The Transformation of the European Central Bank – A Legitimacy Crisis: From Being the Anchor of Price Stability to Being a Ghost Ship of the Banking Regulation

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Abstract

Within the framework of the banking and financial crisis, the European Central Bank ("ECB") has presented itself as being an anchor of stability for the European Economic and Monetary Union, however, the ECB's growing influence has insufficient democratic legitimacy. Transferring banking supervision to the Single Monetary Mechanism at the ECB, as well as the ECB's Governing Council participating in the opening of banking resolution procedures, conflicts with the primary-law mandate of the ECB to maintain monetary stability. The ECB was only granted independence from being supervised and controlled by other EU organisations to perform monetary policy: the additional authorisations for banking regulation rest, under primary-law, on a weak basis or even on no basis at all. Furthermore, for exercising supervisory and resolution powers that are likely to affect fundamental rights, neither "organisational-personally" nor "objective-factually" can be ascribed to the organisations that were democratically elected by the people and are legitimised as supervisory bodies under constitutional law.

Key Words: Democratic Legitimation, Monetary Policy, Economic Policy, Banking Supervision, Banking Regulation

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I. Background and Objective of the Article

The globalisation of the world economy has led to an increase in credit institutions in cross-border activities within the European internal market, which has been further intensified by increasing international competition and the global digitalisation of financial markets. Complex links between individual credit institutions and markets have arisen, making supervision difficult. International banking transactions and the interconnectedness of financial markets has led to an increase in the financial sector's business risk, which became apparent with the outbreak of the sovereign debt and banking crisis in 2008.

A. Legal and Institutional Framework of the Banking Regulation

In legal terms, this crisis originated from considerable discrepancies between different national regulatory rules and supervisory actors, as well as a lack of special resolution rules in Europe. Fragmented supervisory rules and competences could not be properly coordinated during the crisis. The supervision of business behaviour largely took place at a national level and was subject to widely varying regulations between the Member States, which impeded proper consideration of the links between the financial markets and their market participants. Consequently, numerous credit institutions encountered liquidity problems that included imminent insolvency and the national central banks, and supervisory authorities were faced with unexpected challenges. The rules of national insolvency law were insufficiently developed for potential bank insolvency as well as for the consequences resulting from such insolvency for the economy, i.e., the institutional investors as well as the private depositors. Until then, bank insolvency had been practically inconceivable.

As a reaction to the grievances and undesirable developments in the financial sector, the substantive rules of the Banking Regulation Law, which act as a basis for the supervisory actors, the Capital Requirements Directive[1] and the Capital Requirements Regulation[2] were tightened at supranational

1. Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, 2013 O.J. (L 176) 338.
2. Corrigendum to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on Prudential Requirements for Credit Institutions and Investment Firms and amending Regulation (EU) No 648/2012, 2013 O.J. (L 321) 6.

level. On the justification of recovery and resolution, the Bank Resolution and Recovery Directive ("BRRD") [3] and the Single Resolution Mechanism Regulation ("SRMR") [4] were tightened as well. Consequently, a Single Supervisory Mechanism ("SSM") at the European Central Bank ("ECB") was established, a Single Resolution Mechanism ("SRM") was created, and a Single Resolution Board ("SRB") and a Resolution Fund were founded. In that way, a more comprehensive regulation was to be imposed on the financial sector and the supervision was to be combined organisationally at both the macroeconomic and microeconomic level,[5] and to be amended by specific rules and actors to address potential insolvencies.

In this context, the ECB plays a key role as monetary policy aims to ensure price stability, while it also supervises the largest credit institutions in the Member States of the euro area by establishing the SSM. Thus, in case of insolvency of a credit institution, the ECB may also participate in the decision as to whether or not the institution meets the conditions for resolution. The President of the ECB, Mario Draghi, provided the ECB's framework for action for the monetary policy with his statement "we will do whatever it takes, within our mandate."[6] Stressing openly "whatever it takes" compares with a universal pretentiousness stretching to banking supervision and banking resolution.

B. Reference Examples from Greece and Italy

The above discussion and the consequences for a democratic Europe become apparent in the examples of the ECB's decisions against Greece's central bank in favour of the Greek credit institutions since the beginning of

3. Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 Establishing a Framework for the Recovery and Resolution of Credit Institutions and Investment Firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council 2014 O.J. (L 173) 190.
4. Regulation (EU) No. 806/2014 of the European Parliament and of the Council of 15 July 2014 on Establishing Uniform Rules and a Uniform Procedure for the Resolution of Credit Institutions and Certain Investment Firms in the Framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010, 2014 O.J. (L 225) 1.
5. Wolfram Höfling, *Finanzmarktregulierung – Welche Regelungen empfehlen sich für den deutschen und europäischen Finanzsektor?*, 1-F VERHANDLUNGEN DES 68. DEUTSCHEN JURISTENTAG BERLIN 2010, 43 (2010).
6. Mario Draghi, President, European Central Bank, Question-And-Answer Session Following the Press Conference of the European Central Bank (June 9, 2012), http://www.ecb.europa.eu/press/pressconf/2012/html/is120906.en.html (last visited Apr. 1, 2017).

2015 (a.), and against Italy's central bank in favour of the world's oldest bank, Banca Monte dei Paschi di Siena, since the end of 2016 (b.)

1. Decisions of the ECB Regarding Monetary Policy and Banking Supervision in Greece

In Greece, the ECB has been monitoring an outflow of savings deposits amounting to approximately EUR 30 billion from the banking supervision's perspective since November 2014, while, on the other hand, in its function as Central Bank, issuing comprehensive Emergency Liquidity Assistance ("ELA") of approximately EUR 90 billion to Greece's central bank. ELA was created to provide financial assistance to a solvent financial institution facing temporary liquidity problems. Moreover, the ECB granted additional precautionary recapitalisation to two Greek banks (the National Bank of Greece and the Piraeus Bank) which were under the supervision of the SSM through the Hellenic Financial Stability Fund. This constitutes government assistance within the meaning of the European rules on state aid, which in turn was approved by the Directorate-General for Competition. [7]

The example illustrates how problematic the link between banking supervision and monetary policy is when they both fall in the hands of the ECB: The supervisory actor examines the solvency of Greece's banks which is being caused by the monetary policy. At the same time, the solvency of Greek institutions alleged by the banking supervision is a condition that needs to be fulfilled in order to be eligible for emergency liquidity.

2. Decisions of the ECB Regarding Banking Supervision and Banking Resolution in Italy

The most recent case of democratically illegitimate conduct of the ECB took place in Italy. At first, the ECB in cooperation with the European Banking Authority ("EBA") developed a new methodology without any specific indicators for a stress test of system-relevant banks in Europe, which was performed by the EBA on the basis of the data provided by the ECB's

7. *State Aid SA.43365 (2015/N) – Greece Amendment of the Restructuring Plan Approved in 2014 and granting of new aid to National Bank of Greece*, EUROPEAN COMMISSION (2015), http://ec.europa.eu/competition/state_aid/cases/261565/261565_1733770_121_2.pdf [hereinafter *National Bank of Greece*]; *State Aid SA.43364 (2015/N) – Greece Amendment of the Restructuring Plan Approved in 2014 and Granting of New Aid to Piraeus Bank*, EUROPEAN COMMISSION (2015), http://ec.europa.eu/competition/state_aid/cases/261238/261238_1733314_ 89_2.pdf [hereinafter *Piraeus Bank*].

Single Supervisory Mechanism (SSM). For the Italian Bank Monte dei Paschi di Siena, EBA's stress test in October 2016 presented capital resources of 12.2 percent of the equity when assuming a base-line scenario without any changes in the economic and the market environment, but, when assuming a crisis scenario, there was a squeeze on capital of -10.4 percent of the equity.[8] These discrepancies in capital resources between two scenarios derive from the large share of impaired credits of the Banca Monte dei Paschi[9] that would result in losses in a crisis situation. However, even though a squeeze on capital of EUR 8.8 billion and a decline in the core capital ratio to 8 percent – which would have resulted in an insolvency of the Banca Monte dei Paschi di Siena after several private investors rejected their financial participation – became apparent already in December 2016 without any significant change in economic conditions, no enhanced supervisory measures of the SSM were taken at the ECB.

