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Stanyo Dinov

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A Comparison of the Function of the Bank of England, the Federal Reserve and the European Central Bank

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Abstract

The current paper investigates the Central Banks of the three advanced financial systems: the UK, the USA and the EU, and the questions related to their supervisory role.

After the global financial crisis in 2007, the Bank of England and the European Central Bank, besides their primary monetary function of maintaining price stability, also became national supervisors and regulators. However, performing both functions in one body is not without any problems.

For one, there are controversies between the objectives of both policies.

For another, the Central Banks became super-authorities with complex structure of their decision making, and their tasks additionally overlapped themselves with those of other authorities.

Furthermore, the equilibrium of the power between the institutions in the financial system gets lost. Consequently, it is argued that the reputation of CBs and the safety of the financial system is more likely to suffer than to gain advantage from this joint conduct.

Therefore, comparing the different approaches applied to distinct financial systems in the contend of the reform's urgency after the financial crisis in 2007, calls into the question: What is the best approach?

However, there is no absolute answer on this question, based on the fact that different systems are compared with their own specifics.

Nonetheless, the represented three systems have quite a lot similarities, based on the fact that they have adopted from each other, as well as they all have commonly recognised international standard for capital requirement - Basel III.

Thus, by weighing up all pros and cons, it still important to find the best approach which could prevent further crises, and which can be more competitive in a changeable and fast developing world.

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Index of abbreviations

ACSS	American Council of State Savings Supervisors
BA	Banking Act
BHCA	Bank Holding Company Act 1956
BIS	Bank for international Settlement
BoE	Bank of England
CB	Central Bank
CCB	countercyclical capital buffer
CCP	central counter parties
CFPA	Consumer Financial Promotion Agency
CFPB	Consumer Financial Protection Bureau
CFTC	Commodity Futures Trading Commission
COP	Congressional Oversight Panel
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CSBS	Conference of State Bank Supervisors
CSDR	Central Securities and Deposit Regulation
DFS	New York State Department of Financial Services
EBA	European Banking Authority
EBOR	European Business Organization Law Review
EC	European Commission
ECB	European Central Bank
ed.	editor
edn.	edition
ECFR	European Company and Financial Law Review
ECOFIN	Economic and Financial Committee
ECU	European Currency Union

EEC	European Economic Community
EFSF	European Financial Stability Facility
EMCF	European Monetary Cooperation Fund
EMI	European Monetary Institute
EMIR	European Market Infrastructure Regulation
EMU	European Monetary Union
EP	European Parliament
ERM	European Exchange Rate Mechanism
ESCB	European System of Central Banks
ESFS	European System of Financial Supervision
ESM	European Stability Mechanism
ESRB	European Systemic Risk Board
et al.	and others
EU	European Union
FCA	Financial Conduct Authority
FDIC	Federal Deposit Insurance Corporation
Fed	Federal Reserve
FHC	Financial Holding Company
FMIs	Financial Market Infrastructures
FMUs	Financial Market Utilities
fn	footnote
FOMC	Federal Open Market Committee
FPC	Financial Policy Committee
FRA	Federal Reserve Act
FRB	Federal Reserve Board
FRDC	Federal Reserve Deposit Corporation
FRS	Federal Reserve System
FSA	Financial Services Act
FSA	Financial Services Authority
FSB	Financial Services Bill
FSB	Financial Stability Board

FSC	Financial Stability Committee
FSC	Financial Services Committee
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Market Act
FSOC	Financial Services Oversight Council
FSOC	Financial Stability Oversight Council
GDP	Gross Domestic Product
GLB Act	Gramm-Leach-Bliley Act
GSA	Glass-Steagall Act
LLR	Lender Last Resort
MPC	Monetary Policy Committee
MS	Member State
NBS	National Bank Supervisor
NCA	National Competent Authority
NCB	National Central Bank
OCC	Office of Comptroller of the Currency
ONI	Office of National Insurance
OTC	Over the Counter
OTS	Office of Thrift Supervision
OUP	Oxford University Press
par.	paragraph
PRA	Prudential Regulation Authority
RRM	Recovery and Resolution Mechanism
RRP	Recovery and Resolution Procedure
SC	Supervisory College
SEC	Security and Exchange Commission
SIFI	Systemically Important Financial Institution
SLC	State Liaison Committee
SRM	Single Resolution Mechanism
SRR	Special Resolution Regime
SRU	Special Resolution Unit

SSRN	Social Science Research Network
SSM	Single Supervisory Mechanism
TARP	Troubled Assets Relief Program
TEU	Treaty of the European Union
TFEU	Treaty of the Function of the European Union
tn	trillion
US	United States
Vol.	Volume

Central Banks as a Bank Supervisor. A Comparison of the Function of the Bank of England, the Federal Reserve and the European Central Bank

1. Introduction

As a result of the Global Financial Crisis in 2007 the financial and bank supervision in many countries was reformed. This dissertation is devoted to examine the three main bodies that historically and symbolically represent three different legal systems, influenced by each other and comparable to one another. They all represent the model of free market economy, whose roots began with the idea of economic liberalism and wellbeing from Adam Smith. The legislators in the UK, the USA and the EU have chosen solutions that are in some ways similar though in other ways different to reform these financial systems. A pivotal role in the new reforms is that the Central Banks (CBs) have to supervise the banks. Beside their primary function to trigger the monetary policy they also become the role to be bank supervisor.

Therefore, on the basis of their historical development, the dissertation will present and compare the post-crises reforms by these three systems, with the main focus on the CBs' role as banking supervisor. In this regard, problems will be discussed and some alternative solutions will be presented. The most important conclusions will be outlined at the end.

2. The Central Banks and their function

Originally the function of the banks[1] in any society was one of custody and safe keeping. The role of the banks are to be financial intermediaries which carry out a number of key functions in the market economy.[2] Although there is disagreement with regard to the number and relative importance of each of these functions, they are generally based on concepts of saving, credit and payment.

CBs differ from the other banks due to the fact that naturally some of them become more influential and they also acquired the function to exercise states control over

1 The terminus "bank" is defined in the UK through statutory law: s 2, 91 BA 2009, and Case Law United Dominions Trust v Kirkwood [1966] 2 QB 431. Lord Denning defined "bank" through three characteristics: accepting money, collecting cheques for customers and placing these at the credit of the customers' accounts; honouring cheques or orders drawn on bankers by the customers when presented for payment, and debiting their customers' accounts; keeping running accounts for customers in which debits and credits were entered.

2 Charles Goodhart, The Evolution of Central Banks, (Press Classic 1988), 86. For instance, they provide transactions, accounting services and portfolio management.

the domestic banking system.[3] Beside these common features the historical evolution of the CBs is different from those of other banks.[4] For instance, Bank of England (BoE) was a private bank and latter become a CB,[5] in opposite to the Federal Reserve (Fed) and the European Central Bank (ECB) which were set up as a publicly directed institutions. The Fed wanted to differ from the centralised model in Europe[6] and avoiding the name "Central Bank" a system was

3 Cf. Charles Goodhart (2), 2, 73. The transition of the BoE from profit-maximizing, competitive bank to CB did accrue naturally. Some CBs were set up as such ab inito. There are two different approaches, for instance, F. A. Hayek, Denationalisation of Money- the Argument Refined, 3rd ed., (London Institute for Economic Affairs 1990, 77, 101 f.) argued that society does not need CB, but competition from banks. In opposition, M. A. Friedman, A Program for Monetary Stability, (Fordham University Press 1960), 6 f., supported the idea of the CBs as a banking regulator. Moreover, (F. Hirsch, The Bagehot Problem, (1977) Manchester School of Economic and Social Studies, Vol. 45, No. 3, 252) described that these approaches can be quite similar in either case. The voluntary club approach involves cartels. By the legalistic approach, 'the regulatory bodies will feel some need to allow badly run banks to collapse, in order to avoid moral hazard, but will come under pressure to support larger banks in order to avoid system crises'. Therefore, the depositors will prefer larger banks as safer, which will lead to oligopoly.

4 Cf. European Central Bank, The role of Central Banks in prudential supervision, 8. CBs may benefit from their traditional focus on systemic risk, and from the knowledge of area-wide developments in money and securities market and in market infrastructure.

5 Charles A. E. Goodhart and Dimitri P. Tsomocos, Changes in Central Banking, (Cambridge University Press 2010), 122. The Riksbank in Sweden was also a private bank and later in 1668 become the first CB.

