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EUROPE'S POST-CRISIS SUPERVISORY ARRANGEMENTS – A CRITIQUE*

*René Smits***

Abstract: *This paper, based on presentations before audiences in Lisbon, provides an overview of the causes of the credit crisis and discusses one of the reports issued in the wake thereof, the De Larosière Report. Its main findings in respect of financial sector regulation are reviewed: a single European rulebook, colleges of supervisors, deposit guarantee schemes, bank resolution regimes and 'living wills' as well as transparent corporate structures of banks. The proposals for the establishment of a European Systemic Risk Board (ESRB) and a European System of Financial Supervisors (ESFS) are described and subjected to critical reviews, both from a legal angle and from a broader perspective. Emphasis is given to the European Banking Authority (EBA), as one of the agencies within the ESFS. Suggestions are made to broaden the legal underpinning of the proposals in order to place the new bodies on a firm footing. This paper argues that, even though major steps toward a stronger Union-wide response to difficulties in the financial sector, the De Larosière proposals and the Commission's legislative follow-up do not provide an adequate response to the lessons from the crisis. Federal authority for overseeing the financial sector is required: this implies Treaty change.*

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* This paper is based on a presentation on the De Larosière Report and its follow-up during the conference *10 Anos do Sistema Europeu de Bancos Centrais*, held on 6 July 2009 at the *Fundação Calouste Gulbenkian*, and on a further presentation on the same subject during the academic launching of *Revista de Concorrência e Regulação* (Competition and Regulation Review) jointly sponsored by the *Instituto de Direito Económico, Financeiro e Fiscal da Faculdade de Direito de Lisboa* (IDEFF) and the *Autoridade da Concorrência* (Portuguese Competition Authority) on 6 March 2010 at the *Faculdade de Direito da Unversidade de Lisboa* (Law Faculty of the University of Lisbon) in Lisbon (P). The author gratefully acknowledges research assistance by Michał Karasiewicz, Carl Mair and Mathieu Bui, paralegals. Opinions expressed are those of the author and may not be attributed to *NMa* or to the Commission.

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1. INTRODUCTION

This paper sets out to do three things. First, following on from the De Larosière Report[1], I will attempt to sketch some of the causes of the credit crisis with particular focus on the contribution of 'supervisory failures'. Second, I will discuss and critique the Commission's proposals to translate the De Larosière recommendations into legal texts. Third, I will cast a wider net to engage other issues not covered by De Larosière, but which nevertheless are relevant for financial sector regulation in Europe, including recent developments in the area, up to and including 8 April 2010. I will conclude by sketching a perspective on better arrangements and on why Europe needs to get its house in order.

2. CAUSES OF THE CRISIS

Securitisation, opaqueness of instruments, lack of insight of supervisors

Manifold are the causes of the credit crisis. It began to unfold with cracks in the financing of mortgage-backed securities and in interbank liquidity. [2] Although securitization was heralded, by its commercial backers and supervisory authorities alike, as an effective method of spreading, and thereby reducing risk, when unexpected risk appeared, this risk spread contagiously among all the holders of securitised assets. Securitization proved to be a two-edged sword: apparently reducing risk in good times but aggravating it in bad. Globalisation only exacerbated the effects of securitisation: one could find holders of asset-backed securities in the remotest places and on bank balances that the general public and the supervisory authorities had not suspected to carry such risks. All market players and overseers had followed a 'belief' in financial markets tending towards efficient equilibrium. This tenet proved to be a fallacy. Neither do financial markets tend towards efficient equilibrium nor do economic actors always behave rationally.[3] Securitization was also characterised by a level of sophistication which made it hard for managers and both internal (supervisory board, non-executive directors) and external (auditors, financial supervisors, central banks) supervisors to keep up with new financial instruments and to

1 Report of The High Level Group of Financial Supervision in the EU, Jacques De Larosière, Chairman. (Hereafter: the "De Larosière Report"), available at: http://ec.europa.eu/internal_market/finances/committees/index_en.htm#package (last accessed: 8.04.2010).

2 Tett, 2009: generally.

3 See Cooper, 2008: generally. See also Soros, 2008: generally.

adequately assess their risk. By way of example: the market for credit default swaps grew from USD 630 billion to USD 62 trillion within the span of eight years, i.e. from 2000 to the second semester of 2007.[4] A general opaqueness obscured financial markets. Their transparency was darkened by off-balance sheet items (securitized assets sold off to special-purpose vehicles (SPVs) and structured investment vehicles (SIVs), intricate legal structures of financial institutions, making it difficult for management and supervisors alike to determine which legal entity actually contained what kind of risk), and the operation of financial institutions that were outside the purview of ordinary prudential supervision.

Parallel financial system, role of Credit Rating Agencies, Basle-II and accounting standards

Private equity funds and hedge funds, at times sponsored by supervised banks, gathered risks and played roles below the horizon of the regular supervisory bodies. This parallel financial system also included Credit Rating Agencies (CRAs) with a double role, both advising financial institutions on complex securitization instruments and labeling such instruments as safe (AAA) on the basis of what appeared to be questionable assumptions. Add to this all the procyclical effect of Basel-II, the prudential rules only recently introduced to minimize credit, market and operational risk that, for large internationally operating banks, relied heavily on their own internal risk control mechanisms. Basel-II requires banks to hold own funds (core capital) in relation to the riskiness of their assets and off-balance sheet contingent liabilities. When assets diminish in value they require higher capital ratios, thus aggravating any downward trend in the economy. The mark-to-market rules applied under international accounting standards also helped the crisis to unfold. As long as assets increased in value, financial institutions showed bigger balance sheets and fatter profits each quarter. As soon as the price of assets started to tumble (real estate, loans to finance real estate, structured products), banks were forced by these accounting rules to include them on their balance sheet at lower values. This incentivised fire sales with each financial institution trying to outdo the other in getting rid of toxic assets once the price was still relatively high or the loss relatively limited.

4 According to data collected by the International Swaps and Derivatives Association, available at: http://www.isda.org/statistics/pdf/ISDA-Market-Survey-historical-data.pdf (last accessed 06.04.2010).

Dispersed supervision

More to the point in the context of this contribution, mention should be made of the dispersion of supervision on both sides of the Atlantic. Both in the United States and in the European Union, there is a State / federal divide. In the US, insurance companies and many banks are supervised at State level, whereas other financial institutions are supervised by various agencies at the federal level. In the EU, there is a high degree of federal harmonization of prudential and market rules that are enforced at State level. Also, lender of last resort assistance, i.e. the provision of liquidity to banks that can no longer fund themselves in the market, is given by National Central Banks (NCBs) and solvency assistance (bailouts, nationalizations) is organized at State level. This picture is further complicated by the fact that, in the US, investment banks fall outside the scope of supervision of the Federal Reserve System, being organized as falling under the SEC only – a situation quickly remedied at the height of the crisis when all remaining investment banks sought refuge under the umbrella of the Fed, registering as banks. In the EU, separate agencies are often responsible for prudential or micro supervision, for the supervision of conduct of business rules and market behaviour, and for systemic risk. This led to coordination and information issues, when in time of need, information channels dried up and coordination was markedly absent.

Macro-economic imbalances

This picture of the financial system prior to the crisis as an accident waiting to happen fits into a macroeconomic tableau of global imbalances. Asian countries, notably China, and oil exporting countries invested their surpluses in America, leading to excessive credit in the US. Also, central banks were 'guilty' of excessive provision of liquidity. They sought to smooth out any potential crisis by ensuring that the "irrational exuberance" of (financial and housing) markets was sustained by ever more money pumped into the economy. This kept interest rates low, fuelling the credit boom and the asset price bubble. This policy came to be known as the 'Greenspan put': investors could rely on assets increasing in price: any future sale would be at a higher price than the purchase price. This helped inflate the housing price bubble.

Cultural aspects

At a more philosophical level, the crisis was exacerbated by the link between awards in the financial system with bonuses related to short-term profits.[5] Bank employees and managers were thus induced to market financial instruments and provide financial products that provided short-term profits without regard to their long-term profitability, or their effects on the economy as a whole. Often excessive bonuses led to a culture of greed in total dereliction of the needs of the customer who might not have adequately assessed the riskiness of the products sold. At a micro level, this led to unsustainable banking. The relationship between financial transactions and the real economy was totally out of control.[6] The financial service industry should change to take the lessons of the crisis on board. The supervisory authorities should also learn their lessons. As Adair Turner, Chairman of the Financial Services Authority (FSA), said in an address to the British Bankers' Association Annual International Banking Conference:[7] "It is therefore essential that we learn lessons and accept the need for radical change – change in the style of supervision, change in the regulations applied to banks, and changes in the banks themselves. We hope to return to more normal economic conditions: we must not allow a return to the 'normality' of the past financial system."

More cultural causes of the crisis may be mentioned. The financial system and society at large seem to be based on a combination of various forms of behaviour, some of which seem to belong to the animal world rather than the human world: greed, fear and herd behaviour, but also: trust. The cultural aspect has been emphasized by several authors who have written about the crisis.[8] Beyond the sphere of legal analysis, it may be remarked that

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5 See the interview with Paul Volcker, Chairman of the Economic Recovery Advisory Board, in the *Financial Times* 12 February 2010: "I do think that the compensation practices particularly in finance have gotten out of touch and created incentives that are not very helpful…They've gotten obscenely large in terms of the discrepancies between the average worker and the leaders."

6 According to Adair Turner, Chairman, FSA, foreign exchange trading now makes up over 70 times the volume of global trade and long-term investment flows. See his speech of 17 March 2010 to CASS Business School, 'What do banks do, what should they do and what public policies are needed to ensure best results for the real economy?', available at http://www.fsa.gov.uk/pubs/speeches/at_17mar10.pdf (last accessed: 8.04.2010).

7 Adair Turner, Chairman, FSA, 'Address to the British Bankers' Association Annual International Banking Conference 2009', 30 June 2009, available at: http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0630_at.shtml (last accessed 6.04.2010).