This would have been the first case where the SRM could have been applied, but as the conditions for taking resolution measures are examined and identified by the ECB, it did not come to that. The ECB instead exercised its discretion, broadened its mandate, and assumed that the Banca Monte dei Paschi di Siena was a solvent bank – even though creditors who are usually prepared to take risks, such as investment banks and funds, rejected their financial participation[10]– and that its capitalisation covered neither short-term losses nor short-term potential losses. In that way, conditions of a precautionary recapitalisation were assumed. [11] Therefore, the flexible interpretation of the European Union ("EU") state aid regulations by the Directorate-General for Competition, which is subject to final examination,

8 . *2016 EU-wide Stress Test*, EUROPEAN BANKING AUTHORITY (2016), http://www.eba.europa.eu/documents/10180/1519983/EBA_TR_IT_J4CP7MHCXR8DAQMKIL78.pdf (last visited Apr. 1, 2017); Ilias Triantafyllakis, *Italienische Banken: Wenn nicht alle Wege zum Bail-in führen*, WERTPAPIERMITTEILUNGEN 2248, 2255 (2016) (viewing critically and who considers stress tests to be merely an indicator. Stress tests alone should not be sufficient to decide that an institution is going to suffer losses or to default.).

9. *IMF Country Report No. 16/222*, INTERNATIONAL MONETARY FUND 1, 79 (July 11, 2016), http://www.imf.org/external/pubs/ft/scr/2016/cr16222.pdf; *Comunicato Stampa*, MONTE DEI PASCHI DI SIENA (July 4, 2016), https://www.mps.it/media-and news/comunicati/ComunicatiStampa Allegati/2016/CS_BCE_ITA.PDF.

10. F. Giugliano, Editorial, LA REPUBBLICA, Dec. 19, 2016 (refers to JPMorgan, Mediobanca, Qatari State fund).

11. EUROPEAN CENTRAL BANK, OPINION OF THE EUROPEAN CENTRAL BANK OF 3 FEBRUARY 2017 ON LIQUIDITY SUPPORT MEASURES, A PRECAUTIONARY RECAPITALISATION AND OTHER URGENT PROVISIONS FOR THE BANKING SECTOR (CON/2017/01) (2017).

paved the way politically for Italy to decide to grant state aid amounting to EUR 20 billion for recapitalising its banks.[12]

In that way, newly established legal frameworks as well as the democratically legitimised regulation architecture were politically undermined.[13] From a legal point of view, this is alarming. This example illustrates that the ECB further tightened the already critical connection between monetary policy and banking regulation as it received the power to initiate banking resolutions by performing the banking supervision. This presents the possibility of massively infringing the rights of private legal personalities.

C. Objective of the Article

Practice shows that EU institutions like the European Commission or the ECB, once they have been established, extend their mandates and their areas of influence. A problem arises, however, if tasks are assigned to institutions that only have indirect democratic legitimacy and that are also not subject to any checks and balances on an interinstitutional basis due to political necessity – as in the case of assigning the banking supervision to the ECB. It becomes particularly problematic if these institutions themselves can interpret and determine their mandate.

This article first looks at the concept of "regulation" (II.) in order to work out the sense and purpose of banking regulation as a special form of public economic governance. Secondly, it will argue that banking regulation through the ECB has no democratic legitimacy (III.). The ECB's legal framework for governing monetary policy will be defined in the broadest sense so that in times of crisis, politically motivated competences for banking regulation are concentrated in one hand. Thirdly, the monetary policy becomes the vicarious agent of the banking supervision role (IV.). In this regard, the ECB's monetary policy mandate is being extended by countenancing ELA which leads to the direct financing of credit institutions critical to supervision that proved to be at risk to go into insolvency. Fourthly, the means of banking resolution are overshadowed by the banking supervision as the ECB's actions are neither for the aim of monetary policy, nor do they have democratic legitimacy, but instead present a massive encroachment on individual legal positions requiring democratic control (V.). To conclude the article, the author dares an evaluation of the ECB's changed role (VI.).

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12. *See* Consolidated Version of the Treaty on the Functioning of the European Union art. 107(3)(b), May 9, 2008, 2008 O.J. (C 115) 47; Case T-349/03, Corsica Ferries France v Commission, 2005 E.C.R. II-2197.
13. Martin Hellwig, *Italiens Banken – Die Probleme warden verschleppt*, WIRTSCHAFTSWOCHE, Jan. 1, 2017, at 6; Roberto Petrini, LA REPUBBLICA, Dec. 20, 2016, at 11.

II. Wording, Classification, Sense and Purpose of Banking Regulation

The term "regulation" of financial markets and banks is ever-present in the daily news as well as in political, economic, and legal discussions. Regulation is a common term, both in science as well in the politico-media everyday life.[14]

What does this term mean in general? A uniform definition of "regulation" still does not exist.[15] Regulation includes any governmental control of market conditions for the public benefit. In the area of financial markets, regulation includes any influence on business conditions and behaviour patterns of financial institutions. In particular, by statutory capital and liquidity requirements, organisational requirements as well as administrative supervision and resolution, the State may influence the financial market and the financial sector both indirectly and directly. Consequently, "banking regulation" is understood both in the sense of traditional banking supervision as well as in the sense of the newly created task of banking resolution. The State disposes of several instruments for banking regulation ranging from authorisation to market participation, to the supervision of market behaviour, to an intervention in the market as well as to the specification of market conditions.[16]

In principle, banking regulation is typical "*Gewerbeaufsicht*"[17]: the State supervises the risks of credit institution to address threats for other credit institutions or private depositors and investors. The purpose of banking regulation is the protection of the financial services sector as a whole[18] as well as securing the market functions.[19] The protection of the financial services sector as a whole focuses on the supervision of solvency and liquidity to

14 . Giandomenico Majone, *The Regulatory State and its Legitimacy Problem*, 22 WEST EUROPEAN POLITICS 1 (1999); Matthias Ruffert, *Begriff*, *in* REGULIERUNGSRECHT § 7, para. 1 (2010).

15 . Martin Eifert, *Regulierungsstrategien*, *in* GRUNDLAGEN DES VERWALTUNGSRECHTS BAND I: METHODEN, MAßSTÄBE, AUFGABEN, ORGANISATION § 19, para. 1 (2012); TONY PROSSER, LAW AND THE REGULATORS 4 (1997).

16. PROSSER, *supra* note 15, at 5.

17. Hans Christian Röhl, *Finanzmarktaufsicht*, *in* REGULIERUNGSRECHT, *supra* note 14, § 18 para. 82.

18. Kreditwesengesetz [KWG] [Banking Act], Sept. 9, 1998, BGBL. I at 2776, last amended by Gesetz [G], July 17, 2017 BGBL at 2446, art. 6 ("counteract undesirable developments in the banking and financial services sector" referring to the purpose of Art.109 para. 2 Basic Law for the Federal Republic of Germany "overall economic equilibrium".

19 . ALEXANDER THIELE, FINANZAUFSICHT 97 (2014); STEFFEN AUGSBERG, RECHTSETZUNG ZWISCHEN STAAT UND GESELLSCHAFT 38 (2003).

ensure banks' ability and willingness to pay.[20] By securing the market functions, systemic risks in the financial services sector are prevented.[21] Systemic risks are dangers for the business activities of banks, which are not confined to a single institution but have negative repercussions on the overall economy through so-called domino effects.[22] Banking regulation, therefore, focuses on supervision as well as the recovery and resolution planning of "system-relevant" banks, whose collapse could not be compensated and could trigger dangerous chain reactions.[23]

Where does this special significance of banks in relation to other economic operations within an economy come from? States and central banks have not only politically, but also macroeconomically a positive interest in ensuring the overall functionality of business finance to preserve jobs, to secure the financing of government tasks, and to enable private pension schemes. The potential effects of a collapse of a single firm are in no other economic area that serious. This is because of the global interdependence and the special trust dependence of the entire system.[24] Against this background, the significance and the purview of the banking regulation become clear and result in the importance of democratic control by the executing regulatory actor.

