33 Challenges Related to the Power of the European Central Bank to Apply National Law

Olivier Voordeckers[*]

33.1 Introduction

The establishment of the European Banking Union is a historical step in the direction of enhanced integration in the field of banking supervision and resolution.[1] The Banking Union is not an institution, but rather a concept describing the legal framework that thoroughly restructures banking supervision and resolution in the Euro area. It is composed of three pillars: The Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM) and a European Deposit Insurance Scheme (EDIS). At the time of writing, the latter is yet to be set up, with a proposal for Euro-area wide Deposit Insurance Scheme on the table of the EU legislature.[2]

The SSM is conceived by the SSM Regulation,[3] which fundamentally reshapes the institutional design of banking supervision. While banking supervision was traditionally a purely national affair, the SSM Regulation gives vast supervisory tasks and powers to the European Central Bank (ECB), transforming the latter into a full-fledged banking supervisor. The SSM does however not imply a complete transfer of supervisory competences from the national to the EU level. Instead, it entrusts the ECB with the supervision of those Euro Area credit institutions that are significant in terms of size, economic importance and value of cross-border activities.[4] Today, 129 banks have been qualified as significant credit institutions under direct ECB supervision.[5] All the other banks remain under the

* PhD candidate, University of Luxembourg and University of Piraeus, olivier.voordeckers@uni.lu.

1 Pierre-Henri Conac, 'L'union bancaire: Une avancée historique!' (2014) 206 Journal de droit européen 41.

2 Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme, COM/2015/0586 final – 2015/0270 (COD).

3 Council Regulation (EU) No. 024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (SSM Regulation) [2013] OJ L287/63.

4 SSM Regulation, Art. 6(4).

5 ECB Annual Report on supervisory activities 2015, pp. 48-49, available at https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssmar2015.en.pdf.

supervision of the national banking supervisors, commonly referred to as national competent authorities or 'NCAs'.

The SSM Regulation contains a list of supervisory tasks that the ECB must fulfil, such as authorising entities to carry out the business of a credit institution, and assessing the acquisition of qualifying holdings. Furthermore, the ECB must to ensure that supervised entities comply with 'prudential' banking regulation, i.e. the rules that are currently imposed by the Capital Requirements Regulation (CRR)[6] and the Capital Requirements Directive IV (CRD IV).[7] To that end, the SSM Regulation provides the ECB with a set of investigative powers,[8] as well as the power to adopt certain administrative measures[9] and to impose pecuniary penalties on supervised entities.[10]

The Capital Requirements Directive IV (CRD IV) deals mainly with prudential requirements that impose conditions on to the taking-up and pursuit of activities as a credit institution. As it is a Directive, it is an act of Union legislation that is not directly applicable. Consequently, national measures of implementation must transpose the rules enshrined in the CRD IV into the national legal order of the EU Member States. This implies that all the rules and requirements of the CRD IV eventually take the form of national law. In order to make sure that the ECB can carry out its task of ensuring compliance with prudential regulation, including the CRD IV, the SSM Regulation stipulates that the ECB has to apply national legislation implementing Directives.

The fact that the ECB has to apply national legislation is revolutionary. It is indeed the first time that a European institution is competent to enforce national law.[11] This feature of the SSM risks to make the ECB's supervisory work particularly burdensome for different reasons. To start with, in order to ensure compliance with requirements of the CRD IV, the ECB potentially needs to apply 19 different national legislations,[12] as the CRD IV is subject to different national implementations. This stems from the fact that the Member States are only under an obligation to achieve the result desired by the CRD IV, while they are free to choose the form and methods.[13] Another problem relates to the fact that certain Member States impose requirements that go beyond the strict implementation of the CRD

6 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 [2016] OJ L176/1.

7 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 (Capital Requirements Directive IV; CRD IV) [2016] OJ L176/338.

8 SSM Regulation, Arts. 10-13.

9 SSM Regulation, Art. 16.

10 SSM Regulation, Art. 18.

11 Andreas Witte, 'The Application of National Banking Supervision Law by the ECB: Three Parallel Modes of Executing EU Law?' (2014) 21 Maastricht Journal 89.