6 After the unsuccessful attempts to be created the First and the Second Bank of the United States.

created of twelve important US banks in the most powerful US states. Differently, the ECB was formed using the US federal model but with the idea to be a central and independent bank of sovereign EU-Member States (MSs).

CBs are important institutions, because they have helped to guide the development of modern financial and monetary system and they play a major role in the economic policy.[7] The adoption of CBs regulatory and supervisory role[8] was founded in the nineteenth century.[9] Regulation is distinguished systematically between two dimensions: in the narrower and the broader sense. Regulation in the narrower sense includes selected instruments of state economic law to create and enable safe competition on markets.[10] Regulation in the broader sense is related to any form of governmental influence on the economy and com-

7 Ben S. Bernanke, The Federal Reserve and the Financial Crisis, (Princeton University Press, Princeton and Oxford 2012), 2.

8 Pan, Eric J., Challenge of International Cooperation and Institutional Design in Financial Supervision: beyond Transgovernmental Network, (2010) Chicago Journal of International Law, 243, 265 f. Supervision and regulation are different categories. Supervision is a distinctive form of regulation. As the regulation is related to rulemaking and setting rules, the supervision is connected with the monitoring and evaluating how these rules are applied from the financial institutions.

9 Charles Goodhart (2), 8.

10 Alexander Wellerdt, Organisation of Banking Regulation, (Springer 2015), 29. Both, a legislative and an administrative intervention are possible. By banking regulation, regarding statutory capital and liquidity requirements, organisational requirements as well as an administrative supervision and resolution, the state may interfere indirectly and directly in the financial sector.

petition on the market.[11] The area of banking regulation is a form of regulation in the broader sense.[12]

Basically, there are two approaches about the main function of the CBs.

The first one is the British uniform approach, where the CBs have at the same time the responsibility of monetary policy[13] as well as the banking supervision.[14] The idea behind this is that the CB have to prevent systemic risk[15] and act as a Lender Last Resort (LLR) collecting all necessary information. Arguments in favour of conducting supervision from the CBs are:

11 Ibid.

12 Ibid.

13 Ben S. Bernanke (7), 3. The monetary policy have to achieve macroeconomic stability: stable economical and low and stable inflation.

14 Ibid., 4. CB plays a role in supervising the banking system, assessing the extent of risk in banks' portfolios.

15 Cf. BIS, Report of the Committee on Interbank Netting Schemes of the Central Banks of the Group of Ten countries 1999, 6, ‹http://www.bis.org/cpmi/publ/d04.pdf›, accessed 18 June 2015. See Benjamin Geva, Systemic risk and financial stability: the evolving role of the central bank, (2013) Journal of International Banking Law and Regulation, 407ff. CBs have to limit the systemic risk in payment systems and financial markets.

(1) the use of information from banking policy and supervision,
(2) the focus on systemic risk,
(3) the technical expertise.[16]

16 Cf. European Central Bank (4). Yiwei Fang et. al., 'Institutional Structure and Effectiveness of Central Banks during the Financial Crisis: An Empirical Analysis' in Syvester Eijffinger and Donato Masciandaro (edt.), Handbook of Central Banking, Financial Regulation and Supervision, Edward Elgar, Northampton 2011, 185.

In order to carry out their obligations independently, the CBs have in this case to separate strictly the function of monetary policy from banking supervision.[17]

17 Cf. Charles Goodhart/Dirk Schoenmark, Should the function of monetary policy and banking supervision be separated?, (1995) Oxford Economic Paper, 546. Otherwise there will be a conflict of interests. For instance, where the monetary policy aims a higher interest rate in order to maintain an exchange rate or to bear down inflation; the regulatory authority, which is freighted about the adverse effect such as higher interest rate might reflect the profitability and solvency of the banking system. In addition, some part of private sector might expect that the CB are influenced by financial system stability considerations when determining monetary policy. However, in the UK such a conflict of interests is of a magnitude less important than those between purely monetary objectives and political imperatives. See Frederic S. Mishkin, 'Macroprudential and Monetary Policies', in Douglas D. Evanoff and others edt., The Role of Central Banks in Financial Stability: How Has It Changed?, 409 f. In the standard view there is a dichotomy between monetary policy and banking supervision where the supervision includes micro as well as macro oversight. The two types of policy have to be conducted separately, where monetary policy must focus on minimizing inflation and output gaps and the prudential regulation and supervision have to prevent excessive risk-taking that could affect financial industry. The lack of equilibrium between these two types of policies led to the financial crisis. See Charles A. E. Goodhart and Dimitri P. Tsomocos, (5), 133. There is a tide of establishing separate universal FSA like in Germany, Japan and Korea. See Claeys S. and K. Schoors, 'Bank supervision Russian style: Evidence of conflict between micro- and macro-prudential concerns', (2007) Journal of Comparative Economics, 630-657. Empirical evidence of micro- and macro-prudential objectives in the CB of Russia. See Benjamin Born a. al. (16), 252 f. 'Jackson Hole consensus' leading to a common understanding that the two goals should be conceptually separated.

The second approach is the so called German model, which separates the function of the monetary policy belonging to the CBs and the banking supervision which is given to another independent authority.[18] In the UK a proponent of this model was the former British prime minister Gordon Brown with his reformative Financial Services and Markets Act (FSMA) 2000. Arguments in favour of separation are:

(1) avoiding potential conflict of interest between monetary policy and supervision,
(2) the tendency of financial conglomerates to be active at the same time on different banks, security and insurance markets. The supervisory authority could monitor effectively overall risk exposure in these large and complex financial groups,
(3) the need to avoid excessive concentration of power in the CBs.[19]

Following these approaches it could be considered that the CBs' main task is to be a central regulator in the national banking system. For some CBs like: BoE, Fed and ECB this

18 Cf. Charles Goodhart/Dirk Schoenmark (17), 541; Thortnton (1802); Bagehot (1873). The CBs should act in a public good and not as a private competitor for business.

19 European Central Bank (16), 5.

involves also carrying out banking supervision.[20] However, all CBs contribute to financial stability through their influence on banking regulation relating to liquidity and capital.[21]

The CB role of banking supervision includes the duties of:

(1) investor protection, and the financial institutes' obligations on the issuance and enforcement, conducting business and disclosing information rules,
(2) micro-prudential supervision, including all on and off-site surveillance of the safety and soundness of individual institutions aiming to protect depositors and retail creditors,
(3) macro-prudential analysis which encompasses all activities for monitoring the exposure to systemic risk and identifying potential threat arising from macroeco-

20 Cf. Group of Thirty, 'The Structure of Financial Supervision' 2008, 24 f., 31, ‹http://www.legco.gov.hk/yr08-09/english/panels/fa/papers/fa0223cb1-837-3-e.pdf› accessed 8 August 2015. See Guynn Randall D., Global Financial Crisis and Proposed Regulatory Reform, (2010) Brigham Young University Law Review, 421, 462. G 30 report set out four alternative regulatory approaches regarding the financial supervision: the Institutional (one institution is permitted by its regulators to extend into new business lines within the existed entity); the Functional (supervisor is determined by the business that is transacted by the entity); the Integrated (a single universal regulator conducting both safety and soundness and business regulation); the Twin Peaks (where the supervisory function are separated between two regulators). As well in the UK, this has been adopted in the Netherlands and Australia. Nevertheless, in Australia the prudential regulator is independent from the CB.

21 Howard Davies and David Green, Banking of the Future, (Princeton University Press), Oxford 2010, 69.

nomic or financial market development or from market infrastructure.[22]

Besides these functions, the CBs are responsible for:

- advising governments regarding monetary policy,
- raising money for the government through managing short-term and long-term funding by issuing bills and bonds,
- managing the interest rate,
- issuing banknotes,
- controlling the payment systems,
- lending money with low interest rate to other banks,
- controlling the national currency reserves,
- acting as a LLR for other banks and creating confidence in the banking system,
- liaison with international bodies.[23]

22 Cf. European Central Bank (16), 3. See Benjamin Geva (15), 409, Macro-prudential regulation focus on risks to financial system as a whole, with a view to protecting the real economy from severe disruptions in the provision of financial services.

23 Cf. Stephen Valdez and Philip Molyneux, An Introduction to global financial markets, 7th edn., (Palgrave Macmillan 2013), 57; Richard Roberts, Inside International Finance, (Orion Business Books), London 1999, 99 f.