8 See Tett, 2009: 300. See also Fox, 'Cultural change is key to banking reform', in the *Financial Times* 26 March 2010.

a paradigm shift is needed for society to evolve from the short-term focus and exclusive pursuit of narrowly conceived self-interest that engendered this crisis, a change of perspective, such as the one that physicist and natural scientist Albert Einstein (1879-1955) called for when he said: "We are part of the whole which we call the universe, but it is an optical delusion of our mind that we think we are separate. This separateness is like a prison for us. Our job is to widen the circle of compassion so we feel connected to all people and all situations."[9]

3. REPORTS ON THE CRISIS

More down to earth, many reports have been written on the need for financial regulatory reform. The U.S. Treasury[10] and the UK Parliament[11] have come up with proposals and evidence. A fine analysis of the causes of the crisis and an intellectually sound overview of possible ways out is the 'Turner Review', written by the Chairman of the FSA.[12] On a more local level, a report on the competences of De Nederlandsche Bank (the Dutch central bank) concerning Icesave, the Icelandic bank that gave premium interest rates and thereby collected hundreds of millions of euros from Dutch savers, was compiled by colleagues of the Law Faculty of the University of Amsterdam.[13] From a more academic point of view, a book should be mentioned that appeared in the midst of the crisis[14]: 'Towards a New Framework for Financial Stability'. Many more instances can be cited. The De Larosière Report, on which this paper focuses, contains a number of suggestions that I would like to highlight.

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9 Letter of 1950, as quoted in *The New York Times* (29 March 1972) and *The New York Post* (28 November 1972).

10 US Treasury, 'Financial Regulatory Reform: a new foundation', 17 June 2009.

11 House of Lords, European Union Committee, 'The Future of EU financial regulation and supervision' – 14th Report of Session 2008-2009 Volume 1: Report, 17 June 2009.

12 'The Turner Review: a regulatory response to the global economic crisis', March 2009, (Hereafter: the 'Turner Review'.

13 De Moor-van Vugt, Perron and Krop, 'De bevoegdheden van de Nederlandsche Bank inzake Icesave', 11 June 2009, at http://www.minfin.nl/dsresource?objectid=71520&type=org (last accessed: 8.04.2010).

14 Mayes, 2009.

4. THE DE LAROSIÈRE REPORT: ISSUES

Single European rulebook

The De Larosière Report argues that a single European rulebook should be developed.[15] It should do away with national exemptions allowed under current EU directives in the area of financial regulation. I consider this an urgent need. On previous occasions I have argued for regulations as the preferred legal instrument for the adoption of supervisory norms in the finance industry.[16] However, whether this is legally possible under the EC Treaty or its successor treaty, the Treaty on the Functioning of the European Union (TFEU), is unclear. Many legal instruments in this area have been adopted under Article 44 EC (nowadays Article 50 TFEU[17]) which contains a competence to adopt directives. Only recourse to Article 95 EC, now Article 114 TFEU, allows the Union legislature to adopt measures, i.e. directives or regulations.[18] The use of the correct Treaty basis for adoption of legal instruments relating to the financial services industry has already been an issue under current Community prudential supervision legislation.

Colleges of supervisors

The De Larosière Report favours a continued development of colleges of supervisors.[19] Colleges seem to be embraced as a useful tool for supervision of groups spread over several jurisdictions, even though the experience with cross-border supervision during the crisis was dismal. The lack of coordination and cooperation among supervisors was keenly felt. The cases of Fortis and Dexia highlighted the difficulty even neighbouring Europeans sometimes have to agree on measures serving the public good. The Basle Committee on

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15 See the De Larosière Report paragraph 109, p. 29.

16 See Smits, 2005: 199-212.

17 See Article 50 (1) TFEU: "In order to attain freedom of establishment as regards a particular activity, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee, shall act by means of directives."

18 See Article 114 TFEU (*ex Article 95 TEC*): "1. Save where otherwise provided in the Treaties, the following provisions shall apply for the achievement of the objectives set out in Article 26 [internal market completion clause, rs]. The European Parliament and the Council shall, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee, adopt the measures [underlining added, rs] for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market." The term "measures" encompasses regulations, directives and decisions, as well, as, possibly, other legal acts of a *sui generis* nature.

19 See the De Larosière Report, p. 51.

Banking Supervision has recently issued for consultation draft principles for the operation of colleges of supervisors.[20] The European Union itself already adopted legislation providing more coherent rules concerning colleges of supervisors.[21]

There are competition and regulation concerns with the continued development of colleges of supervisors as proposed by De Larosière. First, there is the danger that each college will develop differently from its peers overseeing other cross-border firms, undermining effective supervision and a level playing field among larger financial institutions. Second, there is a risk of the continuation of a patchwork of supervisory standards: colleges consist of different authorities, reflecting national markets in which supervised institutions are active, with different ideas on how to act in the face of prudential concerns or when banks are in distress. Both previous elements seem to be acknowledged as an asset, rather than as a liability, for colleges in the above-mentioned consultative document of the Basle Committee on Banking Supervision. It considers that colleges should develop in accordance with the specifics of the banking group they oversee and in line with particularities of the supervisors.[22] Even though this may be a realistic rendering of the current state of affairs, such diversity may undermine the level playing field among larger banks operating on a cross-border basis within the internal market. A stronger solution with federal supervision seems the only remedy. Third, colleges lack decision-making powers; they merely engage in exchange of information and the comparison of best practices.[23] Fourthly, they may be

20 Basle Committee on Banking Supervision, 'Good Practice Principles on Supervisory Colleges', March 2010, available from: http://www.bis.org/publ/bcbs170.htm (last accessed: 6.04.2010).

21 See, notably, Article 131 a, of the Consolidated Banking Directive (2006/48/EC) inserted by Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management, OJ No. 302/97, 17.11.2009.

22 The accompanying Press Release to the Basle Committee on Banking Supervision, 'Good Practice Principles on Supervisory Colleges', 30 March 2010, states that: "(...) the principles (...) acknowledge that no single college structure is suitable for all banks and that a college might have multiple or variable sub-structures. Indeed, the structure of each college should be determined by the characteristics of the banking groups being considered as well as the particular supervisory needs".

23 Even the new rules adopted in Directive 2009/111/EC do not change this state of affairs.

unwieldy bodies consisting of representatives of a large number of interested supervisory authorities.[24]

Deposit Guarantee Schemes

On deposit guarantee schemes (DGS), the De Larosière Report does not contain far-reaching proposals.[25] It stops short of proposing burden sharing among Member States. Thus, 'passing the buck' will continue and nationalist tendencies will persist. Any move towards more host State competences to restrict deposit taking would not be in line with internal market principles. The amendments[26] to Directive 94/19/EC[27] are a bare minimum. They involve raising the minimum coverage of deposit guarantees from EUR 20,000 to EUR 50,000, and reducing the pay-out delay from 3 months to 20 days. The report drawn up, pursuant to Article 12 of the DGS Directive[28], introduced by Directive 2009/14/EC, indicated ways of harmonising funding.[29] I consider that we should go beyond that towards EU burden sharing and the same

24 See the testimony of Mr. Patrick Pearson before the House of Lords, 'The future of EU financial regulation and supervision' – 14th Report of Session 2008-2009 Volume II: Evidence, p. 106: 'There was a meeting of the ABN AMRO college three years ago set in Aruba or Curacao for obvious reasons, to be sure that everybody would come, and there were 76 people'.

25 See the De Larosière Report, p. 34-35.

26 See Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19/EC on deposit-guarantee schemes as regards the coverage level and the payout delay, OJ No. L 68/3.

27 Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes, OJ No. L 135/5.

28 Art 12 (1) of the DGS Directive (as amended by Directive 2009/14/EC) states: "1. The Commission shall submit to the European Parliament and to the Council by 31 December 2009 a report on: (a) the harmonisation of the funding mechanisms of deposit-guarantee schemes addressing, in particular, the effects of an absence of harmonisation in the event of a cross-border crisis, in regard to the availability of the compensation payouts of the deposit and in regard to fair competition, and the benefits and costs of such harmonisation; (b) the appropriateness and modalities of providing for full coverage for certain temporarily increased account balances; (c) possible models for introducing risk-based contributions; (d) the benefits and costs of a possible introduction of a Community deposit-guarantee scheme; (e) the impact of diverging legislations as regards set-off, where a depositor's credit is balanced against its debts, on the efficiency of the system and on possible distortions, taking into account cross-border winding-up; (f) the harmonisation of the scope of products and depositors covered, including the specific needs of small and medium enterprises and local authorities; (g) the link between deposit-guarantee schemes and alternative means for reimbursing depositors, such as emergency payout mechanisms. If necessary, the Commission shall put forward appropriate proposals to amend this Directive."

29 See European Commission Joint Research Centre, 'Possible models for risk-based contributions to EU Deposit Guarantee Schemes', June 2009: "the goal is to suggest common risk-based approaches that could be implemented, on a voluntary basis, by EU DGS".

conditions for drawing on DGS everywhere in the EU. Only such a step will prevent a recurrence of the element of the crisis which spoke to the imagination: depositors who were not familiar with the details of their protection under host or home State regimes, a scrambling for increased protection on a divergent basis by Member States and allotment of liability to home State funds after paying out under a host State scheme, as in the case of the Icelandic banks.

Bank resolution regimes and 'living wills'

Another issue discussed in the De Larosière Report concerns the bank resolution regime.[30] As the saying goes, banks operate internationally but come home to die. Thus, it is the parent company's or headquarters' national law which decides the manner in which a financial institution is wound up. Current EU rules provide for hardly any harmonisation, as they are largely confined to conflict-of-law rules and mutual recognition of each other's winding up procedures.[31] This falls short of a common bank resolution regime which I consider necessary for financial institutions operating in the internal market. This links in with the need for a common exclusive definition of credit institutions. The current patchwork of definitions allows for certain financial institutions to escape supervision in some Member States and for a misalignment of supervisory scope within the internal market, with prudential supervision extending further in some Member States than in others.[32] Agreement on the exact scope of prudential supervision in the internal market would also contribute to the effectiveness of common rules for resolution of the subjects of this supervision.[33]

Short of a joint mechanism to wind up financial institutions, the drawing up of 'living wills' is has now become high on the wish list of supervisory authorities. 'Living wills' are schemes under which a bank (or, wider, a financial institution) sets out which kind of measures it envisages to undertake in case of distress or dying: finding new capital, improving liquidity, unwinding transactions, winding-up subsidiaries, and ultimately winding up the parent

30 The lack of coherent, let alone uniform bank resolution regimes is touched upon in the De Larosière Report, paragraphs 125-143 on pages 32-37, as well as in paragraphs 104 (p. 27) and 204 (p. 52).

31 See Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the Reorganisation and Winding up of Credit Institutions, OJ No. L 125/15.