12 At the time of writing, the Euro Area counts 19 Member States of the 28 European Union Member States.

13 Consolidated version of the Treaty on the Functioning of the European Union (TFEU) [2012] OJ C326/47, Art. 288.

IV. As a consequence, it is not clear to what extent national law is implementing the CRD IV. Can the ECB also apply national rules that go beyond the requirements imposed by the CRD IV, but that pursue the same objectives and fall within the CRD IV's scope from a material point of view?

While the aforementioned problems are certainly interesting and deserve further research, this paper will focus on another issue that is related to the ECB's power to apply national law. When taking a closer look to a number of requirements of the CRD IV, it becomes clear that they are formulated in rather abstract terms and criteria, giving a broad margin of discretion to national banking supervisors when assessing compliance with those rules. Through the exercise of their margin of discretion, NCAs have developed prudential standards, in order to guide the application of vague prudential requirements. As a consequence, even in Member States where the requirements of the CRD IV have been transposed identically, the NCAs may have introduced divergent standards to apply those rules, giving rise to differences in the prudential regimes of those Member States. Now that the ECB has taken up the role of prudential supervision of significant credit institutions, the question arises as to what extent the ECB can harmonise those standards throughout the Euro area by setting its own prudential standards and applying them consistently.

With regard to the broad margin of discretion that banking supervisors enjoy in the application of prudential rules, standard setting fosters legal certainty by giving an expression to the expectations and policy goals of the supervisor. The ECB being charged with the task and responsibility to apply national legislation,[14] it seems to be common sense that it can – and even should – formulate the standards according to which it will apply certain prudential requirements. The effect thereof would be that those requirements are subject to harmonisation at the stage of their application: The broad criteria imposed by the CRD IV would indeed be narrowed down to requirements that are more detailed and more specified. Alternatively put, the ECB would take the harmonisation of prudential regulation beyond the level of harmonisation achieved by the CRD IV. The purpose of this paper is to identify challenges related to such a power of harmonisation, and to raise questions for further research.

Part 33.2 of this paper will develop what internal market harmonisation is, and what forms it can take. Part 33.3 will thereupon evaluate the early supervisory practice of the ECB in order to assess whether it has the potential of achieving internal market harmonisation. Part 33.4 will discuss future challenges brought by the power of the ECB to apply national law. Part 33.5 will conclude.

14 SSM Regulation, Art. 4(3) and 6(1).

33.2 What Is Harmonisation?

A clear definition of harmonisation is lacking. The concept of harmonisation is subject to a range of different doctrinal definitions.[15] It is also plagued by terminological confusion, as it not clearly distinguished from terms such as 'approximation', 'coordination', 'unification', 'convergence', *et cetera*.[16] The following paragraphs do not aim to formulate a definition of harmonisation, but to identify some main traits.

It has been observed that "harmonisation seen through the lens of the founding Treaties is conscious, intended, and requires the volitional setting of a European standard by a European institution, to which the Member States adapt their legal orders."[17] As such, harmonisation should be distinguished from convergence, which occurs when States start using concepts or principles from other jurisdictions in a rather spontaneous fashion, for instance when legislatures or judges draw inspiration from foreign legislation or jurisprudence.[18]

Harmonisation is often the consequence of the adoption of EU legislation, giving rise to 'positive integration'.[19] Such integration occurs when the EU legislature actively sets a common standard at EU level, with the objective of ironing out different national standards.[20] In relation to the internal market, this form of harmonisation finds its legal basis in the TFEU. Pursuant to Article 114 TFEU, which is considered to be the EU's 'general' harmonisation competence, the European Parliament and the Council can jointly adopt "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."[21] Article 114 TFEU therefore constitutes the legal basis of the CRR, which harmonises a vast range of prudential requirements applying to the banking industry.

