Services, European Central Bank

09:10 **Keynote speech: Financial stability and the ECB**

Yves Mersch, Member of the Executive Board, European Central Bank

09:40 **Panel 1**

The relevance of the principle of an open market economy for monetary policy

Chair: Frederik Malfrère, Head of the Institutional Law Division, European Central Bank

This Panel will analyse the role of the principle of an open market economy in the definition and implementation of monetary policy. Although the principle is at the heart of monetary policy, it has received little attention in the case law of the Court of Justice of the European Union and in legal doctrine. The Court of Justice has discussed the principle of an open market economy in the context of economic policy measures taken by Member States, but left the Member States with broad discretion and thus refrained from further defining it. The different presentations in the panel will therefore attempt to add flesh to the principle of an open market economy. In order to do so, it will not only be necessary to further analyse and potentially transpose the case law to monetary policy measures, but also to examine in more detail what an open market economy entails and where and how it could become relevant in the area of monetary policy. In the latter context, the panel will deal with the relationship between the principle of an open market economy and the primary objective of price stability. The interesting question will be what prevails in the event of conflict.

The primary objective of price stability and the principle of an open market economy: which trumps?

Karen Kaiser, Senior Legal Counsel, European Central Bank

The principle of an open market economy: what it is and how it can be applied to monetary policy

Clovis Hopman, Head of the Risk Management and Strategy Department, De Nederlandsche Bank

The application of the principle of an open market economy in the area of economic policy: lessons to be learned for monetary policy?

Leo Flynn, Legal Adviser, Legal Service, European Commission

Discussion with questions from the audience

10:50 **Panel 2**

Delegation of tasks to external bodies, internal delegation and assignments to national competent authorities in the preparation of ECB decisions

Chair: Eleni Koupepidou, Head of the Supervisory Law Division, European Central Bank

Delegation of tasks within EU institutions is the subject of a long-running but topical debate. The proliferation of EU agencies with a prominent role in processes that impact third parties, such as the Single Resolution Board, raises questions regarding the limits of delegation. As regards internal delegation, the challenges of the supervisory decision-making process were clear from the beginning of the SSM. Delegation of certain types of decision increases efficiency, but the scope and limits of delegation should be respected to avoid legal risk. Partly with the aim of increasing efficiency, the ECB has this year implemented a process to task national competent authorities with the assessment of certain fit and proper procedures, while the final decision is taken by the ECB. This new type of process raises legal concerns that should be properly addressed.

Delegation of tasks within the EU institutions: scope for action for agencies in the light of the Meroni judgement

Audrone Steiblyte, Member of the Legal Service, European Commission

- Delegation in the ECB's decisions. Scope and limits. Recent experiences**
 Willem Bovenschen, Senior Legal Counsel, De Nederlandsche Bank
- Assignments to the national competent authorities in the preparation of the ECB's decisions. Alternative fit and proper process. Legal challenges**
 Carmen Hernández Saseta, Adviser, Supervisory Law Division, European Central Bank
- Discussion with questions from the audience**
- 12:00 **Search engines don't understand lawyers, but smart technologies can improve access to legal information**
 Marc van Opijnen, Adviser Legal Informatics, Ministry of the Interior and Kingdom Relations, Publications Office of the Netherlands (UBR|KOOOP)
 Chair: Monica Löhdefink, Principal Legal Counsel, European Central Bank
- Discussion with questions from the audience**
- 12:40 **Lunch**
- 14:15 **Panel 3**
Efficient use of technology to support the legislative process
 Chair: Valérie Saintot, Head of the Legislation Division, European Central Bank
 In an era of digitalisation and technological innovation, the ECB's Directorate General Legal Services has set itself the challenge, as part of its overall strategy, of exploring the best technological solutions for the preparation of ECB legal acts and instruments in all official EU languages. To this end, the panel will investigate the opportunities provided by new technology to enhance the efficiency, speed of delivery, consistency and quality of ECB legislation. It will assess existing and coming technology that could be used in the drafting, editing and translation of ECB legal acts and explore the possibilities for developing specialised tools to support the legislative process.
- Knowledge and information management at the ECB: the role of technology**
 Fabienne Allegret-Maret, Principal Information Management Expert, European Central Bank
- The use of technology in drafting legislation at European Union level**
 Brunhilde Schültke, Principal Legal Adviser, Legal Service, European Commission
- The efficient use of technology to support drafting and analysis of legal documentation in a legal private practice context**
 Ben Kingsley, Partner, Slaughter and May
- Discussion with questions from the audience**
- 15:30 **Failing or likely to fail but no resolution – what then?**
 Emilie Yoo, Principal Legal Counsel, European Central Bank
- Failing or likely to fail but no resolution – a possible point of view**
 Silvia Scatizzi, Legal Officer, Resolution Task Force, Directorate-General for Financial Stability, Financial Services and Capital Markets Union, European Commission
 Chair: Alexander Karpf, Head of the SSM Law Section, European Central Bank
- Discussion with questions from the audience**
- 16:00 **Coffee break**
- 16:30 **Panel 4**
Inviolability of the ECB's archives and the role of national central banks and national competent authorities
 Chair: Fabian von Lindeiner, Head of the Governance and Civil Service Law Section, European Central Bank
 This panel will assess the scope of the inviolability of the ECB's archives and the implications for information management at national central banks (NCBs) and national competent authorities (NCAs). When determining this scope, due account has to be taken of the fact that the ECB is different from other EU institutions insofar as it "functions" outside its own premises. The ECB is not only part of the European System of Central Banks, the Eurosystem and the Single Supervisory Mechanism; to carry out its tasks, it also depends on a regular exchange of information with NCBs and NCAs. The panel will examine the impact of these particularities from a theoretical perspective but also analyse the NCBs' and NCAs' responsibility to protect ECB archives held in practice

by them and the challenges this entails. This leads to the more general, practically important, question of their obligations with regard to the storage and management of such archives.