32 This issue is also addressed by the De Larosière Report, p. 28.

33 Recent academic writing on the issue of bank resolution in the EU includes Garcia et al (2009: 240-276).

company. 'Living wills' or resolution and recovery plans (RRPs) are considered a necessity for systemically important financial institutions (SIFIs). If it is only systematically important financial institutions which are required to draw up 'living wills', public perceptions of who is an SIFI and who is not may raise a moral hazard issue. There is a simple but expensive solution to this, suggested at a recent conference by Klaas Knot, Director, Financial Markets at the Dutch Ministry of Finance: applying the rules for winding up banks to all financial institutions and requiring all financial institutions to draw up RRPs.[34]

Transparency of corporate structures

Preceding the question of who is to draw up a 'living will' and what any RRP should contain, is the issue whether supervisors should continue to allow corporate structures that lack transparency. Many financial institutions operate with opaque company structures, often established to shift capital to low-tax jurisdictions and sometimes to make use of regulatory arbitrage. In some cases, clients of a bank do not even know which legal person they are dealing with; they might find out when the legal documentation concerning the deal they entered into arrives. Banks and other financial institutions should not use the corporate veil to shield their true identity. A reasonable use of corporate personality for tax and regulatory reasons should not allow financial institutions to keep their business beyond the reach of the public realm. They should thus be required to organize in transparent structures, certainly when they belong to the category of SIFIs. There is already legislation on the books which requires this. The post-BCCI Directive[35] amended the financial sector legislation with a requirement of transparency of corporate structure as a licensing condition. The Consolidated Banking Directive[36] states in its preamble (paragraph 60) that "The Member States should be able to refuse or withdraw banking

34 Klaas Knot, Keynote address at Conference 'Bank Crisis Resolution – "Living Wills"', 11 March 2010, Duisenberg School of Finance, Amsterdam.

35 European Parliament and Council Directive 95/26/EC of 29 June 1995 amending Directives 77/780/EEC and 89/646/EEC in the field of credit institutions, Directives 73/239/EEC and 92/49/EEC in the field of non-life insurance, Directives 79/267/EEC and 92/96/EEC in the field of life assurance, Directive 93/22/EEC in the field of investment firms and Directive 85/611/EEC in the field of undertakings for collective investment in transferable securities (UCITS), with a view to reinforcing prudential supervision, OJ No. L 168/7.

36 Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) ("Consolidated Banking Directive"), OJ No. L 177/1.

authorisation in the case of certain group structures considered inappropriate for carrying on banking activities, in particular because such structures could not be supervised effectively. In this respect the competent authorities should have the necessary powers to ensure the sound and prudent management of credit institutions." In its operative part, Article 22 of the Consolidated Banking Directive provides that home State authorities must require as an element of "robust governance arrangements" that the credit institution has "a clear organizational structure with well defined, transparent and consistent lines of responsibility".[37] So, there is currently applicable legislation that permits supervisors to require transparency and robust governance, two elements that seem to have been sorely lacking when banks had to be rescued or unwound. Such transparency will facilitate the drawing up of 'living wills'.[38]

Dichotomy between prudential supervision and monetary policy

One has to conclude that the De Larosière Report does nothing to alter the dichotomy between State-centred prudential supervision and federal decision-making with decentralised execution at national, i.e. State, level, in the area of monetary policy. This may be one of the major fault lines of EMU. Having a single currency and free movement of capital and payments but relying on State-based supervision has been identified as a trilemma in the past.[39]

5. THE EUROPEAN SYSTEMIC RISK BOARD

Proposal and general scheme

The De Larosière Report proposes the establishment of two new European bodies and the transformation of three committees operating under the Lamfalussy framework into full-fledged supervisory authorities.

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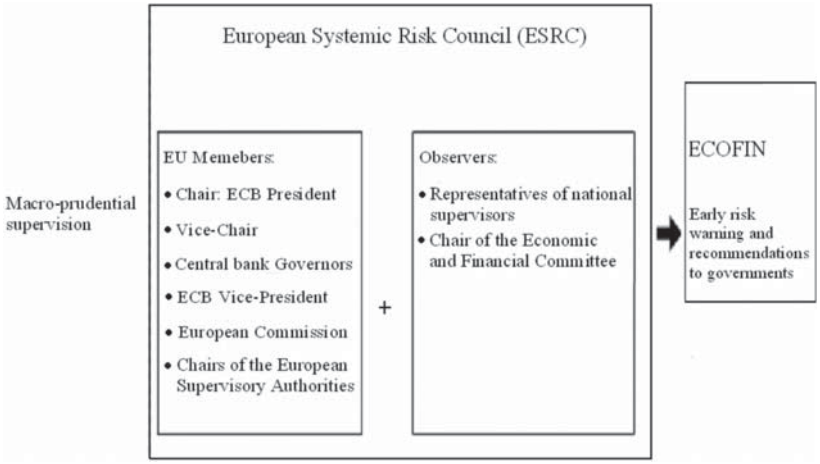
37 Article 22 of the Directive reads as follows: "Home Member State competent authorities shall require that every credit institution have robust governance arrangements, which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, and adequate internal control mechanisms, including sound administrative and accounting procedures. 2. The arrangements, processes and mechanisms referred to in paragraph 1 shall be comprehensive and proportionate to the nature, scale and complexity of the credit institution's activities. The technical criteria laid down in Annex V shall be taken into account."

38 For recent academic writing, see Avgouleas *et al.*, 2010 and Herring, 2010.

39 Schoenmaker, 2010.

The first new body is a European Systemic Risk Board.[40] This body is to oversee the systemic risk in the European financial system and report identified risks to the Ecofin Council. It would consist of the ECB President as Chair and a Vice Chair, of the Governors of the EU's national central banks, the ECB Vice President, a member of the European Commission and the Chairs of the European Supervisory Authorities. Representatives of national supervisors and the Chair of the Economic and Financial Committee[41] would be observers in the Board. The ESRB would replace the Banking Supervision Committee (BSC) of the ECB. This body "systematically monitors cyclical and structural developments in the euro-area/EU banking sector and in other financial sectors. It does so in order to identify any vulnerabilities and to check the resilience of the system".[42]

Figure 1



The De Larosière Report suggests including the national supervisors along with the NCB Governors whenever necessary. It states this as follows: "given the importance of having this group interact closely with those supervisors

40 Called a 'European Systemic Risk Council' in the text of the De Larosière Report, p. 44.

41 An auxiliary body on economic and financial affairs, governed by Article 134 TFEU.

42 See the ECB website, available at: http://www.ecb.int/ecb/orga/tasks/html/financial-stability.en.html (last accessed: 8.04.2010). It is the body which assists in the carrying out of the prudential supervision tasks of the ESCB.

who are not part of central banks, it should be clearly stated that whenever the subject discussed justifies a wider presence of insurance and securities supervisors (as well as banking supervisors for those countries where banking supervision is carried-out outside the central bank), it would be assured. In such cases, a Governor could choose to be represented by the Head of the appropriate national supervisory authority".[43] Thus, a group of officials coinciding with the ECB's General Council[44] plus additional members to represent national supervisors, would oversee systemic risks. Their macro-prudential function would be exercised in close coordination with national supervisors who should provide the ESRB with all the necessary information, ensuring a free flow of confidential information.[45]

Responsibilities

According to the Commission's proposal to establish the ESRB[46], the Board "shall be responsible for the macro-prudential oversight of the financial system within the Community in order to prevent or mitigate systemic risks within the financial system, so as to avoid episodes of widespread financial distress, contribute to a smooth functioning of the Internal Market and ensure a sustainable contribution of the financial sector to economic growth".[47] Beyond this objective, the Commission proposes that the ESRB will have a number of tasks ranging from collecting and analysing information about systemic risks, identifying and prioritising these risks, issuing warnings and recommendations and cooperating with other EU and international bodies in this field.[48]

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43 See the De Larosière Report, paragraph 179, p. 44.

44 The temporary third decision-making body of the ESCB consisting of the President and Vice-President of the ECB plus all NCB Governors, see Article 141 TFEU: "1. If and as long as there are Member States with a derogation, and without prejudice to Article 129(1), the General Council of the European Central Bank referred to in Article 44 of the Statute of the ESCB and of the ECB shall be constituted as a third decision-making body of the European Central Bank."; see also Art 45 ESCB statute.

45 See the De Larosière Report, paragraph 180, p. 45.

46 Proposal for a Regulation of the European Parliament and of the Council on Community macro prudential oversight of the financial system and establishing a European Systemic Risk Board, Document COM(2009) 499 final, 23.9.2009 (Hereafter: 'Proposal for a European Systemic Risk Board').

47 Article 3 (1) of the Proposal for a European Systemic Risk Board.

48 Article 3 (2) of the Proposal for a European Systemic Risk Board mentions these tasks as follows:
"(a) Determine and/or collect, as appropriate, and analyse all the information relevant for the mission described in paragraph 1; (b) identify and prioritise such risks; (c) issue warnings where risks are deemed to be significant;

Structure

Following the De Larosière Report, the Commission proposes that the structure of the ESRB is as follows. The General Board consists of the President and Vice President of the ECB, the Governors of the NCBs, a member of the Commission and the chairpersons of the European Supervisory Authorities (ESAs) discussed below. As non-voting members, the proposal includes "one high level representative per Member State of the competent national supervisory authorities" and the President of the Economic and Financial Committee. As indicated above, the non-voting members from national supervisory authorities may be rotating according to the subject matter under discussion.[49]

Besides the General Board, a smaller Steering Committee of 12 persons will operate to prepare Board meetings, review documents to be discussed and monitor progress in the Board's work.[50] The Secretariat "shall provide analytical, statistical, administrative and logistical support to the ESRB under the direction of the Chair of the General Board in accordance with [the proposed Council Decision pursuant to Article 127 (6) TFEU]".[51] The idea is that the ECB will perform this secretarial function. To that end, the Commission proposed a legal act pursuant to Article 105 (6) EC, currently Article 127 (6) TFEU. This brings us to the proposed legal instrument in respect of the ECB.

(d) issue recommendations for remedial action where appropriate; (e) monitor the follow-up to warnings and recommendations; (f) cooperate closely with the European System of Financial Supervisors and, where appropriate, provide the European Supervisory Authorities with the information on systemic risks required for the achievement of their tasks; (g) coordinate with international institutions, particularly the International Monetary Fund and the Financial Stability Board as well as the relevant bodies in third countries on matters related to macro-prudential oversight; (h) carry out other related tasks as specified in Community legislation."