Next to Article 114 TFEU, several Articles of the TFEU provide for specific "sectorial" legal bases for legislative harmonisation.[22] It is worth mentioning Article 53(1) TFEU, which empowers the European Parliament and the Council to adopt Directives for the

15 Eva J Lohse, 'The Meaning of Harmonization in the Context of European Union Law – a Process in Need of Definition' in Mads Andenæs and Camilla Baasch Andersen (Eds.), *Theory and Practice of Harmonisation* (Theory and Practice of Harmonisation, Edward Elgar 2012).

16 Ibid.

17 Ibid.

18 Ibid.

19 Robert Schütze, *From Dual to Cooperative Federalism: The Changing Structure of European Law* (Oxford University Press 2009) 193-194.

20 Ibid.; Lohse, 'The Meaning of Harmonization in the Context of European Union Law – a Process in Need of Definition'.

21 TFEU, Art. 114(1).

22 Amedeo Arena, 'The Doctrine of Union Preemption in the EU Internal Market: Between Sein and Sollen' (2010) 17 Columbia Journal of European Law 477; See TFEU, Arts. 46, 50, 52(2), 53.

mutual recognition of diplomas, certificates and other evidence of formal qualifications. It is important to highlight that Article 53(1) TFEU is the legal basis of the CRD IV, which deals *inter alia* with the conditions for the obtainment of a banking license in order to take up and pursue of the activities of a credit institution. Two observations should be made regarding Article 53(1) TFEU. First, to the image of Article 114 TFEU, measures based on Article 53(1) TFEU must be adopted following the ordinary legislative procedure.[23] In other words, legislative harmonisation of regulation relating to the internal market (based on Article 114 TFEU) and, more specifically, to formal qualifications (based on Article 53(1) TFEU) is subject to a requirement of constitutional nature, namely a bicameral legislative procedure.[24] Second, it should be noted that Article 53(1) TFEU only allows for the use of Directives. As a consequence, in the field of banking, it is not legally possible to achieve a full transition towards a body of material law solely composed by Regulations, because the rules relating to the taking-up and pursuit of activities as self-employed persons are subject to a specific legal basis imposing the use of Directives.[25] Hence, a limited core of prudential banking regulation will always need to be incorporated in Directives.[26]

The adoption of EU legislation is not the only means of harmonisation. The emergence of common EU standards can also be achieved through judicial means. On the basis of Article 267(a) TFEU, the CJEU has jurisdiction to give preliminary rulings concerning the interpretation of the Treaties. This has allowed the CJEU to interpret the Four Freedoms enshrined in the Treaties, namely the free movement of goods,[27] persons,[28] services,[29] and capital.[30] While these Four Freedoms require the removal of national obstacles to their realisation, they are not self-sufficient. They need common judicial interpretation that condemns national measures that jeopardise their effectiveness. The CJUE's interpretation of the Four Freedoms pushes Member States to abolish national obstacles to free trade,[31] giving rise to harmonisation of the internal market. This has been referred to as 'negative integration',[32] in the sense that the Four Freedoms, as interpreted by the CJEU, induce the

23 TFEU, Art. 53(1). See also TFEU, Art. 114(1). The ordinary legislative procedure, which is defined in Art. 294 TFEU, consists in the joint adoption by the European Parliament and the Council of a regulation, directive or decision on a proposal from the Commision.

24 Robert Schütze, *European Constitutional Law* (2 edn, Cambridge University Press 2012) 244.

25 Council of the European Union (Opinion of the Legal Service), Interinstitutional Files 2012/0242 (CNS) and 2012/0244 (COD), ST14752/12 (Brussels, 9 October 2012), para. 19.

26 Ibid.

27 TFEU, Art. 28.

28 TFEU, Arts. 45 and 49.

29 TFEU, Art. 56.

30 TFEU, Art. 63.

31 Lohse, 'The Meaning of Harmonization in the Context of European Union Law – a Process in Need of Definition' (*supra*).