3. The Bank of England

3.1. Historical background

The Bank of England (BoE) was founded in 1694 with the divisions from Charles Montagu and from the plan of the Scotsman William Paterson as a private bank. By managing one or another set of governments' accounts, goldsmiths and silversmiths deposits via security it became increasingly powerful over time. The Bank has the monopoly to issue notes and acted as guardian of the gold standard, the bedrock of the international financial system since 1844.[24] Until the Second World War the Bank was still private. On 1st May 1946 it was nationalised and became a CB under the control of the HM the Treasury. From then until 1998 the Bank was officially under Treasury control and the Treasury could give the Bank directions 'in the public interest' what it is still may now. However, in fact this prerogative was never implemented and the Bank manage to maintain discrete independence.[25] The Treasury, in effect the Chancellor defines what is mean by 'price stability' and the BoE is responsible for maintaining

24 Cf. Richard Roberts (23), 101. Howard Davies and David Green, (21), 11. The Banking Act (BA) 1844 gave the BoE a monopoly on the issue of banknotes.

25 W. Clarke, How the City of London Works, 7th edn. (Sweet & Maxwell 2008), 21.

price stability.[26] The BoE exercised for many years an informal supervisory authority over the UK banking system based less on rules than on “moral suasion”.[27]

Until 1970 s the finance and banking system in the UK was still deregulated. At the time many international banks opened their offices in London and the system has to be changed as per the new demand. With the BA 1979 (enacted in compliance with the EC First Banking Directive) the legislation authorised the BoE with banking supervision. These were later expanded in the BA 1987.[28] This changed in 1997, when Parliament voted to give the Bank operational independence with a clear remit to pursue price stability. The responsibility of BoE for micro level supervision was stripped by creating the Financial Services Authority (FSA). The BoE lost its priority to regulate the banking sector and became a new task to maintain financial and economic stability in general.[29]

26 W. Clarke, (n 25), 21.

27 William Blair, The reform of financial regulation in the UK, (1998) Journal of International Banking Law, 44.

28 The BA 1987 allowed the BoE to control advertising for deposits by licensed institutions and deposit takers and it had investigative powers to explore any breaches of restriction on acceptance of deposit and defining its meaning. The BoE has authority to require an institution to provide any information necessary in order for it to carry on with any of their duties under the Act. See also *SCF Finance Co. Ltd Masri* (No 2) [1987] QB 1002.

29 G. Tett, Fool's Gold, (Abacus 2012), 182.

3.2. Banking Act 1998

The BA 1998 regulated more clearly the relationship between the Treasury and the BoE. The Act established a Monetary Policy Committee (MPC) as a committee of the Bank with the Governor as a chairman, to formulate and implement monetary policy.[30] The Treasury could give recommendation to the Bank or to the MPC with respect to monetary policy in public interest and by extreme economic circumstances.[31] The system worked in the way that the Government sets the inflation target and the MPC organise its implementation.[32]

3.3. The Financial Services Modernisation Act 2000

A central goal of the FSMA 2000 was to maintain the financial stability in the UK. The FSMA took the banking supervision from the BoE and gave it to the independent new created FSA. The FSA became very powerful in terms of scope, powers and discretion. Its four regulatory objectives were: market confidence, public awareness, consumer protection and reduction of financial crime. In discharging its general responsibility, the function of the FSA was focused on three aspects.

30 S 13 BA 1998.

31 S 19(1)(2) BA 1998.

32 Nevertheless, the role of the Treasury was not used as a possible option in the FC 2007, when the bank used its obligation as a LLR too late in order to support other banks and the stability of the system as a whole.

Firstly, its scope was cross-sectorial, covering the whole financial sector, extending to banking, insurance and investment markets.

Secondly, it regulates both the prudential and conduct of business aspects of those markets.

Thirdly, it has had enormous influence: authorising firms, legislating, monitoring, investigating and enforcing supervisory regime.

The idea for single agency model was from the former British Prime Minister Gordon Brown, and represented the view that nowadays all markets come together and financial institutions meanwhile become active at the same time on different markets. Therefore, an independent body should collect information and observe all these markets. The FSA cooperated together with the BoE and the Treasury in order to guarantee financial stability in the UK. In this regard there was established a Financial Services and Market Tribunal (s 134 FSMA 2000).[33] The so called "tripartite system" involving the Treasury, the BoE and the FSA which were responsible for the financial stability in the UK. The tripartite committee was "a vehicle for communication and exchange of views".[34] The division of re-

33 The Tribunal was an independent first-instance tribunal to which certain decisions of the FSA may be referred. One of the reasons for the establishment of the Tribunal was the requirement in Article 6 of the European Convention on Human Rights, that person has the right to a hearing before an independent tribunal.

34 Economic Affairs Committee - Second Report Banking Supervision and Regulation, Chapter 5, ‹http://www.publications.parliament.uk/pa/ld200809/ldselect/ldeconaf/101/10102.htm› accessed 2 June 2015. Characteristic of the former Governor of the BoE Sir Mervyn King.

sponsibilities between the "tripartite authorities" was set out in a Memorandum of Understanding (MoU).[35] According s 2 MoU, the BoE was responsible for the stability of the monetary system through its monetary policy function. The Bank oversaw the whole financial system infrastructure,[36] regarding the payments systems.[37]

The role of the FSA according the FSMA 2000 was to perform micro-prudential supervision of financial intermediaries. It supervised financial markets, securities listing, clearing and settlements systems. The authority performed conduct-of-business supervision. Regarding the macro-prudential supervision, the FSA's role was un-

35 Memorandum of Understanding between the HM the Treasury the Bank of England and the Financial Services Authority‹https://www.google.co.uk/search?q=MoU+tripatute+system+Bank+of+England+Treasury+FSA&ie=utf-8&oe=utf-8&gws_rd=cr&ei=RtvFVfbZK8LYg-gTK1KTYDA›, accessed 8 August 2015.

36 Bank of England's supervision of financial and market infrastructures - Annual Report March 2015, 8, ‹http://www.bankofengland.co.uk/publications/Documents/fmi/annualreport2015.pdf›, accessed 8 August 2015. The legal framework that shapes the BoE's supervision of the Financial Market Infrastructures (FMIs) are: Part 5 of the BA 2009; FSMA; Uncertificated Security Regulation 2001, regulating the security settlement systems. The activities on the bank on the over the counter (OTC) derivative market and the central counterparties (CCPs) are regulated through the European Market Infrastructure Regulation (EMIR) and Central Securities and Deposit Regulation (CSDR).

37 Under s 2A of the BA, the objective of the Bank is to protect and to enhance the stability of the financial system in the UK. In pursuing this object the Bank is required to work with the other relevant bodies including the Treasury and the FSA.

clear.[38] It had extensive delegated "legislative" powers, as it is entitled to make rules and issue requirements as to the financial standing and conduct of authorised persons. It also gained wide powers of investigation and discipline.[39]

The Treasury, the third party of the tripartite committee was responsible for "the overall institutional structure of financial regulation and the legislation which governs it."[40] It had no responsibility for the activities of the FSA and the BoE, but if a financial problem arises with potentially system-wide consequences, the FSA and the BoE together can decide whether the Treasury needs to be alerted, according s 5 MoU.

The FSMA 2000 reforms should therefore, not be overstated, but be viewed as a further step in the evolution of banking regulation, rather than in its revolution.

3.4. Banking Act 2008 and 2009

The Banking (Special Provisions) Act 2008 was the first regulatory response from the British Government in the face of the credit crunch. This emergency legislation was enacted in order to allow the Government to own temporarily banks which were collapsing, such as Northern Rock. The BA 2009 implemented later the following Capi-

38 S 3 MoU. The FSA's responsibilities as "the authorisation and prudential supervision of banks, building societies, investment firms, insurance companies and brokers, credit unions and friendly societies".

39 S 284 FSMA 2000.

40 S 4 MoU.

tal Requirements Regulation and Directive CRR/CRD IV.[41] For this purpose created was a special Recovery and Resolution Mechanism (RRM) with special tools.[42] Inside the BoE there was introduced a Financial Stability Committee (FSC). In order to enhance the stability of the financial systems of the UK, a Special Resolution Unit (SRU) was created inside of the BoE, which had to conduct the resolution of the distressed banks. The SRU planed for and implemented a Special Resolution Regime (SRR) established under the BA 2009.

3.5. The Financial Services Act 2010

The FSA 2010 was the third and final piece of major legislation implemented by the UK Labour Government in the face of the financial crisis. The Act introduced changes in: Financial Stability Objective, Consumer Education Body, Living Wills.