Inviolability of the ECB's archives

Heiko Sauer, Professor of German and European Public Law, Rheinische Friedrich-Wilhelms-University Bonn

The protection of ECB archives stored at national central banks: the case study of Cyprus

Christoforos Dimitriou, Legal Counsel, Legal Department, Central Bank of Cyprus

The obligation of national central banks and national competent authorities to protect the ECB's archives

Tatyana Filipova, Head of the Legal Revision Supervision Section, European Central Bank

Discussion with questions from the audience

17:30 **End of Day 1**

19:30 **Dinner and reception** – Restaurant Opéra (Opernplatz 1, 60313 Frankfurt am Main)

Keynote speech: Europe and the rule of law

Siofra O'Leary, Judge at the European Court of Human Right

Friday, 7 September 2018

9:30 **Registration**

10:00 **Panel 5**

The future of the European Master Agreement

Chair: Otto Heinz, Head of the Financial Law Division, European Central Bank

The European Master Agreement (EMA) has the potential to become a fundamental piece of the legal architecture for the financial markets in the EU. Its importance and role is currently underlined by the changes Brexit will bring about, as English law – the governing law and place of jurisdiction of key master agreements – will cease to be EU law or an EU jurisdiction. The panel will give an introduction to the project to put the EMA on new footing in order to ensure its long-term viability and to fulfil its role in the European legal infrastructure. The panel members will also describe the key features of the agreement, and the recent changes made to it in the light of regulatory developments.

Introducing the project of the European Banking Federation to reform the EMA

Sébastien de Brouwer, European Banking Federation

The importance and benefits of the EMA in general and in particular for central banks. The role central banks can play in supporting the EMA

Yolaine Fischer, Head of the European and Financial Law Division, Banque de France

Introducing the EMA, including a description of the overall structure, and the new updates

Holger Hartenfels, Managing Director / Associate General Counsel, Deutsche Bank

Governance and supporting architecture relating to the EMA

Volker Enseleit, Principal Legal Counsel, European Central Bank

Discussion with questions from the audience

11:20 **Panel 6**

The use of guarantees in different Eurosystem operations – consolidation of doctrine

Chair: Kestutis Laurinavicius, Head of the Market Operations Law Section, European Central Bank

In view of their economic and legal features, guarantees can serve as a risk mitigation measure, enhancing for example the credit quality of assets, and can be provided quickly, in particular at times of market disruption. Nevertheless, given the divergences in

national law governing the guarantees and the status of guarantors, and given the context in which the guarantees are used, the legal assessment of their use is becoming ever more important. This panel will outline how guarantees are relevant to Eurosystem operations, with a focus on monetary policy, give the background to their use and analyse legal issues surrounding their interpretation, application and enforcement. It will also explore the use of guarantees in structured finance instruments, particularly in asset-backed security (ABS) structures. The panel will discuss both well-established guarantee forms, such as those used by the European Investment Fund and European Investment Bank, as well as more innovative guarantees under national law regimes. The Eurosystem's approach to guarantees in ABS structures will also be outlined.

The use of guarantees by central banks – the criteria relating to and the limits of relying on guarantees

Olga Stavropoulou, Head of Financial and ESCB Law Section, Legal Department, Bank of Greece

The use of guarantees by private banks in the financial sector and related legal issues

Asmaa Cheikh, Director Banking and Financial Regulation Department, Société Générale

Guarantees used in structured finance

Sarah Palmer, Principal Legal Counsel, European Central Bank

Discussion with questions from the audience

12:30 **Lunch**

13:30 **Panel 7**

The role of central banks as benchmark administrators

Chair: Bram van der Eem, Head of the Market Infrastructure Law Section, European Central Bank

This panel will review the legal aspects of the current challenges surrounding benchmark reforms, particularly in the context of the envisaged role for central banks in administering new transaction-based benchmarks. In addition to reviewing the issues directly relevant for the Eurosystem, we will also hear the views of a central bank already contributing to such a task and that of a commercial bank.