III. Releasing the Anchor: Law is Losing Importance – The Democratic Legitimisation of Banking Regulation by the European Central Bank is put on the Side Line

The objective of creating a supranational regulation of financial markets and market participants resulted in a shift of performing tasks from Member State to Union level. Due to the differentiation and europeanisation of classic administrative tasks, such as supervision and guidance, a plural administrative organisation has been developing in the field of financial market regulation since 2008,[25] to which legally essential tasks and competences vis-à-vis national

20. Röhl, *supra* note 17, para. 14.
21. SIMON GLEESON, INTERNATIONAL REGULATION OF BANKING 28 (2012).
22. BVerfGE 124, 2 BvR 852/07, Sept. 16, 2009, 235 (246) (Ger.).
23. Christoph Ohler, *Bankenaufsichtsrecht*, *in* BESONDERES VERWALTUNGSRECHT: BAND 1: ÖFFENTLICHES WIRTSCHAFTSRECHT § 32, para. 18 (2012).
24. THIELE, *supra* note 19, at 91.
25. Wolfgang Hoffmann-Riem, *Eigenständigkeit der Verwaltung*, *in* 1 GRUNDLAGEN DES VERWALTUNGSRECHTS, *supra* note 15, § 10 para. 17; Eberhard Schmidt-Aßmann,

administrations are attributed in order to ensure a centralised regulation without any influence of Member States.

With regard to their democratic legitimacy, the position of the regulation actors appears critical. The principle of democracy takes this to mean that the ECB breaks the direct chain of democratic legitimacy as a regulation actor, under primary legislation receiving an independent status in the Treaty on the Functioning of the EU as well as an autonomous decision-making power of monetary policy and of the market participants.[26] It is doubtful how an independent authority like the ECB is compatible with the principle of democracy within the meaning of the European Treaties and the German Basic Law. The standards of democratic legitimisation (A.) and the requirements for the legitimisation (B.) of institutions result from a synopsis of all 28 Member States of the EU which in turn are supplemented and extended by mature national provisions of the German Basic Law. Moreover, special requirements are imposed on the democratic legitimacy of independent administrative entities (C.) as it constitutes an exception from the administrative organisation that requires further justification and in practice exposes further weaknesses of the ECB (D.).

A. Democratic Legitimacy Standard

The EU is obliged to follow the principle of democracy in all of its actions, Article 2 of the Treaty on the European Union ("TEU"). Both, the institutional action of institutions as well as the personal actions of decision makers have to answer to the people of the Member States of the EU, or at least to the democratically legitimised institutions of such people.[27] The European principle of democracy creates a dual legitimacy through the direct representation of the Union citizens in the European Parliament as

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Verfassungsprinzipien für den Europäischen Verwaltungsverbund, *in* GRUNDLAGEN DES VERWALTUNGSRECHTS BAND I: METHODEN, MAßSTÄBE, AUFGABEN, ORGANISATION, *supra* note 15, § 5 para. 30; Hans-Heinrich Trute, *Die demokratische Legitimation der Verwaltung*, *in* GRUNDLAGEN DES VERWALTUNGSRECHTS BAND I: METHODEN, MAßSTÄBE, AUFGABEN, ORGANISATION, *supra* note 15, § 6 para. 60; Hans-Heinrich Trute, *Verantwortungsteilung als Schlüsselbegriff eines sich verändernden Verhältnisses von öffentlichem und privatem Sektor*, *in* JENSEITS VON PRIVATISIERUNG UND „SCHLANKEM" STAAT 13, 15 (1999).

26 . Ernst-Wolfgang Böckenförde, *Demokratie als Verfassungsprinzip*, *in* HANDBUCH DES STAATSRECHTS – VOLUME 2: VERFASSUNGSSTAAT § 24, para. 24 (2004); MATTHIAS JESTAEDT, DEMOKRATIEPRINZIP UND KONDOMINIALVERWALTUNG 102, 329 (1993) (critically differentiating); KLAUS STERN, DAS STAATSRECHT DER BUNDESREPUBLIK DEUTSCHLAND BAND II: STAATSORGANE, STAATSFUNKTIONEN, FINANZ- UND HAUSHALTSVERFASSUNG, NOTSTANDSVERFASSUNG § 41, 10b (1980).

27. Klaus Ferdinand Gärditz, *Europäisches Regulierungsverwaltungsrecht auf Abwegen*, 135 ARCHIV DES ÖEFFENTLICHEN RECHTS, no. 2, 251, 277 (2010).

well as the indirect representation of national parliaments in the European Council and in the Council under Article 10(2) and (3) of the TEU.

As a result, the legitimisation standards at a Union level of a supranational confederation of states may be differentiated from legitimisation standards at a national level. Hence, democratic legitimacy at a European level is understood in two ways: specifically referring to the Union as well as referring to a broader context.[28] The national standards for democratic legitimacy, however, will remain unchanged.[29] The primacy of Union law does not imply any other results as the legitimisation of government action as part of the principle of democracy in Article 20(1) of the German Basic Law is included in the guarantee of permanence under Article 79(3) of the German Basic Law and forms part of the integral core of the constitution within the scope of Article 23(1) sentence 3 of the German Basic Law.[30] According to Article 20(2) sentence 1 of the German Basic Law, democratic legitimacy requires a more immediate relationship of accountability through the elected parliament between the people to the appointed executive of the person in office.

Legitimisation can, in particular, be effected in "organisational-personal" and "objective-factual" terms.[31] "Organisational-personal" legitimisation addresses the individual person in office entrusted with government tasks.[32] Any and all persons in office as well as their decisions have to be legitimised by election hierarchically and regularly across various levels of action through the parliamentary representatives of the people.[33] This is the

28. *Id.* at 276; Albert Bleckmann, *Das europäische Demokratieprinzip*, JURISTENZEITUNG 53 (2001).
29. Matthias Ruffert, *Grundfragen der Wirtschaftsregulierung*, *in* BESONDERES VERWALTUNGSRECHT: BAND 1: ÖFFENTLICHES WIRTSCHAFTSRECHT, *supra* note 23, § 21 para. 30.
30. BVerfGE 89, 2 BvR 2134/92, 2 BvR 2159/92, Oct. 12, 1993, 155 (182) (Ger.); FERDINAND WOLLENSCHLÄGER, GRUNDGESETZ KOMMENTAR: GG BAND II art. 23, paras. 59, 66, 69, 87 (Dreier ed. 2015); INGOLF PERNICE, GRUNDGESETZ KOMMENTAR, VOL. II art. 23 para. 91 (Dreier ed. 2008) (more clearly); Thomas Mayen, *Verwaltung durch unabhängige Einrichtungen*, *in* DIE ÖFFENTLICHE VERWALTUNG 45, 50 (2004); Bernd Holznagel & Pascal Schumacher, *Funktionelle Unabhängigkeit und demokratische Legitimation europäischer Regulierungsagenturen*, *in* EUROPÄISIERTE REGULIERUNGSSTRUKTUREN UND -NETZWERKE 37, 41-44 (2011) (for a different view).
31. Trute, *supra* note 25, paras. 7, 42.
32. BVerfGE 47, 2 BvR 134/76, 2 BvR 268/76, Feb. 15, 1978, 253 (275) (Ger.); BVerfGE 52, 2 BvK 1/78, July 24, 1979, 95 (130) (Ger.); BVerfGE 77, 2 BvR 1178/86, 2 BvR 1179/86, 2 BvR 1191/86, Oct. 1, 1987, 2 (40) (Ger.); BVerfGE 83, 2 BvF 3/89, Oct. 31, 1990, 60 (72) (Ger.); BVerfGE 93, 2 BvF 1/92, May 24, 1995, 37 (66) (Ger.); BVerfGE 107, 2 BvL 5/98, Dec. 5, 2002, 59 (87) (Ger.); BVerfGE 119, 2 BvR 2433/04, 2 BvR 2434/04, Dec. 20, 2007, 331 (366) (Ger.); BVerfGE 123, 2 BvC 3/07, 2 BvC 4/07, Mar. 3, 2009, 39 (69) (Ger.).
33. Trute, *supra* note 25, para. 45.

core idea of an unbroken chain of legitimacy. At the same time, the "objective factual" legitimisation requires the administration to be bound to the people and their representatives.[34] This binding is reflected in the bond of administration to law and the responsibility of the administration to the Parliament as a representative of the people.[35]

In addition to the traditional legitimisation standards, the "output legitimacy" approach is considered occasionally.[36] This approach substantiates the legitimisation of interrelated decisions by achieving legitimate public objectives and requires particularly convincing substantive reasons which justify a decoupling from parliamentary rights of influence and control.[37] However, this approach should be viewed with scepticism. The organisational-personal and objective-factual legitimation procedures lead to political results – that are unknown and cannot be known in advance – whereas an output-based legitimisation assumes that the correct result is already known and that democratic procedures generating findings can be avoided.[38] For this reason, this approach will not be pursued in the following examination of the ECB's legitimacy and its decisions in the fields of monetary policy, banking supervision, and banking resolution.