49 The Explanatory Memorandum to the proposed Regulation establishing the ESRB p. 7, states: "The representative of the national supervisory authorities may rotate depending on the matters that are being discussed (this rotation will be needed in a large number of Member States, where there are different bodies for supervising for instance the financial and the insurance sector)." See, also, Article 6 (3) which provides as follows: "When the agenda of a meeting contains points pertaining to the competence of several national supervisory authorities in the same Member State, the respective high level representative shall only participate in the discussion on items falling under his or her competence."

50 Article 4 (2) of the Proposal for a European Systemic Risk Board.

51 Article 4 (4) of the Proposal for a European Systemic Risk Board.

Legal issues: independence of the ECB

The Commission proposes a legal act to be adopted by the Council which provides that the President and Vice president of the ECB shall be members of the General Board of the ESRB and that the ECB shall provide for the Secretariat to this new Board. The ECB is to "ensure sufficient human and financial resources for the fulfilment of its task of ensuring the Secretariat" and the Chair of the General Board of the ESRB is to "give directions to the Head of the Secretariat on behalf of the ESRB".[52] Before turning to the more fundamental question of the use of Article 105 (5) and (6) EC, or its replacements under the TFEU, I will discuss the issue of the independence of the European Central Bank which is being directed as Secretariat by the Chair of the General Board of the ESRB. This seems an issue in view of the strongly worded independence provisions in respect of the ESCB. Upon closer scrutiny, however, this is not the case as the chair of the General Board will be one of the members of the General Council of the ECB.[53] Article 5 of the proposed Regulation establishing the ESRB specifies the election of the Chair and Vice Chair of the Board for five years from among members of the General Council of the ECB. [54] Thus, in plain English, an independent member of the third decision-making body of the ECB, will instruct the ECB. The only legal question that may arise is whether this state of affairs would undermine the normal hierarchy provided by the Treaty and the ESCB Statute when macro-prudential matters are concerned. Also, in view of the casting vote of the Chair of the General Board and his or her role in representing the ESRB externally, one may question the wisdom of this arrangement, assuming

52 Articles 1-4 of the Proposal for a Council Decision entrusting the European Central Bank with specific tasks concerning the functioning of the European Systemic Risk Board, Document COM(2009) 500 final, 23.9.2009.

53 There are three decision-making bodies of the ECB, the Governing Council, consisting of the Executive Board plus the Governors of the NCBs of the Member States which have adopted the euro; the Executive Board, consisting of the President, the Vice-President plus 4 other members appointed at European level and the General Council. This latter body represents the entire union and not the euro area, as is the case with the Governing Council and Executive Board. Its members are the President and the Vice-President of the ECB plus the Governors of all 27 NCBs. The responsibilities of the General Council are to perform the tasks originally entrusted to the ECB's predecessor, the European Monetary Institute, for the preparation of the introduction of the single currency in the States that have not yet adopted it and the contribution to other ESCB tasks. See Article 141 TFEU (quoted in footnote 44 above) and Articles 44 – 46 ESCB Statute.

54 See the Explanatory Memorandum to the proposed Regulation establishing the ESRB, p. 8, which states: "The Chair will be elected for 5 years from among the Members of the General Board of the ESRB which are also Members of the General Council of the ECB. The Chair will preside the General Board as well as the Steering Committee and instruct the Secretariat of the ESRB on behalf of the General Board."

that the President of the ECB and the President of the ESRB will not be the same person. This may lead to confusion in the outside world as to their respective roles.

Legal issues: use of enabling provision

Turning now to the issue of the use of the enabling provision inserted in Maastricht, the following can be said. The ESCB's tasks in the area of prudential supervision have not been neatly delineated. Reading the original Article 105 (5) and (6) EC shows the convoluted nature of the text.[55] The same holds for their new equivalents after the entry into force of the Lisbon Treaty.[56] Note that the procedure for adopting a legal act entrusting the ECB with special competences has been changed with a lesser role for the European Parliament. At the same time, the exception for insurance undertakings, originally inserted at the behest of the Dutch, has been maintained as an anachronism.[57] I consider that the exception does not eliminate the attribution to the ECB of executive powers in respect of financial conglomerates, including insurance companies.

The Treaty allows the Council to make the ECB competent to exercise executive functions, so that use of this provision would, in principle, not be objectionable. As far as legitimacy is concerned, the provision requires unanimity in the Council and requires the assent of the European Parliament, although the Treaty of Lisbon has altered the latter's role to that of mere consultation. In respect of the ESRB, it should be noted that executive

55 Articles 105 (5) and (6) EC read as follows: "5. The ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system. 6. The Council may, acting unanimously on a proposal from the Commission and after consulting the ECB and after receiving the assent of the European Parliament, confer upon the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings."

56 Article 127 (5) and (6) TFEU read as follows: "Article 127 (5) and (6) TFEU 5. The ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system. 6. The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings."

57 One should know that this exception was apparently motivated by the reluctance of the Dutch to see central banks assuming too wide powers, stretching into the area of insurance. These same Dutch later amalgamated the Dutch central bank with the Dutch insurance supervisor, undermining any reason for maintenance of this exception.

powers can only be attributed in respect of "prudential supervision"; there is no addition of "and the stability of the financial system", as there is in paragraph 5. This makes the use of this provision to attribute powers to the ECB less self-evident. The fact that the ESRB will have wider functions than the General Council of the ECB doesn't seem to pose a problem as the Treaty specifically provides for a widening of powers by secondary legislation. In conclusion, adopting the proposed decision on the basis of Article 127 (6) TFEU seems legally justified.

Legal issues: Article 95 EC (Article 114 TFEU) as a legal basis

The issue whether the proposal for the establishment of the ESRB can be based on Article 114 TFEU is not discussed separately as I deal with this issue later on in the context of the ESFS. Similar concerns can be expressed in respect of the establishment of a Board which is to oversee systemic risk in the internal market. Even though the ESRB is not endowed with decision-making competences as the ESAs, its role seems to go beyond the rather restrictive reading of Article 95 EC for it to be based on that provision or, rather, its successor in the TFEU.

Further independence and governance issues

Apart from the issue of the ECB as Secretariat of the new Board receiving instructions directly from the Chair of the General Board, there is a question of the collegial nature of the Governing Council, the Executive Board and the General Council. There may seem to be an issue when certain members of these collegial bodies are called upon to perform specific tasks. I would not count that as a true legal problem since the President and Vice-President of the ECB already perform special functions under the ESCB Statute, such as their membership of the General Council and, now, the ESRB.

Also slightly awkward are the rules on independence. The proposed provision on impartiality of the ESRB members only concerns their independence from Member States.[58] For the ECB President and Vice President, and for the NCB Governors, more is required: they are to act

58 See the following draft provision: "Article 7 (*Impartiality*) 1. When participating in the activities of the General Board and of the Steering Committee or when conducting any other activity relating to the ESRB, the Members of the ESRB shall perform their duties impartially and shall neither seek nor take instructions from Member States. 2. Member States shall not seek to influence the members of the ESRB in the performance of their ESRB tasks."

independently from *Community* bodies and organs, as well.[59] At the very least, the proposed provision on impartiality is a confusing clause considering the composition of the ESRB.

Finally, the confidentiality clause[60] and the provision for exchange of information[61] do not seem to be in line with directives on prudential supervision of the financial system. The Commission has sought to provide for exchange of information on the basis of an Omnibus Directive amending other financial sector directives.[62] Whether this draft directive fills the lacunae of the current patchwork of rules and roadblocks in respect of exchange of supervisory information among competent authorities and with central banks, providing a uniform regime, remains to be seen and is outside the scope of this already too lengthy article. The compatibility of confidentiality provisions and rules on exchange of information amongst the various directives in the area of financial supervision requires a separate publication.

Criticism – beyond the legal aspects

After looking into the legal aspects, it should be acknowledged that the Board can hardly be expected to be operating as "an effective early warning mechanism", to quote the De Larosière Report. Its composition of 27 fixed members and 27 flex-members (the rotating heads of national supervisory agencies from the insurance, securities and banking sphere) plus 7 fixed other members (i.e., 61 in total, in shifting composition[63]) is not conducive to efficient decision-making on advisory functions, let alone to agreeing actions. Moreover, this unwieldy body is to report to the Ecofin Council, itself consisting of 27 Ministers of Finance with their own agendas often

59 See Article 130 TFEU and Article 7 ESCB Statute.

60 Article 8 of the Proposal for a European Systemic Risk Board.

61 Article 15 of the Proposal for a European Systemic Risk Board.

62 Proposal for a Directive of the European Parliament and of the Council Amending Directives 1998/26/EC, 2002/87/EC, 2003/6/EC, 2003/41/EC, 2003/71/EC, 2004/39/EC, 2004/109/EC, 2005/60/EC, 2006/48/EC, 2006/49/EC, and 2009/65/EC in respect of the powers of the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority, Document COM(2009) 576 final, 26.10.2009. See the ECB Opinion of 18 March 2010 on this proposal: (CON/2010/23), OJ No. C 87/1, 1.4.2010.

63 This is confirmed by the Explanatory Memorandum to the proposed Regulation establishing the ESRB which, on p. 8, explains the introduction of a Steering Committee referring to the number of persons on the Board.

lacking in coherence and decisiveness. The ESRB does not fill the vacuum in which no EU competences exist to act for the single market or the euro area. It is the absence of this federal competence to monitor, warn and take decisive action that should be remedied. Changing the composition and sharpening the tasks of an existing body is not the answer to the problem the crisis highlighted in this respect. Moreover, even though increased cooperation at the EU level with a focus on macro-prudential supervision will probably lead to more joint analysis and action, the national focus of most of its members and the lack of communications will not be remedied by the formation of yet another 'club'.