Regarding the first change, the Act introduced a new duty which required that the FSA consider and review its financial stability objective in consultation with the Treasury (s 1(3) FSA 2010). It allowed the FSA to implement enforcement power in light of this new objective, as opposed being constrained to its previous objective of ensur-

41 Cf. Regulation 575/2013; Directive 2013/36/EU.

42 The RRM consists of five stages: private bank transfer, bridge bank, public transfer, special administrative procedure, special insolvency procedure. Some of the tools: ring fencing, preventive stress test for capital adequacy (Article 177 Regulation 575/2013, or CRR IV), conducting supervisory review and evaluation (Article 97 CRD IV).

ing protection of consumers. The Act required, that the FSA implement rules requiring each authorised persons to prepare, and keep up-to-date a recovery plan.[43] It regulated the remunerations and the bonuses paid to employees of banks and stabilised the financial system.

3.6. Financial Services Bill 2012

The Financial Services Bill (FSB) 2012 had to deliver fundamental changes in the UK financial regulation. Under the previous regime, financial stability in the UK was overseen by a tripartite system. One problem with this system was that the monetary policy and the supervision was split in two different institutions and neither one of them was responsible for the leadership.[44] There was an 'under-lap' of function with no single institution having 'responsibility, authority or powers' to monitor the financial system as a whole and to take necessary action to deal with any systemic threats.[45] For instance, the BoE had a separate Financial Stability Division, with the FSA having a parallel function monitoring market exposures. Moreover, there appeared to be little contact between these two and with no direct reporting at the Tripartite Committee level. Fur-

43 S 7(1) FSA 2010.

44 Marcus Killick, '"Twin peaks" - a new series or a new chimera? An analysis of the proposed new regulatory structure in the UK', (2012) The Company Lawyer, 367.

45 Cf. Para. 1.6. Marcus Killick, (n 45), 369. Because the pre-crisis structure left a gaping underlap between the BoE responsible for monetary policy and the FSA for the regulation of individual financial firms, with neither adequately focused on the systemic risks.

thermore, the Tripartite Authorities acted not quickly enough to safe some financial institutions.[46] In addition, the system had not ensured "financial stability-in particular by failing to identify the risk posed by the rapid and unsustainable increase in debt in the economy."[47]

The new Government identified significant fouls in the previous regime.[48]

Firstly, the BoE, while having statutory responsibility for financial stability, had only limited tools to deliver it and failed to use the tools it had.

Secondly, the FSA had regulatory tools for delivering financial stability, but with such a wide mandate including consumer protection, public awareness, market confidence and reduction of financial crime it was not sufficiently focused on stability issues. In this regard, the purpose was to separate prudential and conduct supervision, requiring different skills and approaches.[49]

Thirdly, the linkage between financial institute supervision and systemic stability issues had fallen between the institutional cracks.[50]

The July 2010 White Paper referred to 'inherent weaknesses and contradictions' in the earlier Tripartite Committee model involving the BoE, the Treasury and the FSA.[51] While the concentration of regulatory authority

46 Group of Thirty (), 41.
47 HM Treasury, "A new approach to financial regulation" (February 2011), Summary: Intervention and options.
48 Ibid., para.1.11.
49 See Speech by Lord Adair Turner, *FSA City Banquet at the Mansion House*, London.
50 Marcus Killick (44), 369.
51 CM 7874, para. 1.5.

within the FSA is referred to, the effect of the new regime was to create an even more powerful CB responsible for regulatory, macro-prudential and monetary policy. The underlying policy objective of the new regime were to restore the position of the BoE as the key financial regulator for the UK financial system. In this regard the FSB 2012 shaped a new regulatory framework. The existed system provides for a shared responsibility for financial stability between the Treasury, the BoE and the FSA was replaced with a new system based on the twin picks model. According the Act, inside the BoE a Financial Policy Committee (FPC)[52] was created and the existing FSA was split into two agencies the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA).[53]

The new reform established:

3.6.1. The Financial Policy Committee

The FPC inside BoE became responsible for the development and implementation of macro-prudential policy in the UK. The task of the FPC in this regard is to identify, monitor and take action to remove or reduce systemic and any kind of risk and to protect and enhance the resilience of the financial system.[54] The specific functions of the Committee are to monitor the financial system's stability,

52 See s 9B of the BoE Act.

53 Cf. s 1a(1) and 2 a FSMA under s 5 FSB 2012, also Schedules 1za and 1zb FSMA. The constitutional provisions which governed the FSA under Schedule 1 FSMA are amended to apply to the FCA and PRA.

54 Clause 9c(2), (3) and (5) FSA 2000.

provide directions, make recommendations and prepare reports. The FPC has to exercise its functions with a view of contributing to the achievement by the BoE of its Financial Stability Objective.[55]

The Treasury and Parliament would be given additional oversight powers in respect of the macro-prudential activities of the FPC. The Bill provided for mechanisms that defines the relationships between the Treasury, the Bank, the PRA and the FCA in the event of crisis in the financial system.[56] The Treasury may make recommendations to the FPC at any time in writing with the FPC confirming whether it accepts the recommendations and any action to be taken.[57] Directions can be issued to the FCA or PRA on macro-prudential measures and the FPC may make recommendations within the Bank, to the Treasury or FSA and PRA.[58]

3.6.2. The Prudential Regulation Authority

The Prudential regulation were transferred to the BoE through its subsidiary, the new PRA. The PRA become responsible for the micro-prudential supervision of all firms subject to 'significant prudential regulation' including banks and other deposit-takers such as building societies and credit unions, broker-dealers and insurers and friendly societies.[59] The general function of the PRA is to promote

55 Clause 9c(1) of the FSB.
56 Recital 12 FSB 2013.
57 Clause 9 d FSB.
58 Clause 9g-1, m, n, o and p FSB.
59 CM 7874, para. 3.12.

the safety and soundness of the financial system and to ensure that the adverse effect of any failure is minimised.[60] In this regard, the PRA works closely with FPC within the BoE and the FCA. The PRA second objective is to ensure safe competition. This secondary objective is only applicable when the PRA is advancing in its primary objectives and does not operate as a stand-alone objective. Nevertheless, this goal overlaps with the object of the UK Competition Authority.[61]

As a part of BoE, the PRA's is connected to the BoE's other functions including its role as LLR, its work on market oversight and infrastructure, prudential policy, financial sector resilience and the exercise on resolution power.[62] By the supervision international active financial institutes the PRA had to work actively with other national authorities together in supervisory colleges (SCs).[63]

3.6.3. The Financial Conduct Authority

The need to have a separate FCA was justified on the basis of attempting to avoid 'in-built tensions' between different regulatory objectives and focusing on the interests of consumers and market participants in a separate 'conduct

60 The Prudential Regulation Authority's approach to banking supervision June 2014, 7.
61 Although in principle the PRA gives the general guidelines and the Competition Commission can enforce them.
62 PRA (60), 16.
63 The PRA would generally be responsible for firms holding $ 9tn in assets and EEA firms with $ 2tn in assets or other systemically important institutions.

regulatory system'.[64] The FCA become principally be responsible for ensuring confidence in financial services.[65] In addition to its strategic objective, the FCA is assigned three operational objectives of consumer protection, market integrity and efficiency and choice.[66] It become power to issue rules governing the conduct of all financial firms and the authorisation of 'non-prudential firms'.

3.7. Financial Services Act 2012

The Financial Services Act (FSA) 2012 expanded greatly the responsibilities of the BoE, and implemented most of the FSB 2012 proposals.

The FPC replaced the Financial Services Committee (FSC), by the BoE. The FPC became authorised to make recommendations to the PRA and the FCA on a comply or explain basis, and to direct both the PRA and the FCA. The Committee has powers in relation to the sectoral capital requirements and responsibility for decisions on the countercyclical capital buffer (CCB) applied to certain financial institutions in the UK.[67]

A firm-specific regulation of financial institutions that manage significant risks on their balance sheets will be carried out by an operationally independent subsidiary of the BoE, the PRA. The PRA has to work closely with the FCA and to observe and conduct prudential regulation for big

64 CM para. 4.3.
65 CM paras. 4.4 and 4.6.
66 S 1b(2) and (3) FSMA.
67 The tool is implemented in the UK via the Capital Requirements Directive. Directive 2013/36/EU.

banks, investment firms, security houses and insurance companies. Moreover, it can enforce credit institutes for recovery and resolution plan, a special resolution regime. In this regard, inside the BoE a SRU was created which has to work closely with the Treasury by putting distressed financial institutions under the BA 2009 SRR.

