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Tobias Tröger

How Not To Do Banking Law in the 21st Century

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SAFE | Sustainable Architecture for Finance in Europe
A cooperation of the Center for Financial Studies and Goethe University Frankfurt

House of Finance | Goethe University
Theodor-W.-Adorno-Platz 3 | 60323 Frankfurt

Tel. +49 69 798 33684 | Fax +49 69 798 33910
policy_center@safe.uni-frankfurt.de | www.safe-frankfurt.de

How Not To Do Banking Law in the 21st Century

The Judgement of the European General Court (EGC) in the Case T-122/15 – Landeskreditbank Baden-Württemberg – Förderbank v European Central Bank (ECB)*[1]

Tobias H. Tröger

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Background

The Judgement of the EGC in the Case T-122/15 – Landeskreditbank Baden-Württemberg – Förderbank v European Central Bank[2] is the first statement of the European judiciary on the substantive law of the Banking Union. Beyond its specific holding, the decision is of great importance, because it hints at the methodological approach the EGC will take in interpreting prudential banking regulation in the appeals against supervisory measures that fall in its jurisdiction under TFEU, arts. 256(1) subpara 1 and 263(4). Specifically, the case pertained to the scope of direct ECB oversight of significant banks in the euro area and the reassignment of this competence to national competent authorities (NCAs) in individual circumstances (Single Supervisory Mechanism (SSM) Regulation, art. 6(4) subpara 2; SSM Framework Regulation, arts. 70, 71).

Critique

Regardless of whether the holding of the EGC can be justified with a view to the purposes of the supranationalization of banking supervision in the euro area, the court's formalist handling of prudential regulation provokes criticism. It prevents the court from addressing the substantive questions at hand from a sound normative basis. Moreover, the EGC takes a vigorous pro-centralization stance in construing the division of competences between the ECB and NCAs, although the case would not have required such a positioning: the plaintiff's arguments based on the fundamental principles of subsidiarity and proportionality (TEU, art. 5(3) and (4)) could arguably have been addressed without such

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[1] The paper appeared on the Oxford Business Law Blog on 16 June 2017 https://www.law.ox.ac.uk/business-law-blog?author=13815 accessed 20 June 2017.

[2] Judgment of the General Court (Fourth Chamber, Extended Composition)in Case T-122/15, 16 May 2017 http://curia.europa.eu/juris/document/document.jsf;jsessionid=9ea7d0f130d501ee50be797b483487c5f4ce9dc0b01e.e34KaxiLc3eQc40LaxqMbN4PaxmSe0?text=&docid=190725&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=302212 accessed 20 June 2017.

sweeping statements (the court, however, derives a highly legalistic argument from its deliberations, see para 65).

1. In the view of the EGC, the decision hinged pivotally on the precise interpretation of art. 6(4) subpara 2 of the SSM Regulation and art. 70(1) of the SSM Framework Regulation, which is questionable, because the key normative considerations arguably should have been heard regardless of how the provisions' element of "particular circumstances" is nuanced (see below at 2.). In any case, to reach a determination, the court first addresses the scope of the ECB's supervisory mandate: art. 4(1) of the SSM Regulation can be understood as conferring the enumerated competences exclusively and comprehensively on the ECB; the assignment would thus leave no room for any original supervisory competence of NCAs in substantive matters that come under the SSM even with regard to less significant banks. Alternatively, the supervisory competences referred to in art. 6(4) of the SSM Regulation could be seen as exempt from the ECB's mandate from the outset; if the latter interpretation were correct, with regard to smaller banks, some of the supervisory tasks named in art. 4(1) of the SSM Regulation would remain, in principle, in the domain of NCAs (see paras 49-64).

The EGC endorses the former interpretation, finding that ECB's competence is exclusive and comprehensive also for less significant banks. Be that as it may, the EGC's decision on the point does not seem to matter for practical purposes. Even if an original competence of NCAs vis-à-vis smaller banks had been affirmed, the ECB's codified powers to issue regulations, guidelines and general instructions (SSM Regulation, art. 6(5)(a)) and to assume direct supervisory authority also for smaller banks at any time (SSM Regulation, art. 6(5)(b)) established a clear-cut hierarchy within the SSM with a supranational dominance. Yet, the integration-hostile incentive effect that emanates from a comprehensive, now legally corroborated downgrading of NCAs to navvies of the ECB should not be underestimated: the indispensable flow of information and the essential collaboration in day-to-day operations is not optimally induced, if the law instead of providing positive incentives only bolsters the role of the top as a whipper-in for inherently untrustworthy NCAs: see Tobias H. Tröger, 'The Single Supervisory Mechanism (SSM) – Panacea or Quack Banking Regulation?' (2014) 15 EBOR 449, 473-477.