6. EUROPEAN SYSTEM OF FINANCIAL SUPERVISORS

ESFS and ESAs

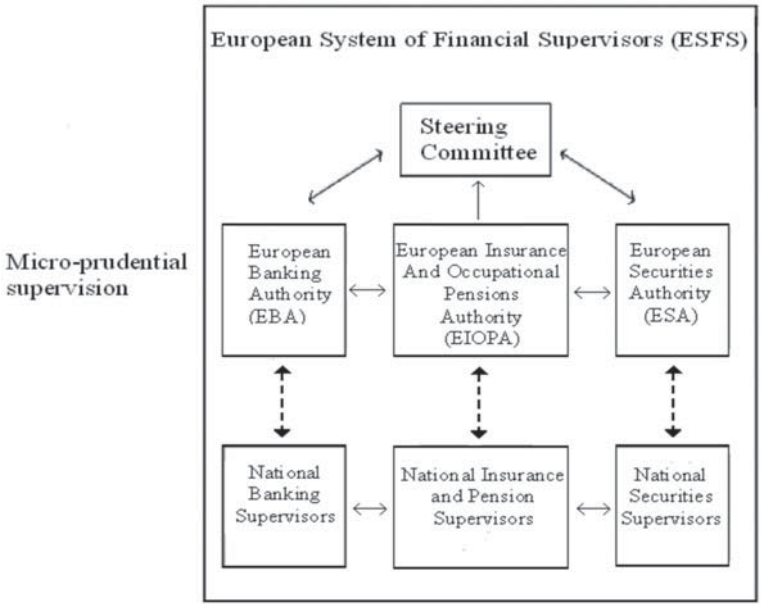
The second major innovation proposed by the De Larosière Report is the establishment of a European System of Financial Supervisors, a network consisting of three European Supervisory Agencies (ESAs).

The best way to describe the ESFS seems to be on the basis of the Commission's proposals for the establishment of one of the ESAs, even though we know that these have been amended in the Council and that the end result may look quite different from what the documents describe in the public domain. It is a deplorable state of European legislation that even after the Lisbon Treaty, interested outsiders cannot gain knowledge of the most recent versions of legal documents that are being discussed and adopted.[64] I will describe the proposal for the establishment of the European Banking Authority (EBA).[65] This description also largely fits the other two authorities, the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA).

64 An exception is made for the amendments proposed by the European Parliament which can be accessed. See Legislative Observatory, available at: http://www.europarl.europa.eu/oeil/file.jsp?id=5804632 (last accessed: 8.04.2010).

65 See Proposal for a Regulation of the European Parliament and of the Council establishing a European Banking Authority, Document COM(2009) 501 final (Hereafter: 'Proposal for a European Banking Authority'), at http://ec.europa.eu/internal_market/finances/committees/index_en.htm (last accessed: 8.04.2010).

Figure 2



The European Banking Authority: structure

The Authority would be a Community body with legal personality, unlike its Lamfalussy predecessor, the Committee of European Banking Supervisors[66], which is itself a recent (2009) innovation on the European Banking Committee established in 2003[67] under the Lamfalussy arrangements. These arrangements, named after the chairman of the committee charged with exploring better supervisory arrangements with a speedier adaptation to market developments, consisted in four levels of action: (1) establishing Community-wide basic norms for the financial services industry in EC legislation adopted by the Council and the European Parliament in co-decision (2) further detailed rules adopted by the Commission (3) agreed implementation by the supervisors and (4) enhanced surveillance by the Commission of the national implementation of the directives. Both these committees were mere advisory organs without separate legal personality.

66 Established by Commission Decision 2009/78/EC of 23 January 2009, OJ No. L 25/23 29.1.2009.

67 Commission Decision 2004/5/EC of 5 November 2003 establishing the European Banking Committee, OJ No. L 3/36, 7.1.2004.

The EBA's highest organ would be a Board of Supervisors on which a permanent[68] Chairperson would sit together with the heads of supervision for credit institutions at national level. The Chairperson would not have a vote. The Board of Supervisors would have other non-voting members: one representative of the Commission, one from the ECB, one from the ESRB and one of each of the other two ESAs. This Board is to guide the work of the EBA and to take the major decisions entrusted to it. The Board of Supervisors is to decide on the basis of qualified majority voting (QMV) on the technical standards and guidelines and recommendations that the EBA is to adopt, as well as on its finances.[69]

The EBA would also have a Management Board, "composed of the Chairperson, a representative of the Commission, and four members elected by the Board of Supervisors from among its members". Its main task would be managerial, as its name suggests: employing staff, preparing annual work programmes and annual reports, and preparing Board meetings.[70]

The Chairperson is to be responsible for preparing the work of the Board of Supervisors and chairs the meetings of the Board of Supervisors and the Management Board. The candidate "appointed by the Board of Supervisors on the basis of merit, skills, knowledge of financial institutions and markets, and experience relevant to financial supervision and regulation, following an open selection procedure" is subject to a confirmation hearing before the European Parliament. This puts him/her in the same position as Commissioners-elect and members of the Executive Board of the ECB. His or her independence is assured because removal may only take place by decision of the Board of Supervisors subject to confirmation by the European Parliament.[71] Another full-time professional, the Executive Director, is to implement the work programme and prepare the work of the Management Board.[72]

Finally, mention should be made of the extensive provisions ensuring there is judicial review of decisions of the EBA, and of its fellow ESAs. To this end, a Board of Appeal is established as a joint body of the EBA, the EIOPA and the

68 See Article 33 of the Proposal for a European Banking Authority.

69 See Articles 25-29 of the Proposal for a European Banking Authority.

70 See Articles 30-32 of the Proposal for a European Banking Authority.

71 See Articles 33-35 of the Proposal for a European Banking Authority.

72 See Articles 36-38 of the Proposal for a European Banking Authority.

ESMA. The guarantees for its composition as functioning as an independent tribunal are wide-ranging. They include the appointment procedure[73], their tenure[74] and the disclosure of their interests and commitments.[75] The Board of Appeal decides cases against decisions by the ESAs within two months of their lodging (!). Further appeal lies with the General Court which may also be accessed to contest decisions of the ESAs if no appeal lies with the Board of Appeal.[76]

The European Banking Authority: responsibilities

The EBA, thus made up organizationally, will be entrusted with tasks the scope of which is breathtaking. The EBA is "to contribute to the establishment of high quality common regulatory and supervisory standards and practices", as well as "to a consistent application of Community legislation". In this context, the EBA will be "preventing regulatory arbitrage, mediating and settling disagreements between competent authorities, promoting a coherent functioning of colleges of supervisors and taking actions in emergency situations". Furthermore, the EBA is "to facilitate the delegation of tasks and responsibilities between competent authorities" and to cooperate closely with the ESRB. It must both feed the ESRB with information on the basis of which it can assess systemic risk, and to ensure a proper follow-up to its warnings and recommendations. The EBA is to conduct peer review analysis of competent authorities and to strengthen consistency in supervisory outcomes. It has to

73 The members are appointed "by the Management Board of the Authority from a short-list proposed by the Commission, following a public call for expression of interest published in the Official Journal of the European Union, and after consultation of the Board of Supervisors"; Article 44 (3) of the Proposal for a European Banking Authority.

74 Their term of office is five years, which may be extended once. There is a single reason for dismissal, namely serious misconduct. This arrangement contrasts with the guarantees for members of the ECB's Executive Board, who may be dismissed for serious misconduct and when they no longer fulfil the conditions required for the performance of their duties (Article 11.4 of the ESCB Statute). Another striking difference is that the members of the Board of Appeal may be dismissed by the Management Board after consulting the Board of Supervisors whereas the ECB Board members can only be 'compulsorily retired' by the European Court of Justice on an application by the Governing Council or the Executive Board of the ECB.

75 Members of the Board of Appeals are to "make a declaration of commitments and a declaration of interests indicating either the absence of any interest which may be considered prejudicial to their independence or any direct or indirect interest which might be considered prejudicial to their independence" and have to do so publically, annually, and in writing.

76 See Articles 44-47 of the Proposal for a European Banking Authority.

monitor and assess market developments. Finally, it may fulfill any other tasks specifically given to it.[77]

With such an organizational set-up and such wide-ranging tasks one can only be somewhat disappointed by the description of the EBA's powers. Largely, they are of a harmonizing nature. The ECB is competent to develop draft technical standards for endorsement by the Commission, to issue guidelines and recommendations to the supervisory authorities and to individual financial institutions and to take individual decisions addressed to competent authorities in the specific cases referred to in Articles 10 and 11. These concern action in emergency situations (Article 10) and the settlement of disagreements between competent authorities (Article 11), respectively. Finally, the EBA may issue opinions to the European Parliament, the Council and the Commission and execute any exclusive supervisory powers over entities with Community-wide reach or economic activities with Community-wide reach entrusted to it.[78] I will focus the discussion on the adoption of technical standards and the role of the EBA in the coordination of consistent application of EU rules pertaining to the financial sector. I will not go into the EBA's roles in respect of peer reviews of supervisors and stress testing of banks, or in its international relations.[79]

Technical standards (Article 7)

After appropriate public consultations[80], the EBA is to adopt draft technical standards acting on the basis of a qualified majority of the members of the Boards of Supervisors[81], as defined in Article 205 of the Treaty. The latter reference should now be read as referring to Article 3 (3) of Protocol No. 36 on transitional provisions attached to the Lisbon Treaty. Article 3 (3)

77 See Article 6 (1) of the Proposal for a European Banking Authority.

78 See Article 6 (2) and (3) of the Proposal for a European Banking Authority. As an additional power, the EBA has "appropriate powers of investigation and enforcement as specified in the relevant legislation, as well as the possibility of charging fees" according to the last sentence of Article 6 of the Commission's proposal.

79 See Articles 15, 17 and 18 of the Proposal for a European Banking Authority.

80 Which include the consultation of a Banking Stakeholder Group, proposed by the Commission in Article 2 of its proposed legal instrument. The European Parliament proposed amendments to strengthen its role; see Articles 7(1) and (8)(1)(*a*), at: http://www.europarl.europa.eu/sides/getDoc.do?type=COMPARL&mode=XML&language=EN&reference=PE438.408 (last accessed: 8.04.2010).

81 Article 29 (1) of the Proposal for a European Banking Authority.

provides that, until 31 October 2014, the old weighing of votes applicable under the EC Treaty will continue to apply. The new voting arrangements set out in Article 16 (4) TEU and in Article 238 (2) TFEU, based on the three conditions of 55% of the votes of the Council members, comprising at least 15 members, and representing 65% of the Union's population, will be applied only after the aforementioned date[82]. As the Explanatory Memorandum to the proposal to establish the EBA makes clear, "The Community legal order requires the Commission to subsequently endorse these draft standards in the form of regulations or decisions so as to give those direct legal effects." The proposal specifies that the Commission is to do so within 3 months. The European Parliament has proposed that technical standards be adopted by the Commission if the Parliament and the Council do not object to them.[83]

Guidelines and recommendations (Article 8)

The EBA must issue guidelines and recommendations to supervisory authorities or to financial institutions. This should be done "with a view to establishing consistent, efficient and effective supervisory practices within the ESFS, and to ensuring the common, uniform and consistent application of Community legislation". The language is clear: consistency, effectiveness, efficiency and uniformity are drummed in. National supervisory authorities must "make every effort to comply" and, if they feel they cannot do so, explain why not.[84] Thus, the comply or explain principle is introduced in the functioning of national prudential supervisors. This is a major step from the current situation in which authorities are expected to align themselves with one another through the practice of cooperation and gentle persuasion. Note, also, that non-compliance has to be reasoned. However, the proposals even go two steps further.