The ESTER project – the role of the Eurosystem in the benchmark reform in Europe

Sarah Jane Hlášková Murphy, Senior Legal Counsel, European Central Bank

Experience of the Bank of England regarding benchmark reform – role of the central bank related to benchmarks

David Geen, Acting Head of Legal, Legal Directorate – Corporate, Bank of England

Views of the private banks on benchmark reform – issues and possible solutions

Fernando Conlledo Lantero, General Counsel, Cecabank

Discussion with questions from the audience

14:40 **Concluding remarks**

Chiara Zilioli, Director General Legal Services, European Central Bank

End of the conference



Biographies

Yves Mersch

Yves Mersch is a member of the Executive Board of the European Central Bank (ECB). His eight-year term started in December 2012. He was Governor of the Banque centrale du Luxembourg from 1998 to 2012 and has been a member of the Governing Council of the ECB since its creation in 1998.

After obtaining postgraduate degrees in international public law and political science, Mr Mersch started his career at the Luxembourg Ministry of Finance in 1975. Since then he has held numerous public sector positions in Luxembourg and abroad, including at the IMF and the UN.



Síofra O'Leary

In July 2015 Síofra O'Leary, BCL (University College Dublin), PhD (European University Institute) was sworn in as a Judge at the European Court of Human Rights, elected in respect of Ireland.

Prior to joining the European Court of Human Rights, Judge O'Leary worked for 18 years at the Court of Justice of the European Union, where she served as a référendaire and Chef de cabinet for Judges Aindrias Ó Caoimh, Fidelma Macken and Federico Mancini. She later ran part of that Court's Research Directorate.

Judge O'Leary has been a Visiting Professor at the College of Europe in Bruges for many years where she has taught LL.M courses on EU law and the individual, and on EU Social Law and Policy in addition to holding a judicial workshop.

She has, in recent years, been a member of the Editorial Board of the Common Market Law Review and is now a member of both its Advisory Board and the Board of the Irish Centre for European Law. In 2016 she was elected an Honorary Bencher of the Honorable Society of King's Inns.

Before joining the Court of Justice of the European Union, Síofra O'Leary was the Assistant Director for the Centre of European Legal Studies at the University of Cambridge and a Fellow of Emmanuel College. She was previously a Visiting Fellow at the Faculty of Law, University College Dublin, a Postdoctoral Fellow at the University of Cádiz, Spain and a Research Associate at the Institute for Public Policy Research in London.

She is the author of two books entitled *The Evolving Concept of Community Citizenship* (Kluwer, 1996) and *Employment Law at the European Court of Justice* (Hart Publishing, 2001) and has published extensively in academic journals and EU law monographs on the protection of fundamental rights in the European Union, EU employment law, the free movement of persons and services, and EU citizenship generally.



Chiara Zilioli

Chiara Zilioli has dedicated her entire career to the European integration project, with a particular focus on European monetary union. After starting her career in the Legal Service of the Council of the European Union in 1989, she moved to the European Monetary Institute in 1995 and then to the ECB in 1998, where she was initially appointed as Head of Division and then subsequently as Director General Legal Services (General Counsel) of the ECB. She holds an LL.M from Harvard Law School and a PhD from the European University Institute. She has been appointed a professor at the Law Faculty of Goethe University Frankfurt.

Ms Zilioli has published three books and several articles, mainly on the position of the ECB within the EU institutional framework and the functions of the ECB. For the past few years she has been a lecturer at the Institute for Law and Finance at Goethe University Frankfurt and at the European College of Parma in Italy. In 2012 she taught a course at the Academy of European Law at the European University Institute. She is a member of the Italian Bar and is married with four children.



Frederik Malfrère

Frederik Malfrère is Head of the Institutional Law Division (ILA) in the ECB's Directorate General Legal Services. The Division provides advice on civil service law, procurement law and other institutional legal issues such as accounting, audit and banknotes. ILA's fields of legal expertise cover matters relating to central bank independence, rules of procedure, decision-making, confidentiality and access to ECB documents and information regimes, the monetary financing prohibition, privileges and immunities, and EU constitutional and administrative law of relevance to the ECB, ESCB, Eurosystem and SSM.

Frederik Malfrère has been an agent for the ECB in various cases before the Court of Justice of the European Union.

Prior to joining the ECB in 2005, Mr Malfrère practised law at the Brussels Bar.

A graduate of the University of Leuven (Belgium), he also holds postgraduate degrees in EU law from the University of Saarbrücken (Europa Institute, Germany) and in Management of the Legal Profession from the St. Gallen Executive School of Management (University of St. Gallen, Switzerland).



Karen Kaiser

Karen Kaiser is Senior Legal Counsel in the Institutional Law Division (ILA) of the ECB's Directorate General Legal Services.

Before joining the ECB in 2014, Karen Kaiser worked as a Senior Research Fellow at the Max Planck Institute for Comparative Public Law and International Law (1999-2007) and clerked for Justices Udo Di Fabio and Peter Müller at the German Federal Constitutional Court (2007-13). She has also gained practical experience in a leading law firm (2013-14). Within ILA, she focuses on questions of EU constitutional law and acts as agent in related cases before the Court of Justice of the European Union.

Ms Kaiser holds a PhD from the University of Heidelberg and has published in the fields of public international law, EU law and German constitutional law.



Clovis Hopman

Clovis Hopman started his career in academia before joining De Nederlandsche Bank (DNB) in 2010. He started at DNB as an economist, advising on monetary policy. Subsequently he moved to DNB's legal department, where he continued to advise on monetary policy but from a legal perspective and participated in the meetings of the ESCB's Legal Committee. Mr Hopman is currently head of DNB's Risk Management and Strategy department.