B. Requirements Concerning Democratic Legitimacy

The banking regulation by the ECB is insufficiently democratically legitimised. Exercising the banking supervision and taking part in the decisions regarding banking resolution constitute a far-reaching transfer of sovereignty to the European level, which in general should require a direct democratic legitimacy. At first glance, the legitimacy of an independent regulatory body – such as the ECB's legitimacy under Article 130 of the Treaty on the Functioning of the European Union ("TFEU") – seems difficult to reconcile with the requirement of an unbroken chain of legitimacy from the

34. Böckenförde, *supra* note 26, para. 21.
35. Trute, *supra* note 25, paras. 11, 49.
36. Stephan Bredt, *Constitutional Economics Und Gewaltenteiliges Demokratieverstandis*, 46 DER STAAT 46 (2007); Gärditz, *supra* note 27, at 278 (for a critical view); Sebastian Müller-Franken, *Die demokratische Legitimation öffentlicher Gewalt in den Zeiten der Globalisierung*, 134 ARCHIV DES ÖEFFENTLICHEN RECHTS 542, 554 (2009); Christoph Möllers, *European Governance – Meaning and Value of a Concept*, 43 COMMON MARKET LAW REVIEW 313, 320 (2006).
37. Trute, *supra* note 25, para. 53.
38. Gärditz, *supra* note 27, at 278.

people to the relevant administrative body and its decisions.[39] In principle, democratic legitimacy requires, both under European as well as German constitutional law, a more immediate relationship of accountability between the people through the elected parliament to the appointed executive. This is the core idea of an unbroken chain of legitimacy. The political independence of any such body constitutes an exception requiring legitimisation.[40]

As already recognised by the Court of Justice of the European Union in its case-law, the establishment of independent institutions is permissible and a personal legitimacy through the administrative hierarchy to the parliament is not a mandatory requirement if the missing parliamentary influence is compensated by reasonable parliamentary control.[41] But an unbroken chain of legitimacy is not a rigid framework.[42] Since the legitimacy of banking regulation and its decisions is put down to the people, the neutrality and objectivity of administration of particular interests are guaranteed at the various stages of the chain of legitimacy. The decisive factor here is not the effectivity of democratic legitimacy[43] that may result from the European Treaties of the Union as well as from the Basic Law of the Federal Republic of Germany.[44] Hence, instead of a direct legitimacy chain, an appropriate legitimisation level is sufficient by virtue of the synergy of various forms of legitimacy within the meaning of the principle of democracy.[45]

C. Democratic Legitimacy of Independent Regulatory Actors

In accordance with Article 130 of the TFEU, the ECB acts independently from the institutions of the EU as well as from the central banks and governments of the Member States when performing its duties and putting its competences into practice. This refers to an institutional, functional, personal and financial independence[46]: In terms of institutional independence, the ECB

39. JESTAEDT, supra note 26, at 261 (for a differing view); Georg Hermes, *Legitimations probleme unabhängiger Behörden*, *in* DEMOKRATIE IN EUROPA 457, 474 (2006) (with a critical yet differentiating view).
40. Gärditz, *supra note* 27, at 277.
41. Case C-518/07, European Commission v. Germany, 2010 E.C.R. I-01885; Case C-11/00, Commission v. European Central Bank, 2013 E.C.R. I-07147..
42. Böckenförde, *supra* note 26, para. 23 (criticises the tendency to require legitimisations).
43. BVerfGE 83, 2 BvF 2/89, 2 BvF 6/89, Oct. 31, 1990, 37 (50) (Ger.).
44. Böckenförde, *supra* note 26, para. 23.
45. BVerfGE 83, 37 (50); Trute, *supra* note 25, para. 14; JESTAEDT, *supra* note 26, at 285, 288, 297.
46. Lorenzo Bini Smaghi, *Central Bank Independence in the EU: From Theory to Practice*, 14 EUROPEAN LAW JOURNAL 446, 447 (2008); Dirk Meyer, *Unabhängigkeit und Legitimität der EZB im Rahmen der Staatsschuldenkrise*, ZEITSCHRIFT FÜR DAS GESAMTE KREDITWESEN

acts without taking instructions when performing its duties under Article 7 of the Statute of the European System of Central Banks and the European Central Bank ("Statute of the ESCB and of the ECB"); in functional terms, this independence is reasoned by the primary objective of ensuring price stability in the Member States under Article 2 of the Statute of the ESCB and of the ECB. As regards to the personal independence, the ECB acts through the Governing Council which, according to Articles 10 and 11 of the Statute of the ESCB and of the ECB, comprises the respective independent members of the Executive Board and of the governors of the national central banks. Finally, according to Article 28 of the Statute of the ESCB and of the ECB, the ECB acts financially independently due to the capital base of the national central banks.

With the ECB's independence arises a tension with the principle of democracy that constitutes a part of the EU's fundamental values according to Article 2 sentence 1 of the TEU. There are considerable concerns against this form of independence of the ECB established under primary legislation and organised under tertiary legislation, using an organisational-personal democratic legitimacy of the ECB Governing Council's members and an objective-factual democratic legitimacy of the ECB's actions in the area of banking supervision and resolution.

The members of the ECB's Executive Board only have indirect democratic legitimacy through the European Council while the governors of the national central banks have democratic legitimacy by the respective sending Member States. All ECB Governing Council members, however, independently exercise their powers within the framework of the duties conferred upon them and do not have any parliamentary responsibility according to Article 130(1) of the TFEU. Under European and German law, such far-reaching independence can only be compared with the independence of the judiciary according to Article 253(1) of the TFEU. As a rule, certain parts of the official authority are excluded from the immediate access to parliamentary control in order to create checks and balances to democratic majority decisions when granting independence contractually or constitutionally.[47] The parliament restricts itself to a certain extent and waives its democratically legitimised

127, 127 (2011); ULRICH PALM, THE LAW OF THE EUROPEAN UNION: EUV / TFEU, 60. SUPPLEMENTARY DELIVERY – STATUS: 10/2016 art. 282, para. 29 (Eberhard Grabitz et al. eds. 2016).

47. UDO DI FABIO, DIE ZUKUNFT EINER STABILEN WIRTSCHAFTS-UND WÄHRUNGSUNION: VERFASSUNGS- SOWIE EUROPARECHTLICHE GRENZEN UND MÖGLICHKEITEN 41 (2013).

responsibility.[48] In particular, the withdrawal of control can present a special form of this democratically legitimised responsibility.[49] It is an element of the constitutional principle of the separation of powers which completes the principle of democracy to limit undesirable developments of political power.[50] Just like judges are bound by the rule of law under Article 19(1) of the TEU and Article 20(3) of the German Basic Law, the ECB is bound to the requirements of a stable currency with the express purpose of maintaining price stability, Articles 127(1) sentence 1 and 282(2) sentence 1 of the TFEU.