32 Schütze, *From Dual to Cooperative Federalism: The Changing Structure of European Law*, 194.

EU Member States to eliminate national barriers to market integration.[33] Although the CJEU does not directly impose an EU standard, it indirectly forces Member States to modify their laws in function of the standard upheld by the CJEU, since they risk to face liability for a breach of EU law if they refuse to act accordingly.[34]

On the basis of the foregoing considerations relating to the notion of harmonisation, some intermediary remarks can be made before moving on to an evaluation of the ECB's supervisory practice. A first remark is that harmonisation implies the determination of a standard through legislative or judicial means. This standard can be a clearly defined rule, which is mostly the case for Regulations, or it can be a rather abstract standard that requires national realisation, which is often the case for Directives.[35] The standard can even be implicit, which is the case when the CJEU decides upon the conformity of national measures with the Four Freedoms. While the CJEU does not explicitly formulate a European standard, the latter can be negatively inferred from the CJEU's decision on the validity of the national standard.

A second finding is that harmonisation is a process that involves the Member States.[36] When the EU legislature adopts an act, or when the CJEU takes a decision, the Member States are urged to take the necessary measures to modify their national legal orders in function of the standard set by the legislature or pronounced by the CJEU. This is also the case when the EU legislature adopts Regulations. Even though Regulations are directly applicable and do not necessitate national measures of implementation, it is not exceptional that provisions of Regulations require national authorities to adopt implementing measures.[37] Thus, even in the case of Regulations, the Member States are involved in the harmonisation process, although their involvement might be rather limited.

A third observation that can be made is that Member State involvement in the harmonisation process may be stronger in certain sectors. This is the case when the TFEU only allows for the use of Directives to regulate certain specific issues, such as the rules relating to the taking-up and pursuit of activities as self-employed persons. Directives require the adoption of national measures of implementation, which enhances the Member States' role in the process of harmonisation. This also implies a margin of discretion on the side of the Member States, as for the implementation of a Directive, the Member States only have to achieve the result sought by the Directive, while they remain free to choose the

33 For an in-depth analysis, see Pedro Caro de Sousa, 'Negative and Positive Integration in EU Economic Law: Between Strategic Denial and Cognitive Dissonance' (2012) 13 German Law Journal 979.

34 Lohse, 'The Meaning of Harmonization in the Context of European Union Law – a Process in Need of Definition' (*supra*).

35 Ibid.

36 Ibid.

37 Richard Král, 'National normative implementation of EC Regulations: An exceptional or rather common matter?' (2008) European Law Review 243.

form and methods.[38] One may thus consider that, by imposing the use of Directives for the harmonisation of certain issues, the TFEU safeguards a broader margin of discretion on the side of the Member States in the regulation of those issues.

Having discussed the main traits of harmonisation, the following part will take a closer look at the supervisory practice of the ECB, in order to evaluate to what extent it can achieve harmonisation of national requirements that implement the CRD IV.

33.3 The Supervisory Practice of the ECB: Setting Prudential Standards

On the 4th of November 2014, the ECB has taken up the supervisory mandate conferred to it by the SSM Regulation. Quite rapidly thereafter, it has acknowledged in press releases and policy publications that it is developing uniform supervisory practices, prudential standards and policy stances concerning the application of national requirements that result from the implementation of the CRD IV.[39] Three examples are worth to be mentioned in this regard: the supervisory assessment of the suitability of bank managers (33.3.1), the assessment of qualifying holdings (33.3.2), and the evaluation of remuneration policies (33.3.3).