Leo Flynn

Leo Flynn, a graduate of the National University of Ireland and of Cambridge University, joined the Legal Service of the European Commission in 2002. He is a Legal Adviser and currently deals with issues of economic governance.

Leo Flynn worked in the State aid team of the Legal Service from 2008 to 2016, where he was responsible for issues concerning State aid to banks following the financial crisis of 2009. He also dealt with questions concerning State aid procedure, including recovery and execution of State aid decisions.

Prior to joining the Commission, Mr Flynn worked for five years as a Legal Secretary at the Court of Justice. From 1992 to 1997, he lectured at King's College London. He is currently a Visiting Professor at King's.

He has been an agent for the Commission in some 300 cases, approximately half of which have concerned State aid.



Eleni Koupepidou

Eleni Koupepidou is Head of the Supervisory Law Division (SLA) in the ECB's Directorate General Legal Services. SLA's fields of expertise include providing legal advice to the ECB's banking supervision arm on, for example, the interpretation of SSMR, CRD IV, CRR, SRMR and BRRD, as well as representing the ECB in related litigation concerning banking and supervisory matters.

She previously headed the legal department of the Central Bank of Cyprus. She has also worked as a lawyer at the Cyprus Securities and Exchange Commission and in law firms in Cyprus.

Ms Koupepidou obtained her LL.B from Bristol University and an LL.M in Corporate and Commercial Law from King's College London. She also completed the Bar Vocational Course at the Inns of Court School of Law in London.



Audronė Steiblytė

Audronė Steiblytė is a graduate of Vilnius University and of Lund University. She has been a member of the European Commission Legal Service since 2002, where she has worked in various teams. Since 2013 she has dealt with the legal aspects of banking union. Her field of expertise covers banking supervision, bank resolution, capital requirements, European supervisory authorities, covered bonds, non-performing loans and sustainable finance among others. She provides legal advice on the interpretation of EU legislation, works on legislative proposals alongside DG FISMA and represents the European Commission in cases at the Court of Justice of the European Union. She has been an agent for the Commission in some 250 court cases.



Willem Bovenschen

Willem Bovenschen has worked in the legal department of De Nederlandsche Bank (DNB) since 2001. At DNB he is involved in the preparation of the Governing Council and Supervisory Board meetings. He is also a member of the ESCB's Legal Committee and has participated in its meetings since 2002. Mr Bovenschen advises on European law, institutional law and supervisory law.

Before joining the DNB, he worked for four years in private practice as a tax lawyer. He studied law in the Netherlands and in the United States.

He is the author of publications on the topic of the Treaty on the Functioning of the European Union, the financial crisis, supervisory matters and state auditors. His most recent work on accountability within the SSM was published in the Common Market Law Review.



Carmen Hernández Saseta

Carmen Hernández Saseta is an adviser in the Supervisory Law Division of the ECB's Directorate General Legal Services. She works in various fields of expertise in the Division with a particular focus on horizontal matters, including litigation before the Court of Justice of the European Union. She joined the ECB in 2013 as part of the first group of experts seconded to the ECB to provide support during the preparatory phase of the SSM. Before joining the ECB, she worked in the legal department of the Banco de España. She also has numerous years' experience of working in the private sector. She worked for more than 10 years in various international law firms in Madrid and Brussels, advising on competition law and State aid and representing clients before national and European Courts.

Ms Hernández Saseta studied at the University of Saragossa and at the Université Libre de Bruxelles, where she obtained a DES in European Law. She has been a member of the Madrid Bar since 2001.



Monica Löhdefink

Monica Löhdefink is responsible for the Knowledge Management function in the Directorate General Legal Services at the ECB. She is also currently part of a team working on the creation of a knowledge management programme at ECB enterprise level. Her areas of interest include collaboration and change management in the knowledge management context.

Prior to joining the ECB, she worked at leading law firms in the City of London and Düsseldorf; she is admitted to practise law in England and Wales and in Germany.

Ms Löhdefink is a graduate of the universities of Oxford and London (City) and of the Oxford Institute of Legal Practice.



Marc van Opijnen

Marc van Opijnen studied administrative, international and European law at the universities of Groningen and Leiden, in the Netherlands.

His interest in the potential of the internet led him to master the necessary computer skills and develop the Netherlands' first web-based case law database in 1997. From 2000 to 2013 he held various positions at the Council for the Judiciary, acting as an intermediary between the law, the administration of justice and IT. He is particularly interested in all legal and technical aspects relating to online access to court decisions, which was the subject of his PhD thesis at the University of Amsterdam in 2014.

He is currently affiliated to the Publications Office of the Netherlands (UBR|KOOP) and is closely involved in various national and European projects aimed at improving access to legal information, particularly via innovative technologies. He is a long-standing member of the EU Council working party on e-law and Chair of the Expert Group on the European Case Law Identifier (ECLI). He regularly publishes works relating to his fields of interest.