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82 See Art 238 TFEU. These rules are altered in the following situations. Where the proposal is not Commission-initiated: A 'qualified majority' is then defined as at least 72% of the members of the Council, representing Member States comprising at least 65% of the population of the Union. Also, in the situation where not all Members of the Council vote, a 'qualified majority' shall be defined as at least 55% of the members of the Council representing the participating Member States, comprising at least 65% of the population of these States.

83 See Articles 7a-7d proposed by the European Parliament, at: http://www.europarl.europa.eu/sides/getDoc.do?type=COMPARL&mode=XML&language=EN&reference=PE438.408 (last accessed: 8.04.2010).

84 Article 8 of the Proposal for a European Banking Authority "(...) The competent authorities shall make every effort to comply with those [general, rs] guidelines and recommendations. Where the competent authority does not apply those guidelines or recommendations it shall inform the Authority of its reasons."

Enforcing consistency (Article 9)

Normally, consistency should be achieved by the comply or explain principle. In particular when EU legislation provides that financial institutions need to satisfy certain conditions, the EBA can investigate and correct "the incorrect application of Community law". Within two months of having started an investigation, the EBA may "address to the competent authority concerned a recommendation setting out the action necessary to comply with Community law". The national authority is to reply within ten working days, specifying "the steps it has taken or intends to take to ensure compliance with Community law". If the national authority persists in its wayward behaviour, the Commission comes into action. When a month has passed since the EBA's recommendation and there is still no compliance, the Commission may "take a decision requiring the competent authority to take the action necessary to comply with Community law". Again, a time-limit is included in the procedure: the Commission is to act within three, at the most four, months from the adoption of the EBA's recommendation. If this also fails to correct matters (the national authority again has ten working days in which to comply), competence shifts to the Authority again.[85] The EBA may "adopt an individual decision addressed to a financial institution requiring the necessary action to comply with its obligations under Community law including the cessation of any practice". This is dependent upon (a) the direct application of the relevant Community norm[86] and (b) a necessity test[87] related to (c) either "maintain[ing] or restor[ing] neutral conditions of competition in the market" or "ensur[ing] the orderly functioning and integrity of the financial system".[88] The EBA acts in line with the previous decision of the Commission[89], thus ensuring that discretionary decisions are taken only by organs foreseen in the Treaty, a legal issue which I will discuss later on. The system thus is one of

85 The Commission may take the Member State to court pursuant to Article 258 TFEU, the former Article 226 EC.

86 See Article 9 (6) of the Proposal for a European Banking Authority: "where the relevant requirements of the legislation referred to in Article 1(2) are directly applicable to financial institutions".

87 See Article 9 (6) of the Proposal for a European Banking Authority: it should be "necessary to remedy in a timely manner the non compliance by the competent authority".

88 Article 9 (6) of the Proposal for a European Banking Authority.

89 "The decision of the Authority shall be in conformity with the decision adopted by the Commission pursuant to paragraph 4"; Article 9 (6) *in fine* of the Proposal for a European Banking Authority.

acting through the national authority but, if that does not help, sidestepping it and addressing the financial institution itself.

Emergency situations (Article 10)

The coordination mechanism described above applies in normal situations. In emergency situations, the proposal goes further and allows the EBA to address financial institutions more swiftly. The condition precedent for this is that the Commission, the Council or the ESRB determine that an emergency situation exists. This can be done "(i) n the case of adverse developments which may seriously jeopardise the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the Community". Then, the EBA may address a decision to a national authority requiring it to take action "to address any risks that may jeopardise the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system by ensuring that financial institutions and competent authorities satisfy the requirements laid down in that legislation". Should the national authority fail to abide by this decision within the time period that the EBA prescribed, the EBA may "adopt an individual decision addressed to a financial institution requiring the necessary action to comply with its obligations under that legislation, including the cessation of any practice", again on the condition that the relevant rules are directly applicable.

In both normal and emergency situations, decisions by the EBA prevail over "any previous decision adopted by the competent authorities on the same matter".[90]

The Explanatory Memorandum to the proposal to establish the EBA specifies the reason why it is the Union's executive which should determine whether an emergency situation exists: "The determination of a cross-border emergency situation involves a degree of appreciation, and should therefore be left to the European Commission."

Conciliation among supervisors (Article 11)

The EBA is to act as conciliator among supervisory authorities when one national supervisor invokes its assistance in respect of a disagreement with another supervisory authority "on the procedure or content of an action or inaction by another competent authority" in an area where Community

90 Articles 9 (7) and 10 (4) of the Proposal for a European Banking Authority.

legislation "requires cooperation, coordination or joint decision making by competent authorities from more than one Member State". If the authorities concerned have not settled their dispute within the timeframe set by the EBA, the EBA may "require[e] them to take specific action or to refrain from action in order to settle the matter, in compliance with Community law." If the national supervisor holds out and does not comply with the EBA's directions, the EBA has the power to "adopt an individual decision addressed to a financial institution requiring the necessary action to comply with its obligations under Community law, including the cessation of any practice", of course assuming the direct applicability of the provisions of Community law in question. The competence given in Article 11 is without prejudice to the wider coordination powers given in Article 16. The latter provision gives the EBA a general role for the promotion of a coordinated Community response, *inter alia* by facilitating exchange of information between supervisors, "determining the scope and verifying the reliability of information that should be made available to all competent authorities concerned", acting as mediator and "notifying the ESRB of any potential emergency situations without delay".

Fiscal responsibilities of Member States intact (Article 23)

The application of the EBA's powers in respect of emergency decisions or the settlement of disputes among supervisors is subject to a clause safeguarding States' fiscal autonomy. The EBA itself is instructed to ensure that its decisions do not "impinge (...) in any way on the fiscal responsibilities of Member States". In plain English: the EBA cannot instruct a supervisor to bail out a bank or otherwise engage in actions which have budgetary consequences. A Member State may contest a decision taken under Article 10 (emergency decisions) or 11 (settlement of disagreements) as impinging on its fiscal responsibility. Doing so, it "shall justify why and clearly demonstrate how the decision impinges on its fiscal responsibilities". The subsequent procedure differs according to whether the EBA acted in an emergency or in the 'normal' settlement of disputes.

In the latter case (conciliation under 'normal' circumstances), the Member State has one month after the notification of the EBA's decision to the national authority to inform the EBA and the Commission that the national authority will not implement the EBA's decision. This suspends the decision of the EBA. The EBA then has one month within which it informs the

Member State whether it maintains, amends, or revokes its decision. If the EBA maintains its decision, the Ecofin Council decides the issue by QMV within 2 months. If the Council maintains the decision of the EBA or does not act within the 2 months period, the EBA's decision becomes effective again as the suspension is terminated.

In the former case, i.e. in emergency situations, when a Member State notifies the EBA, the Commission and the Council of the supervisor's decision not to implement the EBA's decision, it has to do so within three working days of the notification by the EBA of its decision to the supervisory authority. It is then upon the Council to decide the matter by QMV, within another ten working days. If the Council does not revoke the decision, or maintain it, within this period, the EBA's decision shall be deemed to be maintained. There is no suspension of the decision in the meantime, presumably because the time frame for a final decision is so short.

Further EBA powers

In the area of merger control, the EBA is competent to issue and publish opinions on prudential assessments of mergers and acquisitions which are covered by the post-Antonveneta Directive. This Directive[91] contains procedural rules and evaluation criteria for the prudential assessment of acquisitions and increases of holdings in the financial sector. It provides a precise framework within which prudential supervisors may exercise their discretion to block such acquisitions on prudential grounds. It was adopted in the wake of the take-over battles for Italian banks, notably ABN AMRO's takeover of Banco Antonveneta in which the Governor of the Banca d'Italia was seen to act on nationalist and protectionist grounds. The proposed legal instrument establishing the EBA does nothing to diminish the prudential carve-out contained in Article 21 (4) of the Merger Control Regulation.[92] This carve-out is still applicable. My preference would have been to restrict a national option to rely on non-merger grounds to block an acquisition and to introduce a Union ground to do so, to be exercised by the EBA. The

91 Directive 2007/44/EC of the European Parliament and of the Council of 5 September 2007 amending Council Directive 92/49/EEC and Directives 2002/83/EC, 2004/39/EC, 2005/68/EC and 2006/48/EC as regards procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase of holdings in the financial sector, OJ No. L 247/1, 21.9.2007.

92 Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation), OJ No. L 24/1, 29.01.2004.

proposed situation falls short of this as it only gives the EBA a role in ensuring compliance with Directive 2007/44/EC.

Independence of the EBA

The relevant provisions of the proposal to establish the EBA contain wide-ranging guarantees for the independent exercise of its functions.[93]

EBA: other issues

The EBA's budget is to be funded by national supervisory agencies' contributions, by the EU budget and by fees to be levied pursuant to specific Community legislation. The relevant provision does not say so, but the Explanatory Memorandum does specify that these fees are to be "paid by the industry".[94]

It is remarkable that there is no exclusion of supervisory liability[95] whereas several supervisory authorities at the national level do profit from such exemptions.[96] The EBA's seat would be London.[97]

ESFS as a network of supervisors

The EBA is to operate in a network of supervisors together with EIOPA, ESMA, the Joint Committee of European Supervisory Authorities, and the

93 See, notably, Articles 27, 31 and 34, 35, 37 and 45 of the Proposal for a European Banking Authority. The language used is very close to that pertaining to the ESCB, i.e. Article 130 TFEU and Article 7 ESCB Statute. The language in relation to the Chairperson and the voting members of the Board of Supervisors is as follows: "When carrying out the tasks conferred upon it by this Regulation, the Chairperson and the voting members of the Board of Supervisors shall act independently and objectively in the Community interest and shall neither seek nor take instructions from Community institutions or bodies, from a Government of a Member State or from any other public or private body." Similar language is found in Articles 31, 34 and 37 concerning the independence of the Chairperson and of the Executive Director, respectively.