The FCA carries out the prudential regulation of firms not regulated by the PRA. It became a multifunctional authority conducting issues across the entire spectrum of financial services. Its operational objectives become: facilitating efficiency and choice in the financial market; protecting and enhancing the integrity and confidence of the financial system and securing an appropriate degree of protection for consumers, fighting financial crimes.

3.8. The Financial Services Act 2013

The FSA 2013 seeks to introduce structural and cultural changes,[68] giving the government more power to ensure financial aid to institutions that are not able to absorb losses. The Act introduced a 'bail- in' tool according to Part 3, s 17 FSA 2013 as an additional stabilisation option to the pre-existing RRM from the BA 2009.[69] Banks were required to

68 It complied with the Independent Commission on Banking (chaired by Sir John Vickers) and the recommendations made by the Parliamentary Commission on Banking Standards.

69 The purpose of the bail- in tool is to recapitalise the entity and to ensure the continuity of all service and transactional arrangements. The PRA must consider that any other action cannot be taken to avert the failure. In addition, the BoE must determine that it is in public interest to use the bail-in tool.

have loss absorbing capacity, in addition to the levels of capital required by the Basel III-Regime and the CRD IV. The FSA implemented a special administration for operators of certain infrastructure systems,[70] restricts the powers of persons other than the BoE in relation to the insolvency of infrastructure companies. The Act ensured that the PRA strictly separates, or ring-fences banks' retail from investment activities. It finally introduced a cap for payday loans, higher sanctions for financial crimes, and implemented a financial services compensation skim.

3.9. Assessment

Since its foundation the BoE has assumed a very important role within the UK economy. The two main objectives of the Bank are to ensure the financial stability of the national economy and act as a financial regulator. Along with its monetary function, the Bank took its "old new role" as a bank regulator after the global financial crisis and the UK credit crunch. Thus, the BoE became responsible for the key financial areas: macro-prudential; monetary; liquidity policy; LLR; resolution; payments clearing and settlements. In this regard, the Bank developed into a super-authority concentrating and centralising power, rather than counterbalancing this power between different authorities, as in the previous regime between the monetary policy by the BoE and the supervision by the FSA. Moreover, authorising the BoE as prudential regulator of all financial institutions, there is still a risk to repeat the mistakes with the

70 Part 6 s 111ff. FSA 2013.

FSA, as a single authority responsible for many tasks.[71] One problem of the previous system was that there were not clear responsibilities for the UK financial regulation authority and the tasks seem to be fragmented with the new reform.[72] The twin-peaks supervision becomes in some cases hard to distinguish between prudential and conduct-of-business supervision.[73] The effectiveness of supervision would not be improved with the increase in the number of involved agencies, but the costs of the conducted supervision would probably increase.[74] There is also no clear synchronisation between the authorities which are not under the supremacy of one body.

Furthermore, combining the Bank's responsibility for monetary policy with the financial supervision could create further problems.

The Bank's reputation would be at risk from failures in either activity. The different objects of both functions could lead to errors in prudential supervision, potentially damage monetary policy-credibility.

In addition, the BoE becomes responsible not only for the banking supervision what is its entire nature in comparison to other CBs such as the ECB but for the whole financial sector including security firms and insurance companies.In this respect it raises the question how well it is able to segregate commercial from investment banking.

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71 Michael Taylor, "Twin Peaks": A Regulatory Structure For The New Century, Financial World 2009.

72 Ibid.

73 Ibid.

74 Cf. Debates in the House of Lords (Q 518), (Q 552); Lord Turner Lord Myners views, Economic Affairs Committee (n 34).

Another issue is that to some extent the functions of the PRA and the FCA by the recovery and resolution procedure (RRP), regulating prudential standards and promoting healthy competition, overlapped themselves. The last role also cover the tasks of the UK Competition Commission.

Therefore, the new reforms authorising the BoE with more power and functions which are spread between different bodies should be differentiated more precisely in order to avoid previous mistakes with one super-authority.

4. The Federal Reserve

4.1. Historical background

The Fed was established as the result of the Federal Reserve Act (FRA) 1913 after the US financial crisis in 1907. It was created not to be a CB and to have a limited power between 12 banks of the most powerful US states.[75] The Act enabled Congress to withhold or to restrict actions of the Fed. At the beginning, the Fed's main responsibilities were discounting of commercial paper and acceptances bills as well as promoting effective national payment system. The FRA also gave the Fed authority to "coin money and regulate the value thereof."

Financial regulation was usually not a policy applied by the federal government for a long time.[76] Thereby, the amendments V (state level) and XIV s 1 (federal level) of the US Constitution does not allow any regulation. The at-

75 Allan H. Meltzer, A History of the Federal Reserve 1951-1969, The University of Chicago Press, (Chicago and London 2009), 1 f. Despite the proponents yet some of the Founding Fathers were strongly opposite the formation of central banking system as possibility of Great Britain tried to place the colonies under the monetary colony control of the BoE.

76 In this regard, comparison here could be made with the UK, where in the financial system until 1970 s there was not public regulation.

tempts to create the Bank of the United States in 1791[77] and in 1816 were unsuccessful. The regulation in the financial sector began later through the case law,[78] after many crises and the Great Depression in 1929. The regulation started 1930 s with the F. D. Roosevelt's legislation: Glass-Steagall Act 1933 strictly dividing commercial and investment banking in order to prevent bank depositors from additional exposure to risk associated with stock market volatilities.[79] It followed the Securities Act 1933, Securities

77 Baker Colleen, Federal reserve as Last Resort, (2012) University of Michigan Journal of Law Reform, 69, 81. A conflict between national and states banking interests in the US Congress blocked the proposal for the first Bank of the US. The need after the war in 1812 caused the establishment of the second Bank of the US. The U.S. Subprime Court in Mcculloch v Maryland (1816) decided to settled it constitutionally, but the Congress did nor renewal the charter.

78 Munn v Illinois (1877) where the Subprime Court decided that in some industries the public interest can justify regulation. Later with the case Noble State Bank v Haskell (1911) the court defined that banking can be one of the industries which can be regulated and with the case Nebbia v New York (1934) the regulation in public interest can only be justified, if it is related to a specific area.

79 Ch. s 20 of the Act; Charles A. E. Goodhart and Dimitri P. Tsomocos (5), 124. The Glass-Steagall Act 1933 also created the Federal Deposit Insurance Corporation (FDIC) with authority to resolve failed banks, but left the authority to close banks with their respective regulations to the Fed.

Exchange Act 1934,[80] Banking Act 1933 and 1935,[81] Commodity Exchange Act 1936 and the 1956 Bank Holding Company Act (BHCA).[82] From 1970 s to 1990 s, there was a period of deregulation or the so called "Big Bang"[83] characterised with the movement of the Chicago Law School for a "public choice" and avoiding "regulatory capture".[84] The deregulatory measures culminated with the Gramm-Leach-Bliley (GLB) Act 1999 which abolished the Glass-

80 The SEA requires the Fed to regulate the extension of credit used in connection with the purchase of securities.

81 The BA 1935 shifted power from the Fed to the Board of Governors, eliminating the semiautonomous nature of the reserve banks. Created was the Federal Open Market Committee to clarified disagreements between the Board and regional Reserve Banks.

82 §§ 1841(a)2Aff BHCA 1956 increased the Bord's power to regulate, to approve or reject applications for new banks. This included imposing capital requirements, inspections and merger and acquisition approval. The Act assigned to the Fed primary responsibility for supervising and regulating the activities of bank holding companies. Through the Act, the Congress sought to achieve two basic objectives: (1) to avoid the creation of a monopoly or the restraint of trade in the banking industry through the acquisition of additional banks by bank holding companies and (2) to keep banking and commerce separate by restricting the nonbanking activities of bank holding companies.

83 The term is used as a big bang of the old strict regulation sets and proclamation to free market liberalism and self-regulation.

84 The proponents claimed that the regulators are captured, lobed from big industries and they do not act anymore in public interest. The rules were created for strong monopolies and not for small and middle-sized businesses, therefore, pleaded were for more commercial liberty. See George J. Stigler in 1971, The Theory of Economic Regulation, 3, ‹http://www.ppge.ufrgs.br/giacomo/arquivos/regulacao2/stigler-1971.pdf› accessed on 27th of June 2015. As a rule, regulation is acquired by the industry and is designed and operated primarily for its benefits.

Steagall Act's prohibition of combined investment and commercial banking and the Commodity Futures Modernisation Act (CFMA) 2000, which replaced some parts of the Glass-Steagall Act and opened the American derivative market. The period from 2000 to 2010 was characterised with re-regulation measures in particular represented with the Emergency Economic Stabilisation Act (EESA) 2008 and the Dodd-Frank Act (DFA) 2010.