Valérie Saintot

Valérie Saintot is Head of the Legislation Division in the ECB's Directorate General Legal Services. She studied law in France and in Luxembourg, where she was admitted to the Bar. She began her career as a lawyer at the European Court of Justice in the Research and Documentation Directorate before working as a "lecteur d'arrêts" in the cabinet of the President of the Court of First Instance. She then worked in two law firms in Luxembourg. Ms Saintot joined the ECB's Legal Services in 1999, where she contributed to a number of legal projects and tasks, including: setting up the ECB's Conditions of Employment; acting as country rapporteur for Luxembourg, Lithuania and Poland; and working on procurement, ethics and internal administrative rules. She also represented the ECB in several court cases. She thereafter held various managerial positions at the ECB – in HR; Budget, Controlling and Organisation; and Communications – before returning to Legal Services as Head of the Legislation Division.



Fabienne Allegret-Maret

Fabienne Allegret is a Principal Information Management Expert at the ECB, responsible for the Library's provision of information resources, services and relevant tools to ECB staff members. She regularly advises colleagues on the use of new and existing IT tools to manage their information needs. For the last couple of years Ms Allegret has been developing central bank-oriented information services; with the explosion of information, and inherent information overload, she understands that it is of utmost importance for librarians to provide users with strategic context and focus.

She is currently working on a strategy for knowledge management at the ECB.

Fabienne Allegret has a Masters in Law from the University of Paris I and an MA in Information Services Management from London Metropolitan University. She has worked at the London School of Economics, where she was responsible for a tailor-made information database, and in the knowledge management department of a global law firm.



Brunhilde Schültke

After completing law studies and practical training in Bonn, Geneva, Dortmund and Luxembourg, Brunhilde Schültke started her professional career in the Federal Ministry of Agriculture in Bonn.

She joined the European Commission in 1990, serving in the Quality of Legislation Team of its Legal Service in various capacities from 1994.

Among other tasks, she led the group dealing with financial legislation for some ten years until she was appointed Director of the Team in March 2018.



Ben Kingsley

Ben Kingsley has been a partner in Slaughter and May since 2008. He advises both financial institutions and non-regulated firms on the UK and EU financial regulatory aspects of a broad range of matters and projects including M&A, capital issuances, joint ventures, corporate governance and conduct of business matters, and licensing matters. Mr Kingsley is also co-head of Slaughter and May's Fintech Group, and has a broad range of fintech clients spanning major financial and telecom groups through to smaller challengers and start-ups; key clients include Euroclear, Standard Chartered Bank, Stripe, Vodafone, Tide, WorldRemit and VocaLink. He founded the firm's Fintech Fast Forward entrepreneurs programme and mentors a number of the businesses in that programme.

Ben Kingsley recently co-authored a white paper with ASI Data Science on the responsible deployment of AI in business and is a contributing editor of The International Comparative Legal Guide to: Fintech 2017, a practical cross-border insight into fintech law across 34 jurisdictions. He is listed as a leading individual in the fintech section of the Legal 500 rankings.



Alexander Karpf

Alexander Karpf joined the ECB in 2007 and is currently Head of Section in the Supervisory Law Division. Before working on SSM legal matters, he worked on two major Eurosystem infrastructure projects, TARGET2 and TARGET2-Securities. He has previously worked at the OECD, the Committee of European Securities Regulators, the Austrian Financial Market Authority, the Austrian Ministry of Justice and a law firm in Vienna.

He holds a PhD from the University of Vienna and an LL.M from King's College London.

Mr Karpf has published on different areas of financial and supervisory law.



Emilie Yoo

Emilie Yoo is currently Principal Legal Counsel in the Supervisory Law Division of the ECB's Directorate General Legal Services, where she advises on banking supervisory and crisis management related topics. She has previously gained professional experience at an international law firm and at the Deutsche Bundesbank, in its Policy Division (Directorate General Banking and Financial Supervision).

Ms Yoo studied law at Goethe University Frankfurt, the Université Paris X-Nanterre and Columbia Law School. She completed her legal training in Frankfurt and Brussels and qualified for the Bar in Germany in 2006.



Silvia Scatizzi

Before joining the European Commission, Silvia Scatizzi worked as a lawyer dealing with private and commercial law, contract law, administrative law and bankruptcy law in various law firms in Milan. She joined the Commission in 1995. She first worked in the Unit for Regulated Professions within the Directorate General for Internal Market and Services, where she dealt with the mutual recognition of professional qualifications. She then moved to the Banking and Financial Conglomerates Unit in 2005, where she worked on EU prudential regulation including the Capital Requirements Directive, the Deposit Guarantee Schemes Directive and the Directive on the winding-up of credit institutions. She then dealt with the EU policy on crisis management in the banking sector, contributing to the drafting and negotiation of the Directive on Bank Recovery and Resolution and the Regulation on the Single Resolution Mechanism. She has represented the Commission in various Financial Stability Board (FSB) working groups on crisis management and the Key Attributes for effective resolution regimes. She currently works in the Resolution Task Force within the Directorate General for Financial Stability, Financial Services and Capital Markets Union, where she deals with resolution cases and the relationships between the Commission and the Single Resolution Board.