94 Compare Article 48 (1) (*c*) and paragraph 6.4 of the Explanatory Memorandum.

95 See Article 55 of the Proposal for a European Banking Authority, which reads as follows: "In the case of non-contractual liability, the Authority shall, in accordance with the general principles common to the laws of the Member States, make good any damage caused by it or by its staff in the performance of their duties. The Court of Justice shall have jurisdiction in any dispute over the remedying of such damage".

96 In several Member States, there is a statutory exemption from any liability or for most cases of civil liability in respect of the supervision of the financial system. In the UK, the exempting legal provision is section 19 (1) of the Financial Services and Markets Act: "Neither the Authority nor any person who is, or is acting as, a member, officer or member of staff of the Authority is to be liable in damages for anything done or omitted in the discharge, or purported discharge, of the Authority's functions." The equivalent legal provision in Germany is section 4 (4) of the '*Finanzdienstleistungsaufsichtsgesetz*' (Act on the supervision of the provision of financial services). The equivalent in Belgium is section 68 of the '*Wet betreffende het toezicht op de financiële sector en de financiële diensten*' (concerning the supervision of the financial sector and financial services).

97 See Article 5 of the Proposal for a European Banking Authority.

national competent authorities, plus – for the purpose *of its tasks pursuant to Articles 7 (Technical standards), 9 (Consistent application of Community rules*) and 10 (*Action in emergency situations*), the Commission. Such a network also consists in the area of competition law enforcement but, there, action is case-specific, not institution-specific, and cases are allocated to the federal or national level, and among the latter, on the basis of the 'attachment' of the case to a jurisdiction.[98] The peer reviews foreseen in this network concerning the financial sector are intrusive and far-reaching. They concern the adequacy of institutional arrangements within Member States, including resources and staff expertise, the degree of convergence and compliance with Community objectives[99] and the exemplifying nature of good practices from some authorities which others might benefit from adopting. In the ESFS, the EBA is to reach joint positions with EIOPA and ESMA "as appropriate".[100]

Criticism – before the legal aspects

Even though the ESAs are instructed to reach joint positions, the proposed structure for the ESFS continues the sector segmentation of supervision in Europe which is not in line with the organisation of the financial services industry. This is a first fault line that I find with the De Larosière Report and the follow-up. A truly effective organisation of supervision should enable a supervisor over the entire sector to exercise surveillance over the industry, in close collaboration with the central banks.

This latter point brings to the fore the discussion on the proper place of prudential supervision. This can be with the central bank, as in Italy, Spain, Portugal, Greece and, to a certain extent in the Netherlands, and as might be the case after a Conservative victory in the forthcoming UK parliamentary elections. This may also be at a separate authority, closely collaborating with or staffed by the central bank as in France, Germany, Ireland, or within a separate authority altogether with linkages with the central bank and

98 Specifically, the ability for a competition authority to end an infringement by collecting the necessary evidence on conduct which has effect on its territory. See Articles 12-16 of 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. No. OJ L 1/1, 4.1.2003, and the Commission Notice on cooperation within the Network of Competition Authorities, OJ No. C 101/43, 27.04.2004.

99 See Article 15 (*Peer review of competent authorities*) which speaks of "the degree of convergence reached in the application of Community law and in supervisory practice" and of "the extent to which the supervisory practice achieves the objectives set out in Community law".

100 See Article 42 (*Joint positions and common acts*).

Treasury, as currently in the UK where the FSA and its two counterparts form the Tripartite Authorities. Models are never clear-cut: in the Netherlands, conduct of business supervision is exercised by a separate authority, as in France. Whichever model is chosen, coordination between monetary policy and prudential supervision is always necessary, if not internally in a double-hatted central bank, then between separate bodies. I would favour a close coordination and overlap, through double personal mandates and exchange of staff or a single service exercising the monetary policy and macro-prudential oversight, on the one hand, and prudential supervision, on the other. This would seem the most robust arrangement permitting, nay requiring in-house coordination between departments that will primarily act in the pursuit of either policy end, i.e. otherwise be shielded from one another. Such an arrangement would also allow the free use of information gained under one hat to be used under the other.[101]

Another issue with De Larosìere as such and, consequently, with the legislative follow-up proposals, is that all this concerns the framework for supervision only. This focus on the formal attribution of powers does not address the underlying issues and concerns form over substance. Even though I would advocate a revamp of supervisory structures at the EU level, it is the supervisory approach which is crucial. How banks and other financial industry players are supervised and what norms they are held to is primary. As are sustainable methods of organising the finance industry. But this brings us back to the cultural roots of the problem and largely falls outside the scope of this paper.

The main problem with the De Larosière Report and the follow-up proposed legislation is that it does not repair the lack of clear EU-wide authority to take decisions in respect of supervision, bail-out or liquidation of individual firms. The national focus and the consequent bias of State supervisors will not be remedied. Even though national supervisors are embedded in a Union network and although they will work under ESAs with far-reaching powers of coordination and mechanisms for joint operation[102] they will not have relinquished their powers to a body at the federal level.

101 Provided that the necessary exchange of information is adequately permitted under the supervisory legislation.

102 Assuming these arrangements can stand the test of legal scrutiny and will not be challenged on the basis of lack of legal coherence, on which more below.

This is precisely, however, what the crisis has taught us is necessary. Below, I will discuss the legal issues concerning the De Larosière legislative proposals. Then, I will conclude on the best way forward towards this end.

Legal issues: Article 95 EC (Article 114 TFEU) as a legal basis

The Commission's proposals for the establishment of the ESAs are based on Article 95 EC.[103] This provision, now replaced by Article 114 TFEU[104] concerns harmonisation of national laws in the context of the establishment of the internal market. The question arises whether this legal basis is appropriate to establish agencies whose task goes well beyond harmonisation of the national laws in respect of the finance industry and, actually, are to perform tasks more akin to those of actual supervisory authorities, albeit walking on, at least[105] 27 national legs for each segment of the financial sector. The Commission's view is straightforward but hardly reasoned. I quote the Explanatory Memorandum: "As the tasks to be conferred on the Authorities are closely linked to the measures put in place as a response to the financial crisis and to those announced in the Commission Communications of 4 March and 27 May 2009, they can, in line with the Court's case law, be established on the basis of Article 95 of the Treaty".[106]

Article 95 EC has been interpreted by the European Court of Justice as providing the basis for an agency supporting the harmonisation of national laws. The UK challenged the legal basis of the establishment of this agency by seeking annulment of Regulation 460/2004 establishing the European Network and Information Security Agency.[107] This Agency is a legal person

103 The text of Article 95 (1) EC read as follows: "1. By way of derogation from Article 94 [provision on harmonisation of legislation by unanimity in the Council, rs] and save where otherwise provided in this Treaty, the following provisions shall apply for the achievement of the objectives set out in Article 14 [internal market completion clause, rs]. The Council shall, acting in accordance with the procedure referred to in Article 251 [co-decision, rs] and after consulting the Economic and Social Committee, adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market."

104 For the text of Article 114 (1) TFEU, see footnote 18 above.

105 Sometimes, a segment may be subject to supervision by multiple national authorities, in which case the relevant ESA needs to coordinate the exercise of supervision by such authorities and their counterparts elsewhere in the internal market.

106 See the Proposal for a European Banking Authority, p. 3.

107 Regulation (EC) No 460/2004 of the European Parliament and of the Council of 10 March 2004 establishing the European Network and Information Security Agency, OJ L 077/1, 13.03.2004.

whose task it is to "enhance the capability of the Community, the Member States and, as a consequence, the business community to prevent, address and to respond to network and information security problems".[108] It is entrusted with tasks that include information gathering and awareness raising but which are all focused on supporting the Community and the Member States and regulatory authorities within the latter. The extent of its powers, albeit encapsulated in an internal structure and independence provisions from which the Commission apparently borrowed heavily when submitting its proposals for ESAs, does not even look like those to be entrusted to the ESAs. In its decision[109], the Court accepted that a body could be established on the basis of Article 95.[110] At the same time, the Court found "that the tasks conferred on such a body must be closely linked to the subject-matter of the acts approximating the laws, regulations and administrative provisions of the Member States. Such is the case in particular where the Community body thus established provides services to national authorities and/or operators which affect the homogenous implementation of harmonising instruments and which are likely to facilitate their application."[111] The Court then proceeded to verify whether the Agency's tasks were, indeed, within these confines. It saw "that it was foreseeable that the transposition and application of the [relevant EU directives] would lead to differences as between the Member States" and that there was a danger of "the smooth functioning of the internal market risks being undermined by a heterogeneous application of the technical requirements laid down [in the relevant EU directives]". Thus, the Community legislator could establish the Agency on the basis of Article 95 EC. In the precise words of the Court: "(…) the Community legislature was entitled to consider that the opinion of an independent authority providing technical advice at the request of the Commission and

108 Article 2 (1) of Regulation 460/2004. Other objectives are also mentioned, which do not go beyond this first one.

109 Judgment of 2 May 2006 in Case C-217/04 (*UK v European Parliament and Council*), [2006] ECR 1-3771.

110 In paragraph 44 of the judgment in Case C-217/04 "(...) nothing in the wording of Article 95 EC implies that the addressees of the measures adopted by the Community legislature on the basis of that provision can only be the individual Member States. The legislature may deem it necessary to provide for the establishment of a Community body responsible for contributing to the implementation of a process of harmonisation in situations where, in order to facilitate the uniform implementation and application of acts based on that provision, the adoption of non-binding supporting and framework measures seems appropriate."

111 Paragraph 45 of the judgment in Case C-217/04.

the Member States might facilitate the transposition of the directives at issue into the laws of the Member States and the implementation of those directives at national level."[112] This circumscription of the competence of the legislature to act seems narrow. It does not seem to support establishing ESAs acting within a network of authorities and having wide-ranging powers to overrule national authorities, let alone direct financial institutions when these authorities fail to implement their views. Even when such directions to individual undertakings are based on a prior finding of non-compliance with Community law adopted by the Commission, as is the case in 'normal situations' covered by Article 9 of the proposed regulation establishing the EBA. It can even be questioned whether the Commission has the powers to, indirectly, address such decisions to individual undertakings now that it is not a competent authority and does not have blanket powers to act but only those specifically attributed to it.[113] Its wide powers to "ensure the application of the Treaties, and of measures adopted by the institutions pursuant to them" and to "oversee the application of Union law under the control of the Court of Justice of the European Union"[114] would hardly seem specific enough to permit it to direct the business of individual undertakings in the context of differences of opinion among the supervisory agencies concerned themselves, even on the basis of norms emanating from the Community legislature which apparently leave room for such discussions among supervisors. Article 114 TFEU grants competence to establish agencies for the furtherance of internal market- related harmonization. With some stretch of the imagination, the cluster of bodies responsible for strengthened prudential supervision may be considered akin to such an agency. However, the ECJ confined this harmonizing power to: the adoption of non-binding supporting and framework measures. Alignment of policies and decision-making in respect of individual firms seem to go beyond such a remit. Therefore, Article 114 TFEU seems too small a basis for the establishment of the ESAs.