According to Article 10(1) of the TEU, the European treaties are founded on the principle of representative democracy. This means that any form of independent exercise of sovereign authority under the liberation of political control by the European Parliament, the Council or the Commission, requires a justification. Such a justification is also a prerequisite for any transfer of sovereign rights to European level in accordance with Article 23(1) sentence 3 of the German Basic Law. Any non-conforming transfer to the principle of democracy, e.g., by transferring sovereign rights to independent institutions of the EU, requires a justification by a high-level concern[51] to compensate for the lacking objective-organisational democratic legitimacy. Presence of a high-level concern can compensate both for a lacking organisational-personal as well as an objective-factual democratic legitimacy. It is questionable if monetary policy or banking supervision and banking regulation provide a material interest as justification.

1. Justification of Independence for the Implementation of Monetary Policy

The connection of the monetary policy to the independence of the central bank is that kind of high-level concern. It corresponds politically and economically to the purpose of the tasks and laws in the monetary field to establish an independent central bank that is not subject to national or supranational responsibility in order to remove the monetary policy from the reach of interest groups.[52] Furthermore, the independence is limited to

48. Ulrich Häde, *Jenseits der Effizienz: Wer kontrolliert die Kontrolleure? – Demokratische Verantwortlichkeit und rechtsstaatliche Kontrolle der europäischen Finanzaufsichtsbehörden*, EUROPÄISCHE ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT 662, 664 (2011).

49 . Matthias Ruffert, *Verselbständigte Verwaltungseinheiten: Ein europäischer Megatrend im Vergleich*, *in* ALLGEMEINES VERWALTUNGSRECHT – ZUR TRAGFÄHIGKEIT EINES KONZEPTS 431, 454 (2008).

50. DI FABIO, *supra* note 47, 41.

51. Trute, *supra* note 25, para. 37.

52. BVerfGE 89, 2 BvR 2134/92, 2 BvR 2159/92, Oct. 12, 1993, 155 (208) (Ger.).

exercising the powers, tasks, and duties conferred upon them by the treaties and the Statute of the ESCB and of the ECB with the objective of maintaining price stability for monetary policy.[53]

According to the primary-law obligations under Union law, the limitation of the democratic legitimacy coming from the voters of the Member States is assumed in Article 88 sentence 2 of the German Basic Law. This is a limitation on the guarantee of perpetuity of Article 79(3) of the German Basic Law, which, in particular, states that a change of principles laid down in Article 20 of the German Basic Law – as the principle of democracy in accordance with Article 20(1) sentence 1 of the German Basic Law – is inadmissible. Therefore, such a modification of the democratic principle, according to Article 88 sentence 2 of the German Basic Law, is by way of exception compatible with Article 79(3) of the German Basic Law, as long as the will of the constitution-amending legislature seems to aim for a constitutional basis for the monetary union as laid out by the TEU. [54]

Already in the Maastricht Treaty, the Federal Constitutional Court deduced that the creation of independent authorities shall be limited to this case.[55] The creation of the ECB as an independent institution is not democratic in a traditional way but rather only "expertocratically" legitimised, which is compatible with the principle of democracy to the extent that the ECB's responsibility is limited to ensuring monetary stability and price stability, and that it only acts in pursuit of monetary policy.[56] Moreover, the connection of monetary policy with an independent central bank is a high-level concern, which can be verified empirically.[57] Such an empirical connection is missing between the banking supervision and the stability of the financial system.[58]

2. Justification of Independence for the Implementation of Banking Supervision and Resolution

A far-reaching independence, e.g., for banking supervision or within the framework of banking resolution is not provided. Not purely abstract but rather political decisions requiring democratic legitimacy are concerned as not only the supervisory decisions, but all the more the decisions regarding

53. Ulrich Häde, *ESZB, Eurosystem und EZB*, *in* EUV/AEUV art. 282, para. 46 (Calliess & Ruffert eds., 2016).
54. BVerfGE 89, 155 (208).
55. *Id.*
56. Dietrich Murswiek, *Weiterentwicklung der Europäischen Währungsunion und demokratische Legitimation*, 13 IFO SCHNELLDIENST 6, 10 (2013).
57. BVerfGE 89, 155 (208).
58. Matthias Herdegen, *Europäische Bankenunion: Wege zu einer einheitlichen Bankenaufsicht*, WERTPAPIERMITTEILUNGEN 1889, 1894 (2012).

banking resolution present significant interferences with fundamental rights that should not be reached by independent institutions, but only by organs with parliamentary responsibility.[59] This conclusion can also be deduced under primary-law from Articles 130, 282(3) sentences 3 and 4 of the TFEU, according to which the ECB's independence covers only the content-related terms of competences conferred under primary law to maintain price stability, but does not allow the ECB to determine scale and scope of its own actions.[60] Maintaining price stability presents a special substantive reason that can compensate the missing democratic legitimacy of an independent organ like the ECB which, in turn, means that without a special substantive reason there is no democratic legitimacy for banking supervision or banking resolution. The ECB's mandate is limited to monetary policy, whereas economic policy falls within the responsibility of the Member States and for which the ECB only possesses dependent supporting competences under Articles 2(3), 5(1) sentence 1, 127(1) sentence 2, and 282(2) sentence 3 of the TFEU in case that impacting on economic policy is possible without interfering with the monetary policy is possible.[61] This results in the ECB not having any independent organisational competence in the field of economic policy.[62]

The differentiation between monetary policy and economic policy can be difficult on a case-by-case basis.[63] Criteria for the differentiation are neither set out in the TFEU, nor in the Statute of the ESCB and of the ECB, but only result from the context and the objective of the respective actions.[64] In order to justify the ECB's independence to implement banking regulation, it is essential to decide whether accepting the banking supervision and the (co-)decision-making regarding banking resolution fall within the economic policy competences of the Member States. Maintaining price stability differs from maintaining stability of the euro area.[65] While the euro area's stability can affect the stability of the currency as well as of the prices, an economic policy measure within the framework of banking supervision or banking resolution cannot be treated as equal merely on the basis of a monetary

59. Murswiek, *supra* note 56, at 11.
60. BVerfGE 134, 2 BvR 2728/13, 2 BvR 2729/13, 2 BvR 2730/13, 2 BvR 2731/13, 2 BvE 13/13, Jan. 14, 2014, 366 (400) (Ger.).
61. *Id.* at 403f.
62 . Emilie Yoo, *Europäische Wirtschaftsverfassung; Grundsätze*, *in* EUROPÄISCHES UNIONSRECHT art. 119, para. 3 (von der Groeben et al. eds. 2015).
63 . BVerfGE 134, 366 (401); C. Manger-Nestler & R. Böttner, *Vorabentscheidung zur Rechtmäßigkeit des Ankaufs von Staatsanleihen durch die EZB im OMT-Programm*, NEUE JUSTIZ 422, 425 (2015).
64 . Case C-370/12, Pringle v. Ireland, 2012 EUR-Lex (Nov. 27, 2012); Case C-62/14, Gauweiler v. Bundestag, 2015 EUR-Lex (June 15, 2015).
65. Pringle, 2012 EUR-Lex; Gauweiler, 2015 EUR-Lex.

measure, as it can have indirect effects on the stability of the Euro.[66] Ultimately, the ECB's independence cannot be justified by a special substantive reason, neither for performing the banking supervision nor for co-deciding on banking resolution.[67]

Transferring the European banking supervision to the ECB was not provided for under primary law. According to the Union Treaties, only the transfer of special tasks to the ECB within the scope of banking supervision is provided for in Article 127(6) of the TFEU. Transferring the entire supervision is not permissible[68] as the merely indirectly organisational-personal legitimised ECB is furthermore lacking the objective-factual democratic legitimacy. Moreover, as an internal institution of the ECB, the supervisory board only has weak and construed organisational-personal democratic legitimacy, via the legitimacy of the ECB's Council, and receives comprehensive competences under secondary law without being subject to legal and subject-specific supervision by other EU institutions.[69] It is impossible for other EU institutions to step in towards supervisory measures of the ECB.[70] Even if the legislation of the EU does not provide for any other institution to perform the banking supervision, the take-over of banking supervision by the ECB's SSM presents a purely political decision against the express wording of the legally binding legislation of the EU.