Fabian von Lindeiner

Fabian von Lindeiner has been Head of the Governance and Civil Service Law Section in the Institutional Law Division at the ECB since 2016. He joined the ECB's Directorate General Legal Services in 2005, where his main focus was on legal matters relating to the construction of the Main Building of the ECB, contracts and procurement, institutional matters and statistics. Previously, Mr von Lindeiner worked from 2000 to 2005 in the London and Frankfurt offices of Freshfields Bruckhaus Deringer, specialising in air law, real estate and environmental law.

He studied law at Heidelberg and Greifswald, with a specialisation in the history of law, and obtained his law degrees at Humboldt University, Berlin. He was awarded a PhD at Potsdam University with a thesis on constitutional law, and an LL.M in Environmental Law at Nottingham Trent University.

He has contributed to commentaries on the German Basic Law and the Act on Constitutional Court Proceedings, as well as on the Statute of the ESCB and of the ECB. He has also published articles on environmental law and procurement law and taught on a course on law and literature at Johannes Gutenberg University Mainz.



Heiko Sauer

Prof. Dr Heiko Sauer holds the Chair in German and European Constitutional and Administrative Law at the University of Bonn. He studied law in Düsseldorf and Ferrara, Italy, and obtained his doctorate from Heinrich Heine University Düsseldorf in 2005. Following his practical legal training with placements in the Higher Regional Court of Düsseldorf and the German Ministry of Foreign Affairs, Heiko Sauer served as a clerk to Justice Udo Di Fabio at the Federal Constitutional Court in Karlsruhe from 2007 to 2009. Returning to Düsseldorf, Heiko Sauer was a lecturer in public law from 2009 to 2013 and received his post-doctoral qualification, with authorisation to lecture at a university, in Public Law, Public International Law, European Law and Legal Theory in 2014. His research currently focuses on European constitutional law, including institutional questions of European Economic and Monetary Union, and on the development of a constitutional theory of supranationality. Prof. Dr Sauer is married and has two children.



Christoforos Dimitriou

Christoforos Dimitriou studied law at the National and Kapodistrian University of Athens, completing his postgraduate studies in civil law in 2005. He then qualified as a lawyer in Greece. From 2006 to 2008 he worked in the ECB's Directorate General Legal Services. In 2008 he joined the Legal Department of the Central Bank of Cyprus. He has advised on financial derivatives, payment services, central bank credit operations and other areas of law and was appointed a member of the Legal Committee of the ESCB in 2013. Following the Cypriot banking crisis of 2012-13, he has been contributing to the defence of the Central Bank of Cyprus and the Republic of Cyprus in related litigation and international arbitration. He also acts as a liaison of the Central Bank of Cyprus with the Cyprus Police's team which has been mandated to investigate the causes of the crisis. He lives with his family in Nicosia, Cyprus.



Tatyana Filipova

Tatyana Filipova is currently Head of the Legal Revision Supervision Section at the ECB. As well as being responsible for legal revision work relating to supervision, she is involved in drafting panels for ECB opinions on draft EU and national legislation.

Previously, Tatyana Filipova was Principal Legal Counsel at the ECB advising on institutional law matters. Between 2012 and 2014 she worked as Policy Officer in the Financial Services Policy, Relations with the Council Unit at the European Commission. She started her career in academia and joined the ECB in 2006 as a lawyer-linguist and country rapporteur for Bulgaria.

Ms Filipova obtained Master's degrees in law from Sofia University and in European studies from Bonn University. She holds a doctorate in law from the European University Viadrina, Frankfurt (Oder).



Otto Heinz

Otto Heinz is Head of the Financial Law Division at the ECB, where he oversees financial law-related matters. This includes the legal aspects of the ECB's monetary policy implementation (including collateral policy, market interventions, global central banking cooperation), financial litigation, regulatory matters, payment settlement infrastructures and foreign reserve management.

Otto Heinz is a member of the ESCB Legal Committee. He is also Chairman of the European Financial Market Lawyers' Group, comprising senior lawyers from various banks within the European Union.

He previously worked in investment banking at Goldman Sachs and at Lehman Brothers and was a Director at Bank of America in London. He was in charge of debt and equity capital markets and M&A activities in and outside Europe. He also worked for the European Bank for Reconstruction and Development, with a focus on project finance transactions in central and eastern Europe. He also taught part time at the London School of Economics and at the Central European University, Budapest.

Mr Heinz has a B.A. in Economics from the Budapest University of Economics, a Doctor Juris from ELTE University Budapest, an LL.M in German Law from the University of Trier, and an LL.M in European Law from the University of Oxford.



Sébastien de Brouwer

Sébastien de Brouwer is Chief Policy Officer at the European Banking Federation (EBF). He is a member of the EBF Management Committee. He supervises all EBF policy areas and horizontal functions, such as legal affairs.

As part of his activities, Mr de Brouwer is also a Board member of the European Payment Council (EPC), a member of the Advisory Committee of fTLD Registry Services, LLC and a member of various Expert Groups at EU level. He is also a member of the editorial Board of the *Revue de Droit Bancaire et Financier*.

A Belgian national, he has a degree in Law from the Catholic University of Louvain-la-Neuve and postgraduate degrees in International Law from the University of Leiden and in Business Studies from the London School of Economics.