Even though I would favour strong federal supervisory powers at the Community level, I doubt whether these can be 'created' on the basis of Article

112 Paragraph 64 of the judgment in Case C-217/04.

113 Pursuant to the principle of specific attribution of powers, as laid down in Article 13 (2) TEU.

114 Article 17 (1) TEU.

114 TFEU. At the least, Article 308 EC should have been invoked, as well.[115] This provision has now been replaced by Article 352 TFEU.[116] Article 352 can only be invoked if there are no other competences on which to base a proposed measure. Its enactment should, moreover, be "necessary", not merely desirable, a condition which I think has been met considering the depth of the crisis and the urgency to remedy the fault lines in the EU supervisory response. Of course, the fact that this remedy is not fully effective, in my view, does not detract from this. To my mind, it is clear that the TFEU does not provide for the necessary powers as Article 114 TFEU, as interpreted by the Court, seems too small a basis. Also, the link with the Treaties' objectives seems to be present with the internal market (Article 3 (3) TEU) and the single currency (Article 3 (4) TEU) at stake in the joint response to a deep economic crisis which originated in the financial sector. Use of Article 352 TFEU does entail a problem that the reluctance of the British government to create joint supervisory structures, and its distaste for any encroachment upon national budgetary freedom, should be overcome as no State can be outvoted: unanimity is required. Thus, reservations by the UK may block decision-making. The issue of legitimacy played only under 308 EC, which required mere consultation of the European Parliament. This issue should not prevent adoption of far-reaching proposals under 352 TFEU as the consent of the European Parliament is required. Of course, it may be that national parliaments, making use of Protocol No. 2 attached to the Lisbon Treaty on the applicability of the principles of subsidiarity and proportionality may block adoption of the proposals.[117]

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115 Article 308 EC read as follows: "If action by the Community should prove necessary to attain, in the course of the operation of the common market, one of the objectives of the Community, and this Treaty has not provided the necessary powers, the Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, take the appropriate measures."

116 Article 352 TFEU reads as follows: "1. If action by the Union should prove necessary, within the framework of the policies defined in the Treaties, to attain one of the objectives set out in the Treaties, and the Treaties have not provided the necessary powers, the Council, acting unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament, shall adopt the appropriate measures. Where the measures in question are adopted by the Council in accordance with a special legislative procedure, it shall also act unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament." Paragraphs 2-4 provide for the monitoring of the subsidiarity principle through national parliaments, exclude harmonisation on the basis of this provision where the Treaty excludes such harmonisation, and delimits action on this basis in the area of the Common Foreign and Security Policy.

117 Moreover, the German Parliament will have to give its consent to any act adopted pursuant to Article 352 TFEU. This follows from the German Constitutional Court's decision in respect of the Lisbon Treaty. In its

Legal issues: discretionary authority and inter-institutional balance

Finally, a legal stumbling block may arise because of the absence of the possibility of granting discretionary powers to a body outside of the institutions. This is a consequence of the Meroni case[118], an old decision by the ECJ in the area of the ECSC.[119] The Court did not permit the Commission to delegate powers to a body not foreseen in the Treaty. This case law seems to explain the insertion in the proposals for the ESFS of instances in which the Commission, rather than the ESAs, should act, the adoption of technical standards and the decision, under 'normal circumstances', instructing a national authority to abide by Community rules in the financial sector.[120] This obstacle is only relevant when the Commission has been attributed powers which it then delegates. The question in the case of the ESAs is, whether the Commission has powers as a supervisory authority under the Treaty. In view of the tradition to keep the Commission at bay when individual institutions and their supervision are discussed, one may question whether it is competent at all to act in this area, beyond overseeing compliance with Union law by national authorities and adopting technical standards. The Commission's role in the ESFS comes closer to that of the competent authorities[121] whilst, being a political institution, it lacks the necessary independence and impartiality which, rightly, are required of national supervisors. The exercise of any powers in respect of individual financial institutions should be embedded in the necessary procedural safeguards which may be expected of a supervisory authority.[122]

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decision of 30 June 2009 the *Bundesverfassunggsericht* stated as follows: "With a view to the undetermined nature of future cases of application of the flexibility clause, its use constitutionally requires ratification by the German *Bundestag* and the *Bundesrat* on the basis of Article 23.1 sentences 2 and 3 of the Basic Law. The German representative in the Council may not declare the formal approval of a corresponding lawmaking proposal of the Commission on behalf of the Federal Republic of Germany as long as these constitutionally required preconditions are not fulfilled" [translation by the *BVerfG*; available at: http://www.bundesverfassungsgericht.de/en/decisions/es20090630_2bve000208en.htm (accessed: 19.4.2010)].

118 *Meroni v. High Authority*, [1957-58] ECR 133.

119 The European Coal and Steel Community. The Treaty establishing this Community lapsed 23 July 2002.

120 See above under: *Enforcing consistency (Article 9)*.

121 Note that the Commission is to be provided with all the necessary information for its decision on whether a national authority acted in compliance with Community law; see Article 9 (4), in fine of the of the Proposal for a European Banking Authority.

122 For a critique of the exercise of powers in respect of undertakings suspected of infringing competition law, see Forrester (2009). It is submitted that in the area of antitrust enforcement, a 'criminal charge' is at issue, something which is not the case in the area of financial supervision, at least not as far as the competences of the Commission and the EBA are concerned. National supervisors do, indeed, act in manners

7. THE WAY FORWARD

This description, and critique, from both a legal and a more general angle, of the proposals put forward in the wake of the De Larosière report, lead me to conclude as follows. The EU should go beyond De Larosière and agree EU decision-making in prudential supervision, at least concerning major cross-border banks. It should also consider attributing macro-prudential supervision, including action taking, to the EU level. The former may require Treaty change, the latter probably, as well. Some progress may be made by a broad interpretation of the ECB's mandate under the TFEU. At the very least, the ECB should relinquish its auto-limitation and consider itself a lender of last resort (LOLR) for the euro area. This would imply considering LOLR a Eurosystem function and no longer considering this an NCB function subject to Article 14.4 of the ESCB Statute.[123] The ESCB's tasks in respect of financial stability, to be acknowledged by the adoption of the proposed legal acts in respect of the ESRB, and the close link with monetary policy make LOLR an essential ESCB function.[124] The Commission's legislative proposals implementing the De Larosière Report are a step in the right direction and sometimes astonishingly far-reaching. But they fail to tackle the core issue of lack of EU-wide decision-making at federal level for the financial sector and are, therefore, insufficient. Moreover, even though they do not go far enough to remedy the fault lines in Europe's supervisory structure, they are based on legal foundations which do not seem to hold the new structure securely. Thus, the proper way forward would be Treaty change. Other areas showed a similar lack of effective governance during the crisis and are in need of repair, requiring Treaty change.

Looking beyond financial sector supervisory arrangements, the crisis and the Greek debt crisis coming on its heels, show the need for stronger coherence of economic policy in the euro area. A "*gouvernement économique*", respecting the ESCB's independence, should be considered with the possibility of joint

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which require them to uphold the safeguards of Article 6 of the European Convention on Human Rights and Fundamental Freedoms as interpreted by the European Court of Human Rights (ECctHR), notably in *Dubus v France* (App. No. 5242/04), judgment of the ECtHR of 11 June 2009.

123 Article 14.4 ESCB Statute reads as follows: "National central banks may perform functions other than those specified in this Statute unless the Governing Council finds, by a majority of two thirds of the votes cast, that these interfere with the objectives and tasks of the ESCB. Such functions shall be performed on the responsibility and liability of national central banks and shall not be regarded as being part of the functions of the ESCB".

124 For a more detailed analysis see Smits (forthcoming).

fiscal stimulus and a joint tax base. This, of course, requires Treaty change as well.

Furthermore, the euro area and the EU itself, should finally work towards single representation externally. The dispatched and sometimes discordant voices of the EU Member States in the IMF and in informal groupings such as the G20 and the G8 should come to an end. No Treaty change is necessary here, only the forceful implementation of provisions left largely unused since the introduction of the single currency.[125]

This will make Europe's voice better heard in the context of global efforts to boost growth and reduce unsustainable disparities. The credit crisis has done much to make the achievement of the Millennium Development Goals[126] almost impossible. In a world where 2.6 billion people live on less than USD 2.00 per day (i.e., 39% of the world population) and 1.4 billion people live on less than USD 1.25 per day (i.e., 21% of all humans)[127], the discrepancies between rich and poor are unsustainable, and unacceptable. Add to this the urgency to combat climate change, address environmental concerns and work towards a carbon-free economy and the need for a strong unified European voice in meeting these challenges becomes clear. Europe should focus on these larger issues rather than on its internal makeup. That doesn't mean that we should not adopt legal texts that can be based on the current treaties nor that we should forgo the arduous task of revising the current treaties to safeguard what they have achieved thus far. It means that Europe should do so with its contribution to the solution of global issues in mind. Only when we focus on joining efforts with the United States, China, India and other emerging economies to end this world's multiple crises, by investing in sustainable economic growth and alternative energy use, can we make a change. A proper organization of the European house, both in terms of supervisory arrangements in the financial sector and in the economic and political underpinning of the single currency, will enable Europe to contribute to the change we need.

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125 Notably, Article 111 EC, nowadays Articles 138 and 219 TFEU.

126 For a description of these goals, see the United Nations website, available at: http://www.un.org/millenniumgoals (last accessed: 8.04.2010).

127 According to revised figures from the World Bank, 2008; see: http://web.worldbank.org/wbsite/external/topics/extpoverty/extpa/0,,contentmdk:20040961~iscurl:y~menupk:435040~pagepk:148956~pipk:216618~thesitepk:430367,00.Html (last accessed 9.04.2010).

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