4.2. The US financial system and the Federal Reserve Act

From its creation, the US financial regulation has been dominated with the parallel split of dual Federal and State system with multiple agency autonomy and regulatory competition. The Federal Reserve System (FRS) or the Fed has both private and public components to serve the interests of the public and private banks. The primary motivation for creating the FRS was to address banking panics as well as "...to establish more effective supervision of banking in the US...".[85] The Fed is headed by the Board of Governors of FRS (FRB),[86] consisting of a Chairman and Vice Chairman which are appointed by the President and confirmed by the Senate. The Board's primary responsibility is the formulation of monetary policy. An important body inside the Fed is the Federal Open Market Committee

85 FRA 1913, 1.
86 S 714 FRA.

(FOMC),[87] which conducts the money policy and oversees open market operations. The Fed through its Banking Supervision and Regulation Division oversees the US banking system. It has supervisory responsibilities for state-chartered banks that are members of the FRS, bank holding companies and foreign banks.

In addition other regulators of the US financial markets are: the US Security and Exchange Commission (SEC), the Federal Insurance Office as part of the Treasury and the financial authorities of the federal states. To promote consistency in the examination and supervision of banking organizations and for exchanging views on important regulatory issues between state and federal regulatory agencies in 1978, the Congress created the Federal Financial Institutions Examination Council (FFIEC). The FFIECs' purpose is to prescribe uniform federal principles and standards amongst the federal agencies that regulate financial institutions. The FFIEC has to coordinate and harmonise the policy between the FRB, the FDIC,[88] the Office of the

87 The FOMC is with seat in Washington. It is made up of the president of the Federal Reserve Bank of New York, and presidents of four other Fed Banks, who serve on a rotating basis and seven members of the Board of Governors appointed by the President and confirmed by the Senate. Only twelve of the nineteen people are able to vote. The seven members of the Board of Governors have a permanent vote plus the president of the Fed in New York and four members of rotation from the rest of the members.

88 See The Federal Reserve System, Purposes & Functions, Board of Governors of the Federal Reserve System, Washington D. C. 2005, 5. State banks that are not members of the FRS are supervised by the FDIC.

Comptroller of the Currency (OCC),[89] the National Credit Union Administration (NCUA),[90] the State Liaison Committee (SLC)[91] and the Consumer Financial Protection Bureau (CFPB).[92]

Therefore, along with the Fed in the US federal and state level there are a number of different agencies that supervise the financial system.

The created in 1913 FRA and all subsequent legislation made the Fed independent but with never defined independence.[93] Although the Fed is an independent authority, the US government has kept a strong influence on its monetary policy. During the financial crisis in 2007, the Fed acted as a financing arm of the Treasury.[94] Currently the responsibilities of the Fed fall into four general areas:

– Regarding the monetary policy the Fed has three key objectives: maximum employment, stable prices, and moderating long-term interest rates;

89 The OCC was created in 1863 as an independent agency within the Treasury.
90 Supervises not-for-profit, cooperative, tax-free organizations.
91 The SLC includes representatives from the Conference of State Bank Supervisors (CSBS), the American Council of State Savings Supervisors (ACSS), and the National Association of State Credit Union Supervisors (NASCUS).
92 The CFPB was created with the DFA in 2010.
93 Cf. Allan H. Meltzer, Book 2, 1970-1986, Who owns the Federal Reserve?, 1255 f. The Board of Governors in the Federal Reserve System has a number of supervisory and regulatory responsibilities in the US banking system, but not complete responsibility. The Fed is described as "independent within the government" rather than "independent of government".
94 Allan H. Meltzer (93), 1255 f.

- Since 2009 the Fed is responsible for supervision and regulation of banking institutions in order to ensure the safety and soundness of the financial system and to protect the credit rights of consumers;
- It conducts macro-prudential oversight in order to maintain the stability of the financial system from systemic risk;
- The Fed has also to provide financial services to depository institutions and to operate the national payments system.[95]

The Fed's function of banking supervision involves monitoring, inspecting, and examining of banking organizations in order to assess their condition and compliance with relevant laws and regulation. The Fed has primary supervisory authority for state banks. It shares supervisory and regulatory responsibilities for domestic banking institutions with the OCC and the FDIC at the federal level,[96] and with the banking departments of the various states. This dual federal–state banking system has evolved partly out of the complexity of the US financial system, with its many kinds of depository institutions and numerous chartering authorities. It has also resulted from a wide variety of federal state laws and regulations designed to remedy problems that the US commercial banking system has faced over its history.

95 The Federal Reserve System (88), 1.
96 The Federal Reserve System (88), 12.

4.3. Gramm-Leach-Bliley Act 1999

The GLB Act was one of the last pieces of legislation aiming to deregulate the US financial market. It allowed banks, securities firms, and insurance companies to affiliate with each other through financial holding company structure and therefore, abolished the previous Glass-Steagall and Bank Holding Company Acts. To be certificated, financial holding companies have to meet a higher standard.[97] The regulation and supervision of financial holding companies (FHCs) differs from that of bank holding companies (BHCs). The law kept in place the existing regulators for financial subsidiaries of FHCs, but gave the Fed a role similar to that of the UK FSA of an “umbrella supervisor,” in order to bring a full financial services integration.[98] Through this supervision, the financial institutions become involved in different financial activities. By the supervision, the Fed should relay and work closely with other regulated subsidiaries such as the OCC, FDIC, SEC, and the state insurance supervisors.[99] The focus of the umbrella supervisory role of the Fed endorsed by GLB Act was on risks that could adversely affect the insured depository institution. FHCs, in turn, were subject to only limited Fed regulatory

97 The institutions must be well capitalized and well managed in accordance with existing bank regulations, and they must have at least satisfactory ratings under the Community Reinvestment Act.

98 Mark W. Olson, Implementing the Gramm-Leach-Bliley Act: Two Years Later, ‹http://www.federalreserve.gov/boarddocs/speeches/2002/20020208/›, accessed 12 July 2015.

99 Joe Mahon, Financial Services Modernization Act of 1999, commonly called Gramm-Leach-Bliley.

oversight.[100] Fed supervision was focused on the FHC level, on those risks that could affect the depository subsidiaries.[101] However, the consequences of the following financial crisis called into question the acts of the reform.[102]

4.4. Commodity Futures Modernisation Act 2000

The following CFMA deregulated the law of the most OTC-derivates transactions. Before the CFMA with the 1982 Shad/Johnson agreement, the regulatory jurisdiction over futures and options was divided between the CFTC and SEC.[103] The Act significantly restricted the capacity of the CFTC and SEC directly to intervene in OTC-trading between sophisticated market participants for derivative contracts. It moved the regulation of futures markets away from a purely prescriptive rules-based approach towards a

100 Joe Mahon (n 99).

101 Ibid.

102 Cf. Joe Mahon (n 100), The Act allowed distressed investment banks like Bear Stearns and Merrill Lynch to be acquired by financial holding companies rather than go bankrupt, and approved others like Goldman Sachs and Morgan Stanley reorganized as financial holding companies to improve their market reputations. See the speech of the John Dingell. By the passing of the Bill in the US Congress there was a caution, that the Act created group of institutions which are "too big to fail" and the Fed and the Treasury would have to bail them out. The liabilities of these institutions in one financial area will go to follow the liability at the next. Awareness was made also that the Bill limited privacy protections against the sale of private financial information.