Sébastien de Brouwer joined the EBF in 2006. Previously, he was Head of European Affairs and a member of the Executive Committee at Febelfin, the Belgian Financial Sector Federation (including banks). He has also worked in an international bank (custodian) and an insurance company (management of major claims).



Yolaine Fischer

Yolaine Fischer has been Head of the European and Financial Law Division at the Banque de France's Directorate Legal Services since July 2018, having been the Division's Deputy Head beforehand. This Division deals with legal issues related to the Eurosystem's tasks carried out by the Banque de France (monetary policy, foreign reserves, post-market infrastructures, banknotes, statistics). Ms Fischer is also a member of the ESCB's Legal Committee.

Between 2008 and 2013 she worked at the Banque de France as a legal expert on monetary policy and other financial operations and participated, within the French delegation, in the UNIDROIT negotiations on close-out netting.

From 2003 to 2008 she held several positions within the Legal Department of the French banking supervisor (today the ACPR) and participated in on-site inspections of supervised credit institutions.

Yolaine Fischer graduated from the Institut d'Etudes Politiques de Paris (Sciences Po, European Community Division) in 2000 and from the Ecole de Formation du Barreau de Paris in 2001. She also has two postgraduate degrees in law (universities of Paris I Panthéon-Sorbonne and Paris II Assas, where she was awarded a prize in civil law) and has worked as a solicitor in the French office of Denton Wilde Sapte (in its Infrastructures and Energy Department).



Holger Hartenfels

Holger Hartenfels is Managing Director and Associate General Counsel at Deutsche Bank's head office in Frankfurt. He is in charge of the Regulatory Advisory Group for Germany, which advises the bank on prudential regulation, recovery and resolution, and structural reform matters. His responsibilities include regulatory requirements for trading activities and market infrastructure participation, as well as the recognition of credit risk mitigation techniques such as close-out netting, financial collateral and credit derivatives. He frequently assists on a variety of domestic and international financial transactions, including derivatives, securities financing and securitisations.

Before joining Deutsche Bank in 2000, Mr Hartenfels worked as Counsel of the Association of German Banks (Bundesverband deutscher Banken), where his responsibilities included, among other topics, the development of the German documentation for derivatives, securities loans and repurchase transactions. He studied law in Trier and Cologne and has been admitted to the Bar since 1993.

Mr Hartenfels serves as a member of various national and international working groups, including the Association of German Banks' Derivatives Working Group and the International Swaps and Derivatives Association, Inc. (ISDA). He was also a member of the Legal Committee of the European Federation of Energy Traders (EFET) and the UNIDROIT Study Group on Netting of Financial Instruments. Currently he serves as Vice-Chair of the ECB's European Financial Markets Lawyers Group (EFMLG). Mr Hartenfels is also a member of the Panel of Recognised International Market Experts in Finance (P.R.I.M.E. Finance).



Volker Enseleit

Volker Enseleit is Principal Legal Counsel in the Market Operations Law Section of the ECB's Directorate General Legal Services. He has been working for almost ten years in the field of financial law at the ECB. Previously he worked for eight years at a major law firm in the field of finance in Frankfurt and London. He first gained experience of banking matters while spending five months of his practical legal traineeship at Norddeutsche Landesbank in Hanover.

Volker Enseleit studied law in Hanover and completed his legal training at the Higher Regional Court of Celle. He also holds a PhD in law. He is admitted as a Rechtsanwalt in Germany and as a solicitor in England and Wales.



Kestutis Laurinavicius

Kestutis Laurinavicius is Head of Section in the Financial Law Division at the ECB, working on monetary policy, foreign reserve management and various other financial law topics. The team handles cases a number of cases in which the ECB is the defendant in litigation before the Court of Justice of the European Union. Mr Laurinavicius represents the ECB in court cases, advises colleagues on the legal aspects of monetary policy and other market operations, and reviews and prepares briefings to the decision-making bodies of the ECB. Since starting at the ECB in 2003, Mr Laurinavicius has been dealing with legal questions relating to payment and securities settlement systems, the issuance of banknotes, governance and the institutional aspects of the supervisory function.

Prior to joining the ECB, Mr Laurinavicius worked at Lietuvos bankas, advising on legal issues relating to market operations and the implementation of EU financial services law. In 2010-11 he was on secondment to the International Monetary Fund's Legal Department, working on financial sector assessments and new legislative proposals for bank resolution, as well as participating in technical assistance missions to Armenia, Azerbaijan and Eritrea.



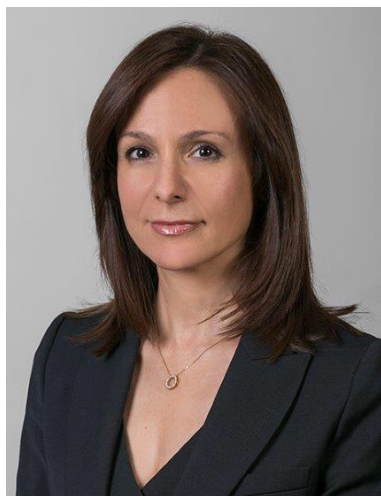
Olga Stavropoulou

Olga Stavropoulou is Head of the Financial and ESCB Law Section at the Bank of Greece.