The ECB's opportunity to decide on the presence of prerequisites for a banking resolution is not foreseen in the Treaties of the European Union at all. Unlike in the field of banking supervision, no special tasks are conferred to the ECB regarding its actions within the field of banking resolution. If banking supervision by the ECB is granted to a limited extent only under primary law, a banking resolution is still less permissible. Winding up banks constitutes an exercise of sovereign authority which may lead to encroachments upon fundamental rights which must not be performed independently from a legal point of view. Unlike the Commission and the Council's supervision of the SRB as well as the respective ministers' supervision of the national authorities for banking resolution, the co-decision-

66. Pringle, 2012 EUR-Lex.

67. EUROPEAN CENTRAL BANK, SPECIAL REPORT SINGLE SUPERVISORY MECHANISM - GOOD START BUT FURTHER IMPROVEMENTS NEEDED 40 (2016) (for a result that is also supported by the audit of the European Court of Auditors regarding the independence of banking supervision); Martin Selmayr, *Ziele und Aufgaben des ESZB*, *in* EUROPÄISCHES UNIONSRECHT art. 127, para. 58f. (2015) (other view).

68. Häde, *Ziele und Aufgaben des ESZB*, *in* EUV/AEUV, *supra* note 53, art. 127 para. 53.

69 . Benedikt Wolfers & Thomas Voland, *Europäische Zentralbank und Bankenaufsicht: Rechtsgrundlage und demokratische Kontrolle des Single Supervisory Mechanism*, BKR 177, 182 (2014).

70. *Id.* at 184.

making of the ECB on banking resolution is not subject to a democratic legitimised control of equal value.

In praxis, the decisions of the ECB for the people and for the bodies of the EU are difficult to verify, which gives the impression of political and technocratic arbitrariness. Banking supervision forms the basis for a potential resolution of banks that could amount to a far-reaching interference with national economies as well as entrepreneurial activity and property in the Member States, and must be answered parliamentarily.[71]

Ultimately, the problem is the creation of competences for the ECB deprived from the checks-and-balances system established between the institutions at European level or the people in the Member States.[72] By the ECB's adoption of banking supervision and co-decision-making on banking resolution, the contractual justification for its independence and, at the same time, the exemption from direct democratic legitimacy collapses.[73] The ECB's independence within the framework of monetary policy cannot be transferred to other policy areas.

D. Weakness of Democratic Legitimacy

The democratic legitimacy of the ECB reveals significant weaknesses, both on an organisation-personal and objective-factual level, which do not satisfy the ECB's importance in the financial crisis. It is crucial that a democratic legitimacy according to Article 10 of the TFEU is ensured, which also takes into account the demographic conditions. In particular, the involvement of national central banks in the Governing Council of the ECB in matters that exceed the monetary policy, or national supervisory authorities in the Council of the EBA, both collide with the principle of representative democracy.[74] By a formally balanced participation of national representatives in the respective bodies (Governing Council of the ECB, Supervisory Board of the SSM), there is a danger that a majority of representatives of less populous, particularly crisis-prone or economically distressed Member States with a single majority, decide in favour of a casual exercise of banking supervision, of the purchase of credit securitisations or government bonds, the

71. DI FABIO, *supra* note 47, at 57.
72. Anna-Lena Högenauer & David Howarth, *Unconventional Monetary Policies and the European Central Bank's Problematic Democratic Legitimacy*, JOURNAL OF PUBLIC LAW 1, 9 (2016).
73. Alexander Kern, *The European Central Bank and Banking Supervision: The Regulatory Limits of the Single Supervisory Mechanism*, 13 EUROPEAN COMPANY AND FINANCIAL LAW REVIEW 467, 490 (2016) (for a critical view); Selmayr, *supra* note 67, para. 58.
74. Herdegen, *supra* note 58, at 1896.

development of further regulatory and implementing standards, or the waiver of a more appropriate resolution.[75] The principles of representative democracy are shaken due to the concentration of executive decision-making powers in a regulatory central area, more precisely, in facilities such as the SRB or the Board of Supervisors of the EBA and even more significantly at the ECB, which are filled according to the principle of equality of states and not by population size or risk of liability.[76]

In this sense, it is particularly disappointing that, according to the principle of formal equality, each President of the participating central banks in the ECB's Governing Council shall have one vote. As of January 1, 2015, the voting rights in the Governing Council of the ECB are subject to a rota system. With the accession of Lithuania to the euro area, more than 18 governors will be represented in the Governing Council of ECB for the first time. Therewith, a new voting procedure is put into force. At a meeting of the Governing Council of ECB, the votes of all members are heard and counted. In addition to the six members of the Executive Board of the ECB, this currently includes 18 presidents and governors of the national central banks of the Euro system, under Article 10.1 of the Statute of the ESCB and of the ECB. Pursuant to the rota systems, the Governors are divided into groups according to the size of their economies and their financial sectors, Article 10.2 of the Statute of the ESCB and of the ECB in conjunction with Article 3a of the Rules of Procedure of the ECB.[77] The five largest countries form the first group. They share four voting rights. This group includes Germany, France, Italy, Spain and the Netherlands. The voices within this group rotate on a monthly basis, so that each month one of the Governors of the five largest countries has no vote in the Governing Council, Article 3a(3) of the Rules of Procedure of the ECB. In other words, every five months, the President of the Deutsche Bundesbank (German Federal Bank) loses the right to vote on decisions in the Governing Council of the ECB, which represents a serious breach of the principle of democracy in terms of the representation of national interests of the peoples of the Member States.

75. *Id.*
76. DI FABIO, *supra* note 47, at 60.
77. Decision of the European Central Bank of 22 January 2004 adopting the Rules of Procedure of the European Central Bank (ECB/2014/1), 2014 O.J. (L 95) 29.3, 56.

IV. The Ghost Ship is picking up Speed – The European Union's Monetary Policy and Banking Supervision Navigate in Uncharted Waters

The objectives of the EU require "for the sustainable development of Europe based on balanced economic growth and price stability" under Article 3(3) sentence 2 of the TEU. Consequently, the reforms of the financial market regulation lead to a centralisation of competences at the ECB, which in addition to monetary policy with the primary objective of maintaining price stability now also assumed the banking supervision of the Member States of the euro area.

Already the European treaties take on the relationship between monetary policy and price stability, and assign a special role to the European System of Central Banks and to the ECB under Article 127(1) of the TFEU. Monetary policy starts at the central bank money market and includes all measures to control money supply which is in accordance with Articles 18 et seqq. Statute of the ESCB and of the ECB comprise in particular open market operations, standing refinancing facilities as well as minimum reserves. Open market operations as the main monetary instrument allow the ECB – according to Article 12.1 of the Statute of the ESCB and of the ECB, this is decided by the Governing Council and executed by the Executive Board – to withdraw money from or add money to the economic cycle and in this way influence and determine the main refinancing rate (base rate of the ECB).[78] The effects of monetary decisions on the economy in general and on the development of prices in particular are referred to as transmission mechanisms of monetary policy.[79] That means, if the Central Bank lowers the main refinancing rate, business banks will expand their lendings since the necessary liquidity can be obtained cheaper from the Central Bank (first transmission mechanism). The monetary supply in the economy is increasing. This means that the operators also increase their demand for investment loans.[80] In this way, the price level and, consequently, the price stability is being influenced. Moreover, Article 127(5) of the TFEU authorised the European System of Central Banks to assist national authorities in the supervision of financial institutions. The wording of Article 127(6) does not specify the extent to which the ECB shall and can be included in banking supervision,[81] it does, however, expressly

78. BERNHARD KEMPEN, EUV/AEUV art. 127, para. 9 (Streinz eds., 2012).
79. EUROPEAN CENTRAL BANK, MONETARY POLICY OF THE ECB 44 (2004).
80. *Id.* at 45.
81. Christian Waldhoff, *Ziele und Aufgaben des ESZB*, *in* EWU: KOMMENTAR ZUR EUROPÄISCHEN WÄHRUNGSUNION art. 127, para. 69 (2013).

allow to only transfer to the ECB "specific tasks" in connection with the supervision, from which in turn the banking supervision as a whole can be excluded.[82]

With price stability being the primary monetary objective and financial market stability being a central objective of banking supervision, a decision dilemma for the ECB is created.[83] First, synergy effects can be developed due to the concentration of monetary policy and banking supervision.[84] All "important" banks exceeding certain threshold values, operating across borders or receiving financial support by the European Financial Stability Facility or the European Stability Mechanism, and at least the three largest banks of each Member State are subject to supervision.[85] Consequently, through ongoing monitoring, the ECB can gain valuable insights into the financial situation of the credit institutions under its supervision. Hence, it can draw conclusions for monetary policy, e.g., for the determination of interest rates for refinancing business banks, which then again have effects on money supply.