2. In the key paragraphs, the court's reasoning remains without sufficient contextualization and normative depth. The main arguments turn on the preliminary question whether the legal framework requires to show – as the plaintiff submitted – the necessity of ECB or – as the ECB and its Administrative Board of Review favored – the necessity of NCA supervision. Put differently, the EGC investigates whether ECB oversight is already "inappropriate" within the meaning of art. 70(1) of SSM Framework Regulation if it is "unnecessary" or whether further circumstances have to be established for such a determination. Contrary to the notion of the court that sides with the second interpretation, the case cannot be solved by answering this question of construction alone. Brushing aside all the substantive arguments brought forward by the plaintiff – represented by the top brass of a leading international law firm – as "irrelevant" (see paras 89, 105, 140, 149) simply by pointing to a faulty formulation of the relevant question of law proves chutzpa but does not convince on the merits. Couldn't and shouldn't the plaintiff's key points have been used mutatis mutandis to answer a "correctly" framed opening question? The EGC does so, if at all, only in apodictic marginalia that refer to the burden of pleading (paras 109-111, 140, 144 with 149) – which is particularly regrettable in light of the otherwise rather verbose character of the judgement.

However, one has to agree with the EGC without reservation, that the individual risk profile of an institution is beside the point when it comes to the determination of whether an institution is significant or less significant (but see the plaintiff's position as referenced in para 144). Any such assessment is a mere snapshot, fraught with many uncertainties that cannot be relied on, not least because of the many possibilities to shift a bank's risk-profile also in the short-term by redeploying its assets. Yet, it is something different if the statutorily stipulated and separately supervised (by a local authority) business model of the plaintiff, that is confined both geographically and with regard to substantive scope and does not have cross-border stability implications, should be taken into account in assessing the case under art. 70(1) of the SSM Regulation. Paying attention to these features only considers national particularities that – according to the "hub and spokes" approach of the SSM – should primarily be achieved through the integration of NCAs' expertise in these matters. Even the far more centrist Commission Proposal for the SSM Regulation acknowledged this view in its explanatory memorandum (see, Proposal for a Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, COM(2012) 511 final, at 5). Of course, the ECB can also consider the pertinent idiosyncrasies. However it seems intuitive that NCAs which are closer to the institutions in every respect are in a better position to do so than the remote center that has to care for 19 Member States and, as the case may be, their local subdivisions. For instance, the sixteen German State business development banks are established under the law of the Federal States. Hence their structure, function etc. varies even within Germany.

Further, the judgement is based on the assumption that the objective of the SSM to provide for a "coherent application of high supervisory standards" (for instance para 31 and para 78; see also SSM Regulation, recitals 12, 15, 87) has to be achieved primarily through extensive ECB supervision. In contrast, it has to be recalled that the purpose of supranational oversight lies first and foremost in securing incentive compatibility in the Banking Union[3]: insofar as the regulatory framework draws above all on the European Stability Mechanism (ESM) to establish common backstops for the banking system in the euro area (art. 19 of the ESM-Treaty establishes a direct bank recapitalization instrument), to facilitate the implementation of monetary policy (see Tröger, 'The Single Supervisory Mechanism (SSM) – Panacea or Quack Banking Regulation?', 456-458), supervisory and resolution competences have to be centralized as well for these institutions that potentially benefit from the newly-created safety net. Only this avoids misplaced incentives that loom if the competences for crisis prevention and management are separated from ultimate cost bearing (moral hazard). By establishing such a connection specifically in the case of the Landeskreditbank Baden-Württemberg the court could have found normatively convincing grounds for its results.

On the other hand, it can be disputed both theoretically and empirically that centralized supervision by an insofar unseasoned institution yields higher quality per se (see for instance Eilis Ferran and Valia Babis 'The European Single Supervisory Mechanism' (2013) 13 JCLS 255, 264; it is even unclear if central bank oversight over the banking system is stability-enhancing: see Charles Goodhart and Dirk Schoenmaker, 'Should the Functions of Monetary Policy and Banking Supervision Be Separated?' (1995) 47 Oxford Econ Papers 539). This insight is important for applicable banking laws because it should inform the expedient interpretation of the possibility to retransfer supervisory competences to NCAs. Regardless of the conceptual understanding of the relationship of rule and exception as narrow or wide, such a retransfer should occur in all cases in which centralization is theoretically inferior.

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[3] See Rishi Goyal et al. 'A Banking Union for the Euro Area' (2013) Int'l Monetary Fund Staff Discussion Note 13/01, 9-10 http://www.imf.org/external/pubs/ft/sdn/2013/sdn1301.pdf accessed 5 June 2017; Jean Pisani-Ferry et al. 'What Kind of European Banking Union?' (2012) Bruegel Pol'y Contribution No. 12, 16, 17 http://www.bruegel.org/download/parent/731-what-kind-of-european-banking-union/file/1595-what-kind-of-european-banking-union/ accessed 5 June 2017.

Conclusion

Beyond the specific content of the decision, the judgement is not very encouraging because it exhibits a predominantly formalist mode of reasoning. This methodological approach defies confidence that the EGC (and the ECB) will reach functionally well-founded decision in critical cases. Insofar as prudential banking regulation (and its enforcement) can be seen as a determinant for incorporation decisions of banks (for the fundamental concept see for instance Roberta Romano 'Law as a Product: Some Pieces of the Incorporation Puzzle' (1985) 1 J. L. Econ. & Org. 225), the City does not have to worry that institutions are provided with an extra incentive to relocate more operations to the euro area than strictly necessary.