A graduate of the School of Law at Athens University, she pursued her postgraduate studies at University College London and King's College London, where she specialised in commercial and corporate law and banking and finance law.

After practising law in the field of banking and capital markets, she joined the Legal Department of the Bank of Greece before Greece adopted the euro. She has been working ever since in euro area and financial law matters, with a focus on monetary policy, own funds' management, and payment and securities settlement systems. In recent years she has worked on issues related to the financial crisis/adjustment programme, including the EFSF/ESM financial assistance agreements and the Greek debt restructuring.

She was appointed Deputy Head of the Bank of Greece's ESCB Law Section in 2010 and Deputy Head of the Financial and ESCB Law Section in 2011. Since being appointed to her current position as Head of Section in 2013, she has participated in different Eurosystem groups in her fields of expertise and is currently a member of the Legal Committee of the ESCB.



Asmaa Cheikh

Asmaa Cheikh is a qualified Belgian lawyer who works as a Director in the Banking and Financial Regulation team of Société Générale's Group Legal Department. Key areas of practice are bank recovery and resolution planning, as well as banking supervision. She has gained extensive international legal experience in Brussels, London, Frankfurt and Paris. Asmaa Cheikh has held lectureships at Université Paris 1 Panthéon-Sorbonne and Université Nice Sophia Antipolis. Her article on the new Senior Non-Preferred Notes was recently published in the *Revue de Droit Bancaire et Financier*. She holds a Licence en droit public and a Diplôme d'études spécialisées en droit international des affaires from the Université Libre de Bruxelles.



Sarah Palmer

Sarah Palmer, LL.M (Trinity College Dublin), LL.B (Ling. Germ.) (Trinity College Dublin) is Principal Legal Counsel in the ECB's Directorate General Legal Services. She works on financial law matters, primarily in relation to monetary policy and operations, advising on the collateral framework, non-standard monetary policy measures, including the asset-backed security, covered bond and corporate bond purchase programmes. She has also been closely involved in the ECB's initiatives in the regulatory field, particularly in relation to the reforms of the securitisation market in the preparation of the capital markets union, and more recently in preparations for Brexit. Prior to joining the ECB, she worked in the capital markets and securitisation practice of an international law firm in Frankfurt for six years.

Sarah Palmer is a solicitor qualified in England and Wales and an Irish barrister (non-practising).



Bram van der Eem

Bram van der Eem has been Head of Section at the Financial Law Division in the ECB's Directorate General Legal Services since January 2015. He heads a section that advises on EU financial legislation and EMU matters and on financial market infrastructure, as well as with respect to the ESCB's statistical function. He was previously responsible for legal advice on the ECB's monetary policy and its foreign reserves and own funds management.

Bram van der Eem started his career in 2003 in private practice at law firm Pels Rijcken & Droogleever Fortuijn, based in The Hague. From 2009 to 2014 he worked in legal services at De Nederlandsche Bank and as a seconded adviser to the Central Bank of Cyprus. In 2010 he joined the ESCB's Legal Committee (LEGCO).

Mr van der Eem is a graduate of the Radboud University of Nijmegen and of the University of Pantheon-Sorbonne, where he earned his PhD.



Sarah Jane Hlásková Murphy

Sarah Jane Hlásková Murphy is Senior Legal Counsel in the Financial Law Division of the ECB's Directorate General Legal Services. She specialises in the law and regulation of financial market infrastructures, in particular relating to the oversight and operation of payment systems and securities settlement systems. She is also responsible for advising on legal issues relating to the collection and use of statistical information by the ESCB, including for co-ordinating legal advice on the development and production of ESTER by the ECB and to the ECB Secretariat for the Working Group on Risk Free Rates.

Prior to joining the ECB in 2014, Ms Hlásková Murphy was a Senior Associate in the Competition and EU Law Division of Herbert Smith Freehills LLP in London, with a particular focus on advising clients in the financial services sector. She has a Bachelor of Arts (Hons) and a Bachelor of Laws from the University of New South Wales and an LL.M from the University of Cambridge. She is admitted to practise in England and Wales and in New South Wales, Australia.



David Geen

David Geen is Deputy General Counsel – Central Banking at the Bank of England.

Prior to joining the Bank of England in 2016, Mr Geen worked at the International Swaps and Derivatives Association (ISDA) from 2006, where he served as General Counsel from 2008. Between 2000 and 2006 he led the derivatives group in the Legal Department of Goldman Sachs International. He started his legal career at Baker & McKenzie in London, where he was a partner from 1997 to 1999.



Fernando Conlledo Lantero

Fernando Conlledo is General Counsel and Secretary of the Board of CECABANK, a Spanish bank which provides specialised services to other financial institutions. He is currently a member of the European Financial Market Lawyers Group of the ECB.

He was formerly the Deputy Head of Banco de España's legal department, where he worked for 19 years. He is also a former member of the Legal Committee (LEGCO) of the ESCB and of the Working Group of Legal Experts of the European Monetary Institute (the forerunner of the ECB).

A graduate in Law of Universidad Complutense de Madrid, he began his professional career as a lawyer in a private commercial bank. He is the author of various publications in the field of banking and commercial law, central banking and banking supervision.





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