By combining both mandates, a conflict of objectives may arise.[86] There is a risk that the primary orientation of the ECB is softened once the goal of price stability in support of the banking sector is reached. Banking supervision by the SSM in the ECB influences the business behaviour of credit institutions. In limited cases, banking supervision can result in a failing monetary policy if the ECB effects recapitalisation of credit institutions that are viewed as impaired by the banking supervision, in particular by way of interest rate reductions, purchasing asset-backed securities, or purchasing government bonds.

Since November 2014, the banking supervision's influence on monetary policy decisions can be observed in an exemplary way in Greek credit institutions. Via the SSM, in September 2014, the ECB's banking supervision executed so-called stress tests as to the solvency of Greek banks which attest

82. *Id.* para. 72; STEFAN GLATZL, GELDPOLITIK UND BANKENAUFSICHT IM KONFLIKT 257 (2009); CORNELIA MANGER-NESTLER, PAR(S) INTER PARES?: DIE BUNDESBANK ALS NATIONALE ZENTRALBANK IM EUROPÄISCHEN SYSTEM DER ZENTRALBANKEN 266 (2008).
83. Häde, *supra* note 68, paras. 51, 53.
84. Waldhoff, *supra* note 81, para. 78.
85. Council Regulation (EU) No 1024/2013, 2013O.J. (L 287) § 6(4) (these include in Greece the Alpha Bank, Eurobank Ergasias, National Bank of Greece and Piräus Bank. Press Release); *ECB Publishes Final List of Significant Credit Institutions*, EUROPEAN CENTRAL BANK (Sept. 4 2014), http://www.ecb.europa.eu/press/pr/date/ 2014/html/ pr140904_ 2.en.html (last visited Apr. 1, 2017).
86. Kern, *supra* note 73, at 488; *Annual Report 2013/14*, GERMAN COUNCIL OF ECONOMIC E XPERTS paras. 253, 255, http://www.sachverstaendigenrat-wirtschaft.de/fileadmin/dateiabla ge/gutachten/jg201314/JG13_Ges.pdf.

the four banks classified as systemically relevant to be sufficiently solvent.[87] Later, this was adduced as condition for ensuring general ELA to the Greek central bank as well as a precautionary recapitalisation of individual Greek credit institutions. As a result of the change of government in Greece and the political uncertainty as to the future, a bank-run by the population on savings deposits with credit institutions in Greece began. In this time, approximately EUR 30 billion were withdrawn from the savings accounts or transferred abroad – in part up to EUR 1 billion a day. This led to the solvency of Greek banks being limited which then again resulted in controls on capital movements and limitations of withdrawals from savings deposits at automated teller machines.

In the beginning of 2015, ELA was raised from EUR five to 91 billion. ELA particularly refers to the provision of federal funds by a national central bank of the Eurosystem to a solvent financial institution or a group of solvent financial institutions against asset-backed securities.[88] The ECB's Governing Council can (and should) oppose to granting ELA with a two-thirds majority in case it is not compatible with the tasks and objectives of the Eurosystem, pursuant to Article 14.4 of the Statute of the ESCB and of the ECB in conjunction with the ELA rules of conduct. Provided that the ECB's ELA is not opposed by the Governing Council, the Greek central bank grants the requested ELA credits to Greek credit institutions which purchase short-term government bonds as a quid pro quo and account them as security collateral.

The fact that it is *temporary* liquidity assistance for *solvent* credit institutions against *collaterals* is crucial. ELA should not be an instrument of long-term financing as these in turn require a decision that must be democratically legitimised. Nevertheless, these prerequisites were not considered to the full extent as one prerequisite fell into oblivion: The President of the ECB established that ELA should only be granted to solvent banks against collaterals.[89] However, no mention of it being only a temporary financial aid was made. The ELA granted to Greek banks already take a very long time and, in part, have become the only source of financing for these banks which justifies doubts as to their financial solidity.

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87. *Results of 2014 EU-wide Stress Test*, EUROPEAN BANKING AUTHORITY 39, 43 (2014), https://www.eba.europa.eu/documents/10180/669262/2014+EU-wide+ST-aggregate+results.pdf (last visited Apr. 1, 2017).
88. *ELA Procedures*, EUROPEAN CENTRAL BANK (2014), https://www.ecb.europa.eu/pub/pdf/other/201402_elaprocedures.en.pdf.
89. Mario Draghi, *Introductory Statement to the Press Conference (with Q&A)*, EUROPEAN CENTRAL BANK (July 16, 2015), www.ecb.europa.eu/press/pressconf/2015/html/is150716.en.html#qa (last visited Apr. 1, 2017).

In addition, ELAs offset the withdrawal of savings deposits from the Greek credit institutions which purchased governmental bonds instead. New financial resources accrued to Greece and were then cashed out to State employees and pensioners by the state and withdrawn from the bank accounts in the form of cash withdrawals or foreign bank transfers. Some criticised that the beneficiaries of State resources would not have been able to withdraw these funds from their account if the ECB had not authorised the Greek banks to use the ELA credits for purchasing Greek government bonds.[90] Although there is no clear evidence to support this argument, it still becomes clear that the ECB passed over legal provisions when granting ELA. Granting financial support in the form of ELA to one of the Member States is obviously not part of monetary policy.[91] When granting emergency liquidity assistance to the Greek central bank, behind the scenes the Piraeus Bank and the National Bank of Greece were further granted precautionary recapitalisation, via the Hellenic Financial Stability Fund. This implied that, based on the results of the stress test, the squeeze on capital does not accrue from the base-line scenario, but from the crisis scenario and can be balanced out through precautionary recapitalisation by the State Financial Stability Fund to the individual credit institutions. Due to the results of the SSM at the ECB, these conditions were satisfied so that the Directorate-General for Competition at the European Commission declared that granting these capital injections was compatible with the European law on state aid.[92]

The ECB has freed banking supervision. It appears likely that some Greek institutions would have already become insolvent if no emergency liquidity assistance had been granted by the ECB. However, financing insolvent credit institutions is not the task of monetary policy but would have been the task of the Greek State which has democratic legitimacy in this regard.[93] This case example documents the beginning of the ECB's legitimacy crisis as regards both, implementing monetary policy as well as performing banking supervision.

90. Clemens Fuest & Hans-Werner Sinn, *Die Risiken der Notkredite*, HANDELSBLATT 64 (July 10, 2015).
91. Case C-370/12, Pringle v. Ireland, 2012 EUR-Lex (Nov. 27, 2012).
92. *National Bank of Greece*, *supra* note 7; *Piraeus Bank*, *supra* note 7.
93. E. James, Florence School of Banking and Finance, Symposium (May. 22, 2016).