103 Mark Jickling, CRS Report for Congress, The Commodity Futures Modernization Act (P.L. 106-554) 2003, 5.

system that relies more on compliance with principles.[104] The CFMA considered the differences in products and market participants and created a structure that provided a specific intensity of regulatory oversight corresponding with the needs of the markets. The Fed prerogatives were to set margins for futures and stocks and it could delegate this authority to the CFTC and SEC. Furthermore, the Fed was the regulator with systemic responsibilities, *the primus inter pares* among financial regulators which had the power delegated by Congress with special responsibilities for mortgages and consumer protection.[105]

4.5. Emergency Economic Stabilisation Act 2008

In order to prevent the collapse of the US financial system during the subprime mortgage crisis, the US government published in 2008 the Emergency Economic Stabilisation Act (EESA). The EESA provided up to $700 billion to the Secretary of the Treasury to stabilise the economy. The Act authorised the Secretary of the Treasury to establish the Troubled Asset Relief Program (TARP) and to purchase troubled assets from any financial institution. The EESA created a oversight mechanism, setting up a Financial Stability Oversight Board (FSOB),[106] and a Congressional Oversight Panel (COP). The FSOB had to review the acts of the Treasury regarding the TARP and makes recom-

104 The Department of the Treasury Blueprint for a Modernized Financial Regulatory Structure 2008, 49.

105 Alan S. Blinder, Across the Great Divide: New Perspectives on the Financial Crisis (Hoover Institution 2014), 90.

106 S 104 EESA 2008.

mendations to it. The second body, the COP was expected to review the state of the financial markets and the regulatory system and to submit reports to the US Congress. The EESA gave the Fed increased power over short-term interest rates and obligated the FRB to disclose certain material information, regarding certain extensions of credit. In addition, the FRB had to provide periodic updates at least once every 60 days describing the status of the loan, the value of the collateral, and the cost to taxpayers.[107]

4.6. White Paper on Financial Regulatory Reform 2009

In 2009, the US-government adopted the White Paper Reform Part in order to strengthen the regulation of the financial market. While part of blame of the global financial crisis was thrown on the existing US liberal approach of regulation, the Act brought many proposals for changes. It created a new Financial Services Oversight Council (FSOC) insight the Treasury with members consisting of the chairmen and directors of the Fed, and other national supervisory agencies. The FSOC has to oversee the activities of systemically important firms (referred as tier 1 FHCs), and to coordinate interagency cooperation between the national agencies. All systemic important firms have to be required to register as FHCs must be subject to consolidated supervision and regulation by the FRB. In this regard, the Act repealed certain limits on the Fed's authority over functionally regulated subsidiaries imposed by the GLB

107 Davis Polk & Wardwell, Emergency Economic Stabilisation Act 2008, 2008, 25.

Act. The White Paper proposes to amend Section 13(3) FRA in order to allow the Fed to provide liquidity to non-banks after the approval of the Secretary of the Treasury. Moreover, the Act suggested a new regime for the resolution of failing BHCs and FHCs, which would have serious adverse effects on the financial system. Through initiative by the Fed, Treasury, SEC or FDIC financial firms could be put into special resolution process. Ultimately, the Treasury in consultation with other agencies will decide whether to put any firm into resolution.[108] The Fed had been given a responsibility for the oversight of systemically important payment, clearing and settlement systems including through provision of access to its discount window. The Fed had used this power on a number of occasions during the crisis, but it had in each case to wait prior Treasury approval. The amendment simply formalises this relationship. In this regard, the Reform Act simplified the complexity of the US financial system.[109]

4.7. Dodd-Frank Act 2010

In 2010, the US legislature passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA). The Act increased the powers of the Fed as a banking supervi-

108 Allen & Overy, 'The Obama Administration today published Financial Regulatory Reform' 2009.

109 "Complexity has led to cracks in system" *Financial Times* (12 June 2009) 6.

sor.[110] The DFA gave the Fed primary responsibilities for supervising all firms that could create a threat to financial stability in addition to its responsibilities for monitoring financial institutions and protecting consumers.[111] The main task of the Act was to create a body responsible for macro-prudential supervision. Therefore, accordingly the White Paper Reform proposal created by the Treasury was the Financial Stability Oversight Council (FSOC)[112] in order to identify, monitor and manage systemic risk.[113] The FSOC brought together under the Treasury several financial market agencies. The Fed becomes a member of the Council performing the task of regulatory coordination.[114] The FSOC has to decide if large complex systemically financial institutions (SIFIs) are adequately regulated or financial market utilities (FMUs) like stock exchanges will come under the supervision of the Fed.[115] The Fed must conduct macro-prudential oversight over large SIFIs with consolidated assets of $ 50 billion or more whereas other institutions will be supervised by the FSOC.[116] However, through

110 Lucia Dalla Pellegrina, et al., 'New Advantages of tying One's Hands: Banking Supervision, Monetary Policy and Central Bank Independence', 208.
111 Pierre C. Boyer and Jorge Ponce, 'Central Banks and Banking Supervision Reform', (2010) SSRN 158.
112 S 111 DFA 2010.
113 As the White Paper Reform Act called the body Financial Services Oversight Council in the DFA it is renamed as a Financial Stability Oversight Council.
114 Ben S. Bernanke (7), 118 f.
115 Ibid. 119. The SIFIs and FMUs are tasked with submitting resolution plans to the Fed and the FDIC.
116 Consolidated Supervision Framework for Large Financial Institutions, Board of Governors of FRS.

the Council as part of the Treasury, the Fed becomes not the only responsible financial regulator. The DFA created a "last resort" role for the Fed. By providing a liquidity assistance, according s 13(3) FRA, the Fed should consult with the Treasury finding that the financial market utility is not able to secure adequate credit accommodation and in particular circumstances the Fed can act as LLR-authority.

The Act gave the FDIC the right in short procedure to shut down failed banks and protect depositors. Nevertheless, apart from using the instrument of higher capital requirements there was a failure in mitigating systemic risk ex-ante.[117] Created inside the Fed was a Consumer Financial Protection Bureau (CFPB). However, similar to the UK-FCA, the CFPB-functions overlap with the Commodity Futures Trading Commission (CFTC) and SEC.[118] With the creation of the three new bodies: the FSOC, CFPB and the Office of National Insurance, the legislative failure to adopt any structural reform reducing the various regulation bodies.[119] The merger of the Office of Thrift Supervision (OTC)[120] into the Office of the Comptroller of the Currency (OCC) was a welcome but minor reform.[121] Nonetheless, the Act implemented significant changes affecting the oversight and supervision of financial institutions and systemically important financial companies. It

117 Hal S. Scott, 'A general evaluation of the Dodd-Frank US financial reform legislation', 2010 Journal of International Banking Law and Regulation, 478.

118 Ibid.

119 Hal S. Scott, (n 118), 479.

120 Was chartered to oversee all federally state-chartered savings banks.

121 Hal S. Scott, (n 118), 479.

introduced more stringent regulatory capital requirements, and set forth significant changes in the regulation of the securitization market.

4.8. Assessment

The US financial regulation involves a large number of agencies at a federal and state level with distinct roles and very functions. An advantage of this system is that the financial and credit institutions are oversight from many bodies under different angle. However, disadvantages are: compliance with different requirements for the financial institutions; conflicts of interest and power between the authorities as well as "failure to act in a timely fashion."[122] The complexity of the system results in collision of laws and regulations making the Fed's dual responsibility to

122 Cf. Charles Goodhart, (n 2) 74, J. H. Kareken, Deregulation Commercial Banks: The Watchword Should Be Caution, 1981 Federal Reserve bank of Minneapolis Quarterly Review, 4. See also C. J. Benston, Deposit Insurance and Bank Failures, 1983 Federal Reserve Bank of Atlanta Economic Review 14ff. Also J. R. S. Revell, Solvency and Regulation of Banks, 1975 Bangor Occasional papers in Economics No. 5, 37. The main criticisms of the American system of prudential regulation is the multiplicity of supervisory agencies, everyone with its own methods. The only way to avoid multiple agency is they amalgamation. The conflict between FCC Commodity Futures Trading Commission (CFTC) and the Options Clearing Corporation (OCC) about who is going to regulate the derivative market is an example, where the agencies finally, came to the agreement, that futures contract will be regulated by the CFTC and the options through the OCC.

protect public as well as private bank's interest more difficult.

The GLB Act authorised the Fed with umbrella supervision via CFTC and SEC similar to the BoE for the whole financial sector. Nevertheless, the Fed should relay on the oversight of other regulators such as the OCC, FDIC and SEC and after DFA it share its macro-prudential function with the FSOC. In addition, the acts of the Fed could be reviewed by the Treasury and Congress. In this regard, although the Fed is an independent authority, the US government through the Treasury still has a strong influence on its monetary policy, comparable with the position of the BoE.

The specificity of the US financial regulation, particularly its duality on federal and state level, its multitudinous from agencies and the Fed's obligation to share its supervisory and regulatory functions with other authorities.

Another distinctive feature of the system is that, the Fed oversights' functions are transferred to other regulatory bodies. For instance, the FFIEC, has to prescribe uniform principles and standards among the financial institutions; the FSOC inside the Treasury, has to oversee the activities of SIFIs, to coordinate the interagency between state authorities and to monitor and manage potential threats of systemic risk activities. A disadvantage is that the supervision is fragmented between many agencies which do not have the option institutionally to be coordinated under the head one authority.