33.3.1 The Assessment of the Suitability of Bank Managers

Suitability or 'fit and proper' requirements are set out under Article 91 of the CRD IV, which is formulated in very broad and abstract terms. Article 91 requires members of the management body to be "of sufficiently good repute" and to "possess sufficient knowledge, skills and experience to perform their duties." The overall composition of the management body also needs to "reflect an adequately broad range of experiences," and possess "adequate collective knowledge, skills and experience."[40] Moreover, members of the management body must "act with honesty, integrity and independence of mind", and they have to "commit sufficient time to perform their functions in the institution". In addition, Article 91(3) imposes a limit on the number of executive and non-executive directorships that a member of the management body may hold, depending on the "individual circumstances and the nature, scale and complexity of the institution's activities". Article 91(5) specifies

38 TFEU, Art. 288.

39 ECB Annual Report on supervisory activities 2015 (*supra*); Sabine Lautenschläger (Vice-Chair of the Supervisory Board), *Single Supervisory Mechanism. Achievements after one year* (Presentation at the Eleventh High-level Meeting for the Middle East & North Africa Region: Global Banking Standards and Regulatory and Supervisory Priorities).

40 CRD IV, Art. 91(7).

that "directorships in organisations which do not pursue predominantly commercial objectives shall not be taken into account". The aforementioned suitability criteria are interpreted differently across the Euro Area,[41] as banking supervisors enjoy a broad margin of appreciation when they judge upon the satisfaction of suitability criteria.

The ECB has developed "uniform supervisory practices" in the area of suitability requirements.[42] In particular, "common SSM policy stances" have been developed regarding the requirement of sufficient time commitment to perform a management function, the way of counting directorships that may be held by a member of the management body, the assessment of a management body's collective suitability, and the evaluation of relevant experience.[43] In order to verify whether this quest for supervisory uniformity amounts to harmonisation of the relevant prudential requirements, the question that arises is whether the ECB has the power to enforce its in-house standards, or whether their effective application remains subject to the discretion that NCAs enjoy under the CRD IV.

The ECB's powers to ensure compliance with fit and proper requirements are enshrined in the SSM Regulation. It can reject the authorisation of significant as well as less significant credit institutions if it considers that the suitability criteria stemming from the CRD IV are not fulfilled.[44] Furthermore, upon any change to the composition of the management body of a significant supervised entity, or upon any change of facts that may affect an initial assessment of suitability,[45] the ECB decides on appropriate action, which may include a decision requiring the removal of a member (or different members) from the management board.[46] The ECB can impose such a decision directly on significant banks under its supervision, without the need to have recourse to the relevant NCAs. Lastly, suitability assessments can also be triggered by investigations. It is important to highlight that the ECB has autonomous investigatory powers, which it can exercise over significant as well as less significant institutions. For instance, the ECB's staff can autonomously – i.e. without the need to have recourse to the NCAs – require the submission of documents, examine books and records, conduct interviews, and carry out on-site inspections.[47] If the results of an investigation reveal that a member of the management body of a significant credit

41 Sabine Lautenschläger (Member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the ECB), *Single Supervisory Mechanism – Single Supervisory Law?* (Keynote speech at the Workshop of the European Banking Institute hosted by the ECB, Frankfurt, 27 January 2016); EBA Report of 16 June 2015 on the peer review of the Guidelines on the assessment of the suitability of members of the management body and key function holders (EBA/GL/2012/06) 5.

42 Sabine Lautenschläger (Vice-Chair of the Supervisory Board), *Single Supervisory Mechanism. Achievements after one year* (*supra* n. 39).

43 ECB Annual Report on supervisory activities 2015 (*supra*) 51.

44 SSM Regulation, Art. 14(3); SSM Framework Regulation, Art. 77(1).

45 SSM Framework Regulation, Art. 94(1).

46 SSM Regulation, Art. 16(2)(m).

47 SSM Regulation, Art. 10-12.

institution cannot be considered as fit and proper, the ECB has the power to remove at any time that member from the management body.[48]

The ECB's far-reaching powers to ensure compliance with national suitability criteria, in combination with the fact that it has developed its own policy stances on that matter, supports the idea that the ECB will effectively apply its own interpretation of those criteria. Hence, its supervisory practice absorbs the margin of discretion that the CRD IV grants to the NCAs. The SSM thus has the potential to iron out the diversity of prudential standards existing under the CRD IV, and to enforce a harmonised application of national rules.