V. The Ghost Ship is moving on a Zig-Zag-Course – The Banking Supervision's Weakness becomes stronger by the Possibility to Co-Decide on Banking Resolution

The ECB's decision dilemma between maintaining price stability within the meaning of Article 127(1) of the TFEU and exercising special tasks in banking supervision according to Article 127(6) of the TFEU is further intensified by the ECB's authorisation under secondary law to decide on the conditions for banking resolution and opening a resolution procedure according to Article 18(1) subpara. 2 of the SRMR. The ECB is empowered to supervise the SRB of the SRM and to decide in cooperation with the Board if a probability of default exists for an institution, if resolution measures become necessary, and if these measures are subject to the public interest.[94]

However, the ECB has no authorisation under primary law to perform this task. It is doubtful, whether the treaties finally regulate the ECB's powers or whether it would be possible to assign further tasks to the ECB. The main norm of Article 127 of the TFEU does not contain any express provision hereto. The assignment of further tasks regarding banking resolution under the SRMR requires the corresponding authorisation in primary law, as under Article 127(6) of the TFEU.[95] Such transfer of tasks demands an amendment of the treaties.[96] For want of an authorisation of primary legislation, the ECB is already lacking objective-factual democratic legitimacy for co-deciding on the opening of a resolution procedure which is further enhanced by the already missing organisational-personal democratic legitimacy of the ECB's Governing Council.

The SSM's banking supervision has a bearing on the decision of the ECB's Governing Council on the opening of a resolution procedure. This conflict of competence without democratic legitimacy having far-reaching financial market policy effects has been observed as an example with the Italian bank Monte dei Paschi di Siena since December 2016.

Based on the data of the banking supervision by the SSM at the ECB, the stress test of the EBA for the Italian bank Monte dei Paschi dei Siena

94. Denise Bauer & Alicia Hildner, *Die Sanierung, Abwicklung und Insolvenz von Banken - Ein vollendeter Dreiklang?*, DEUTSCHE ZEITSCHRIFT FÜR WIRTSCHAFTS- UND INSOLVENZRECHT 251, 262 (2015) (in detail).
95. Häde, *supra* note 68, para. 58.
96. Bernd Krauskopf & Christine Steven, *The Institutional Framework of the European System of Central Banks: Legal Issues in the Practice of the First Ten Years of its Existence*, COMMON MARKET LAW REVIEW 1143, 1174 (2009).

performed in October 2016 showed sufficient capital resources when assuming a base-line scenario, however, when assuming a crisis scenario, it showed shortages in capital of -10.4 percent in equity.[97] Without essential changes to the economic conditions, a squeeze on capital of EUR 8.8 billion and a decline in the core capital ratio to 8 percent appeared. Due to this, the bank Monte dei Paschi di Siena was threatened by insolvency and resulted in the ECB's Governing Council being faced with the decision on winding up this bank which the ECB finally refused based on a *de facto* doubtful decision.

The conditions for opening a resolution procedure in accordance with Article 32(1) lit. a-c) of the BRRD can be set out step-by-step and subsumed. Three conditions have to be fulfilled cumulatively. Firstly, the credit institution is failing or is likely to fail, Article 32(4) of the BRRD. Secondly, there are no alternative private sector measures, measures by an institutional protection scheme or measures to write down or convert capital instruments, Article 32(1) of the BRRD. Thirdly, taking resolution action is necessary in the public interest, Article 32(5) of the BRRD.

In the present case of the bank Monte dei Paschi di Siena, a payment default is likely, due to the high proportion of defaulted credits. Moreover, negotiations with various funds to provide further liquid funds were unsuccessful. The fact that even risk loving creditors did not provide any further liquid funds is at least another indication of the institution's probability of default. Resolution action seems to be in the public interest, in particular to protect public funds by minimising reliance on extraordinary public financial support according to Article 32(5) in conjunction with Article 31(2) lit. c of the BRRD.

The decision of the Governing Council of the ECB to deny the existence of conditions for resolution takes into account Article 32 IV lit. d) No. iii), subpara. 2 of the BRRD, Article 18(1) subpara. 2, (4) lit. d) No. iii), subpara. 2 of the SRMR. According to this, Monte di Paschi die Siena was neither likely to fail, however, the conditions for precautionary recapitalisation were fulfilled like it was already the case in Greece with the National Bank of Greece and the Piraeus Bank. Nevertheless, any such action can only be taken for solvent credit institutions, which appeared rather doubtful to the case with Monte dei Paschi di Siena due to the above-mentioned considerations. Furthermore, precautionary recapitalisation also requires three conditions to be met: Firstly, recapitalisation shall be precautionary and the squeeze on capital shall be temporary; Secondly, recapitalisation has to be suitable for remedying the effects of serious disturbances; Thirdly, recapitalisation shall not serve loss absorption. When

97. *2016 EU-wide Stress Test*, *supra* note 8.

subsuming these three conditions, it is already questionable if the bank Monte dei Paschi di Siena still classifies as a solvent institution. Precautionary recapitalisation merely is intended to address capital shortfalls established in the stress tests and shall not be used to offset losses that the institution has incurred when selling non-performing loans.[98] Already the objective existence of the first and the third condition appear rather doubtful, but even if the ECB would have assumed the failure or the likely failure of Monte dei Paschi, the European Commission would have been the final decision-maker regarding the performance of a potential resolution. Taking into account the way the Commission already reacted to the compatibility of precautionary recapitalisation and the European State aid rules, it is unlikely that a different outcome would have been reached.

Finally, the ECB decides on the non-existence of conditions for resolution, notwithstanding that – from a legal point of view– the SRB would also be authorised to do so. In political practice, the ECB forces back the SRB in order to, in turn, cover up its own weak vision in banking supervision. The lack of democratic democracy is thus further reinforced.

VI. Summary and Outlook

As an actor of banking supervision and banking resolution, the ECB is lacking democratic legitimacy. Decisions within the scope of banking regulation exceed the mandate of maintaining monetary policy and neither have a legal nor a democratic legitimacy.

Linking monetary policy to banking supervision led to a conflict of interests, which can be seen as uncontrolled navigation in uncharted waters, already in the first case of application. Decisions can no longer be credited to the will of the people and its representatives but are made by a politically-steered panel, disguised as an expert panel. With the formally balanced participation of national representatives in the ECB's Governing Council, there is a risk that a majority of representatives of less populous Member States, or particularly crisis-prone or economically distressed Member States decide in favour of a casual exercise of banking supervision, of the purchase of credit securitisations or government bonds by a simple majority of votes, or for granting emergency liquidity assistance by a two-thirds-majority. The concentration of executive decision-making authority at the ECB which is represented according to the principle of State egalitarianism, and not according to the population or the liability risk, shakes the principles of

98. Triantafyllakis, *supra* note 8, at 2255.

representative democracy within the EU. Considering either demographic conditions or respective financial strength, it might provide an escape route, but such a provision appears not to be politically feasible in the Statute of the European System of Central Banks and of the ECB.

In the current crisis in Greece, commingling monetary policy and banking supervision has led to a partially weak vision of the banking supervision being balanced out by monetary policy. In other words, the solvency of impaired credit institutions is restored by the money printing of the ECB. This resembles careering down the road on the wrong side! Any such overstepping of tasks assigned should have been detected and corrected through checks and balances of other institutions. It would have been the banking supervision's duty to prevent the impending insolvency of the Greek credit institutions. An independent banking supervision outside the ECB should have expected that emergency liquidity assistance could be ended at any time and should have pointed out the solvency problems which would follow from such termination. This weakness of the ECB also continues to exist in Italy where it is not only covered up by the awarding of emergency liquidity assistance but also by the ECB's failure to introduce resolution actions and by the Commission's acceptance of a precautionary recapitalisation by the State of Italy.

A viable solution can only be the separation of monetary policy and banking supervision. For this purpose, it is vital to amend the European Treaties. The more the monetary and economic responsibilities merge, the more the democratic legitimacy of the ECB's independence vanishes. As a consequence of the case examples in Greece and Italy, it would be more honest to adjust the legal circumstances to the actual circumstances than undermining the legislative framework.

The statement made by the President of the ECB at the beginning of the European banking and financial crisis is today in most cases only reproduced in an abridged way. "Whatever it takes" has become the ECB's guiding principle. In monetary policy and banking regulation, the ECB actually undertakes whatever it economically costs. The mandate degenerates into an empty phrase. Legal boundaries of the mandate are often ignored and severely violated. The ECB has changed. There is nothing left but to shout from the shore so that this ghost ship will find its way back into familiar waters based on the coordination of democratic legitimacy and will not run aground.

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