33.3.2 The Assessment of Qualifying Holdings

Article 23(1) of CRD IV prescribes criteria for the prudential assessment of acquisitions and increases in qualifying holdings. The relevant criteria are, *inter alia*, the "reputation" and the "financial soundness" of the proposed acquirer. Once again, the assessment of such vague criteria implies a rather broad margin of discretion of the NCAs, giving rise to a risk of regulatory divergence.

In the ECB's 2015 annual report on supervisory activities, it has acknowledged that it has developed – in cooperation with the NCAs – common SSM policy stances relating to the assessment of acquisitions of qualifying holdings.[49] To the image of the regime applicable to authorisations of credit institutions, the ECB is entrusted with the task to assess notifications of the acquisition and disposal of qualifying holdings in credit institutions.[50] While the assessment is carried out by the NCAs in practice, the ECB always has a final say, as it can decide to oppose the acquisition if it considers that the relevant assessment criteria are not fulfilled.[51] Hence, the ECB will logically seek to make sure that its policy stances are effectively applied. It is therefore to be expected that within the SSM, the criteria for the assessment of qualifying holdings will be subject to harmonisation, stemming from the fact that the margin of discretion of NCAs to develop divergent standards is absorbed at EU level.

33.3.3 The Evaluation of Remuneration Policies

Remuneration policies are an essential element of sound and prudent corporate governance, as they have an important incidence on the risk culture of an institution. Therefore, Article

48 SSM Regulation, Art. 16(2)(m).
49 ECB Annual Report on supervisory activities 2015 (*supra*) 51-52.
50 SSM Regulation, Art. 4(1)(c) and 15.
51 SSM Regulation, Art. 15(2).

92(2) of CRD IV requires NCAs to ensure that credit institutions comply with a list of principles. The main purpose of those principles is to align the personal objectives of employees with the credit institution's long-term interests. For instance, remuneration policies need to be "consistent with and promote sound and effective risk management", and must be "in line with the business strategy, objective, values and long-term interests of the institution". When it comes to variable remuneration, Article 94(1) of CRD IV prescribes another list of principles, requiring *inter alia* that variable remuneration must be based on an assessment of the "longer-term performance" of the individual, taking into account "financial and non-financial criteria".

The prudential analysis of remuneration policies is part of the Supervisory Review and Evaluation Process (hereinafter "SREP"), which NCAs are obliged to carry out pursuant to Article 97 of CRD IV. The SREP includes an assessment of compliance with CRD IV provisions, such as those concerning remuneration.[52] Prior to the entry into force of the SSM,[53] national SREPs were rather diverse. In 2015, the SREP was for the first time carried out according to a common SSM methodology.[54] At the outcome of the SSM's SREP, the ECB can take the necessary supervisory measures. More specifically, the ECB has the power to require institutions to limit variable remuneration. The ECB will expectedly apply the same supervisory standards to the assessment of remuneration policies across all Member States participating in the SSM. In fact, the ECB's Supervisory Policies Division assists in developing statutory prudential requirements on remuneration policies and practices.[55]

The three aforementioned examples witness of the fact that the ECB is effectively and actively harmonising the broad criteria of the CRD IV to a deeper extent, by defining more precise standards and policy stances while enjoying the power to ensure the effective application of those standards. In its 2015 Annual Report on supervisory activities, the ECB states that "euro area policy standards and supervisory practices" have been defined in order to ensure "harmonisation in the application" of national requirements stemming from the CRD IV.[56] In other words, the ECB's supervisory practice achieves harmonisation in the internal market. Such a phenomenon of harmonisation of national norms at the stage of their application is unprecedented, as the it is the first time that an European institution has been vested with the power to apply national law.

52 See ECB, *SSM SREP Methodology Booklet*.
53 The SSM entered into force on the fourth of November 2014.
54 ECB, *The Supervisory Review and Evaluation Process in 2015*, https://www.bankingsupervision.europa.eu/banking/html/srep.en.html.
55 ECB Guide to Banking Supervision (November 2014) para. 24.
56 ECB Annual Report on supervisory activities 2015 (*supra*) 51.

33.4 Challenges Raised by the Harmonisation of National Law by the ECB

A closer look at the ECB's supervisory practice shows that the SSM gives rise to a phenomenon of harmonisation in the application of prudential requirements. By specifying and enforcing standards at EU level, the ECB achieves a degree of harmonisation of CRD IV requirements that goes beyond the degree of harmonisation achieved by the CRD IV. The broad and vague criteria of the CRD IV are indeed narrowed down to more precise standards and policy stances, which the ECB can effectively apply by using its enforcement powers. When the ECB's supervisory practice achieves deeper harmonisation of CRD IV requirements, the proper procedure to obtain that degree of harmonisation is arguably circumvented. The CRD IV has been adopted on the basis of Article 53(1) TFEU, which foresees the application of the ordinary legislative procedure (OLP). As stated above, the OLP is a bicameral legislative procedure that involves both the Council and the Parliament. If the EU wishes to replace the abstract requirements of the CRD IV by more precise requirements that leave less discretion to the Member States, it should consider the adoption of a CRD V. Within the SSM however, the harmonisation of prudential standards seems to happen outside of the scope of the proper democratic procedure.

Contrary to legislative and judicial means of harmonisation, there is no Member State involvement in the harmonisation process that occurs within the SSM. The ECB's prudential standards are not imposed on the Member States. Instead, the ECB applies its standards directly to significant credit institutions under its supervision. It should be recalled that Article 53(1) of the TFEU imposes the use of Directives, thereby safeguarding a higher degree of Member State involvement and as such a broader margin of discretion on the side of the Member States. This margin of discretion, although foreseen by the TFEU, seems to get absorbed within the SSM. It may thus be concluded that there seems to be an issue of democratic legitimacy when harmonisation through centralised enforcement takes the place of harmonisation through centralised legislation.

The fact that the SSM achieves harmonisation of national prudential requirements may also spur scepticism about the sufficiency of the legal basis of the SSM Regulation, namely Article 127(6) TFEU. This provision stipulates that

> 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.

Scholars are divided as to the sufficiency of Article 127(6) TFEU to serve as a legal basis for the SSM. A substantive part of legal scholarship advocates for a narrow reading of Article 127(6) of the SSM, mostly arguing that the notion of "specific tasks" does not allow for the conferral of a general supervisory role upon the ECB.[57] Other publicists advance the contrary, considering that the supervisory tasks listed by the SSM Regulation are sufficiently specific in order to be able to be transferred to the ECB under Article 127(6) TFEU.[58] Hitherto, the ECJ has not had the opportunity to interpret the legality of the SSM Regulation in the light of 127(6) TFEU. The legal basis of the SSM is currently being challenged in a pending case in front of the German Federal Constitutional Court (*Bundesverfassungsgericht*).[59] A reference to the CJEU for a preliminary ruling will hopefully bring clarity about the validity of the SSM Regulation. In any case, the fact that the SSM allows the ECB to harmonise national prudential standards in a way that arguably circumvents the applicable democratic safeguards for internal market harmonisation does not foster an optimistic view on the sufficiency of Article 127(6) as legal basis for the SSM.

If the CJEU were to confirm the validity of the SSM Regulation – which is likely to happen[60] – the ECB might face resistance from the national level. National legislatures or NCAs with regulatory powers might start pouring their own national standards into legislation. In that case, the ECB is left with no power but to apply this legislation, as Article 4(3) of the SSM Regulation provides that, in order to carry out its supervisory tasks, the ECB has to apply national legislation implementing the CRD IV. The fact that national authorities would enjoy the right to not to implement standards that are set at the European level is interesting, and suggests that the harmonisation phenomenon occurring within the SSM is crippled. This is the result of two elements. First, the ECB has no regulatory

57 Takis Tridimas, 'General Report', *in* Bándi, Darák, Halustyik, Láncos, *European Banking Union*, FIDE Congress Proceedings Vol. 1 (Wolters Kluwer 2016) 108, citing Benedikt Wolfers and Thomas Voland, 'Level The Playing Field: The New Supervision Of Credit Institutions by the European Central Bank' (2014) 51 Common Market Law Review 1463, 1485-86; Bernd Krauskopf, Julian Langer, Michael Rötting, 'Some Critical Aspects of the European Banking Union' (2014) 29(2) Banking & Finance Law Review 241, 255; Francesco Martucci, *L'ordre économique et monétaire de l'Union européenne* (Bruylant 2015) point 62; Jean-Victor Louis, *Union économique et monétaire, cohésion économique et sociale, politique industrielle et technologie européenne* (2nd edn, Éditions de l'Université de Bruxelles 1995) 94.

58 Tridimas (*supra* n 57) 108; Niamh Moloney, 'European Banking Union: Assessing Its Risks And Resilience' (2014) 51 Common Market Law Review 1609, 1631, 1659; Gunnar Schuster, 'The banking supervisory competences and powers of the ECB' (2014) Europäische Zeitschrift für Wirtschaftsrecht 2; Gijsbert Ter Kuile, Laura Wissink and Willem Bovenschen, 'Tailor-made accountability within the Single Supervisory Mechanism' (2015) 52(1) Common Market Law Review 155; Schuster, 'The banking supervisory competences and powers of the ECB'.

59 Case No. 2 BVR 1685/14, see Bundesverfassungsgericht, Übersicht für das Jahr 2016, available at www.bundesverfassungsgericht.de/DE/Verfahren/Jahresvorausschau/vs_2016/vorausschau_2016_node.html.

60 See Takis Tridimas, 'General Report', *in* Bándi, Darák, Halustyik, Láncos, *European Banking Union*, FIDE Congress Proceedings Vol. 1 (Wolters Kluwer 2016).

power in the field of banking regulation,[61] meaning that it can only develop soft-law standards, which do not enjoy primacy over national legislation. Second, there is a lack of Member State involvement in the harmonisation process, as pointed out above. This lack of involvement of national authorities might become a real obstacle to the successful outcome of the attempted harmonisation process, due to the possibility of national resistance through the legislative consecration of national policy choices.

33.5 Concluding Remarks

The objective of this paper was to identify challenges related to the power of the ECB to apply national law and to impose its own prudential standards when it exercises that power. It was argued that the application of common prudential standards throughout the Euro Area would give rise to a phenomenon of harmonisation. In order to verify whether the supervisory practice of the ECB is effectively achieving harmonisation, the main characteristics of harmonisation have been identified, namely standard setting and Member State involvement. On the basis of an evaluation of the early supervisory practice within the SSM, it has been noted that the ECB indeed actively formulates in-house prudential standards and policy stances in order to apply them directly to banks under supervision. This allows the ECB not only to make but also to enforce a harmonised Euro area-wide prudential policy.

The challenges that stem from the harmonisation of prudential requirements at the stage of their application result mainly from the fact that those requirements are enshrined in a Directive based on Article 53(1) TFEU. This Article subjects the regulation of CRD IV-related matters – such as formal qualifications – to the constitutional requirement of a bicameral legislative procedure. This procedure is arguably circumvented by harmonising CRD IV requirements through enforcement instead of the legislative adoption of a CRD V. Furthermore, Article 53(1) TFEU only allows for the use of Directives, which implies that it safeguards a higher degree of Member State involvement in the process of harmonisation. The national margin of discretion resulting from higher Member State involvement seems to be absorbed within the SSM, as it allows the ECB to narrow down the broad prudential standards of the CRD IV and to apply them directly to supervised entities. Taking into account these issues, the biggest challenge that the SSM will face is to guarantee the legitimacy of prudential policy-making.

61 See Guido Ferrarini and Fabio Recine, 'The Single Rulebook and the SSM. Should the ECB Have More Say in Prudential Rule-making?' *in* Danny Busch and Guido Ferrarini (Eds.), *European Banking Union* (European Banking Union, Oxford University Press 2015).