In comparison with the UK regulatory system, where the macro-prudential oversight is by the FPC, inside the BoE, in the US, after the DFA, this function is performed by the FSOC as a department of the Treasury, which undermines the Fed's role as a primary supervisor.[123]

Therefore, despite the placard US functional approach of financial regulation there is still need for some kind institutional consolidations in the US supervisory system.[124]

123 Hal S. Scott, (n 118), 479.

124 Cf. Charles Goodhart, (2) 74; C. J. Benston (n 122) 37; Hal S. Scott, ibid.

5. The European Central Bank

5.1. Historical background and responsibilities

The ECB was created in 1998 by virtue the Treaty of Maastricht or TEU in 1992 on the place of the existing European Monetary Institute (EMI).[125] One of the provisions of the Treaty was the establishment of the euro currency. The institutional architecture of the euro includes two parts: the unitary institution ECB itself and the national central banks (NCBs) of the EU-MSs, who collectively represent the ESCB.[126] Therefore, the ECB become a CB of the EU-MSs which have their own CBs, and all they are part of the European System of Central Banks (ESCB).[127] According to Article 130 TFEU and Article 19 SSM-Regulation, the ECB is an independent authority and shall enjoy privileges and immunities of the territories of the EU-MSs by performing its tasks.[128]

125 EMI was created in 1994 on the second stage of the European Monetary Union (EMU) replacing the existed to then European Monetary Cooperation Fund (EMCF) which from its side was established in 1973 from the members of the European Exchange Rate Mechanism (ERM), a system introduced by the European Economic Community (EEC).

126 Howard Davies and David Green, (21), 186.

127 Ben S. Bernanke (7), 2.

128 Article 40 ESCB-Statue.

The ECB carries out its tasks in accordance with the TFEU and ESCB-Statue,[129] as its primary objective is to maintain price stability.[130] In this regard, the ECB is a exception of the standard model of CB. Unlike the Fed[131] or the BoE,[132] the ECB has only one primary objective: the "price stability" regarding Articles 127(1) and 282(2) TFEU, or to maintain the inflation rate up to 2%.[133] Carrying out its basic monetary task according to Article 127(2) TFEU, the ECB should conduct foreign-exchange operations; manage foreign reserves of the MSs and operate payment systems. The ECB has also exclusive right to issue euro-banknotes.[134]

Near its "basic task" to define and maintain the monetary policy regarding to Article 127(2) par. 1 TFEU and Article 3.1. ESCB-Statue, the ECB "shall contribute to ...the prudential supervision of credit institutions and the stability of the financial system".[135] According to Article 127(6) TFEU, Article 25.2. ESCB-Statue and SSM-Regulation, the ECB can be conferred "specific tasks" related to the prudential supervision of credit institutions and other finan-

129 Article 132(1) TFEU.

130 Article 127(1) TFEU and Article 2 ESCB-Statue.

131 According to s 2A FRA, the Fed must pursued monetary policy with the goals of maximum employment, stable prices, long-term interest rates, growth and price stability.

132 See s 11 BA 1998.

133 Cf. Clarified by the Governing Council in 2003. See also Kathryn C. Lavelle, Kathryn C. Lavelle, 'The Foundation of regulatory convergence and divergence between the Federal Reserve and the European Central Bank', 2014 Georgetown Journal of International Law, 1153, 1164.

134 Article 128 TFEU and 16 ESCB-Statue.

135 Article 127(5) TFEU and Article 3.3. ESCB-Statue.

cial institutions. It seems that, at the beginning, there is a conflict, if these two policy are equal balanced, or the ECB specific supervisory tasks have to support the function of its primary monetary objective.

By performing its task according to the TFEU and ESCB-Statue, the Bank can make regulations, take decisions, make recommendations and deliver opinions and it can impose fines or periodic penalty payments.[136] It shall be consulted by all acts-proposals in its fields on union and national level.[137] Furthermore, it can consult the Council, the Commission and the MSs-authorities on the scope the implemented legislation to the prudential supervision of credit institutions and to the stability of the financial system.[138]

5.2. The new European System of Financial Supervision

The need to reform the existed supervisory model as well as the results of the global financial crisis and the European debt crisis forced the EU-MSs to reform their system. In this regard, the European Commission made a proposal, based on the recommendations of Jacque de Larosiere's

136 Cf. Article 132 TFEU, Article 18 Regulation 1024/2013, hereinafter SSM-Regulation .
137 Article 127(4) and Article 285(2) TFEU as well as Article 4 ESCB-Statue.
138 Article 25.1. ESCB-Statue.

group,[139] and since September 2011 in the EU there is a new System of Financial Supervision. The system consist of two legs: a System Risk Board (ESRB)[140] conducting macro-prudential oversight and a European System of Financial Supervision (ESFS) responsible for the micro-prudential supervision.

The ESRB does not have any binding decision-making powers as regards implementation of recommendations. It is hosted by the ECB, where the CB provides the ESRB-Secretariat. Consequently, the ECB has be involved in macro-prudential oversight.

The second pillar of the system, the ESFS in comparison with the ESRB, has legal competence in respect of the national authorities. The ESFS is an alliance of supervisory authorities, from European level: the three committees of the ESAs[141] and national level: the EU-MSs-authorities, comparable with the US-FFIEC.

The system works in a way, that the ESRB earlier identifies potential risks and issues necessary recommendations to the ESFS. Then, the ESFS collaborate the imple-

139 Jacque de Larosière Group Report. The Report found that the European financial market need strong, integrated regulation and supervision. In the view of the Group, there is a lack of appropriate and effective supervision at the macro level, which should encompass all areas of finance and not just the banks. According to the Report, the ECB can effectively exercise its proposed functions within the scope of the ESCB.

140 Parliament and Council Regulation 1092/2010.

141 The European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pension Authority (EIOPA), collectively known as the three Supervisory Authorities (ESAs). See Joint Committee of ESAs, Article 54 EBA-Regulation.

mentation of the recommendations with the national competent authorities (NCAs). Thus a substantive supervision standard will be harmonized by the MSs through the ECB-administration.

5.2.1. The Role of the European Central Bank

The ECB become an important role at an macro and micro level in the new system of supervision.

At the macro level, the CB has to analyze the stability of the financial system and develop an early warning systems for a potential risks. The ECB has to provide the ESRB with all the necessary logistical support and to give evaluation and recommendations in respect of macro-prudential supervision.

At the micro level, the CB assumes direct control over trans-border EU-credit institutions. In the event of a conflict between MSs supervisory authorities, the ECB plays the role of a binding mediator. Within the framework of the financial system, the ECB has a consultative role on matters concerning bank law regarding Article 127(6) TFEU and Article 4(a) ESCB-Statue. In order to perform its duties assigned to the ESCB, the ECB can exert influence on the MSs by means of regulations, decisions, recommendations and opinions.[142]

142 Article 132(1) TFEU.

5.2.2. Evaluation

The new European system of financial supervision seeks to consolidate the fractured elements of the existed European financial supervision model. Nonetheless, the fact that responsibility for the financial supervision is divided over different bodies at the European and at the MSs-level[143] demonstrates that the concept is not a centralised supervisory model. In addition to the ESFS and ESRB at supranational level there are other bodies which are involved in the financial supervision, what has the disadvantage that some of their function overlapped each other.[144]

In terms of the institutional structure, the system lacks one body, which can cover all financial supervision matters. The system leaves the impression that, instead of a reduction of the large financial regime, the reform was focused rather on restructuring the financial supervisory authorities at the supra-national level.

143 The European system of supervision, which is based on the concept of minimum harmonisation, mutual recognition and the country of origin principle, has certain disadvantages. The cross-border supervision depends on the cooperation between the home- and host-MSs-authorities. The financial control procedures at state level differ from one to another and refer to different institutions and criteria. Even harmonised rules are implemented in different ways by the supervisory bodies of each MS, as their authority, jurisdiction and legal praxis vary.

144 Under Article 134 TFEU, the Council, Commission, Parliament, ECB, and the Economic and Financial Committee (ECOFIN) are all involved in the European financial system matters. Regarding to certain tasks such as the prevention, management and resolution of crises, as well as developing of strategies and securing financial stability, ECOFIN and ESRB display similar functions.

5.3. European Banking Union

In order to strengthen the financial regime in the Eurozone and to further stimulate the European integration, the EU-MSs created a Banking Union in 2012. The institutional framework of the Banking Union is based on three legs: Single Supervisory Mechanism (SSM), Single Resolution Mechanism (SRM), and Single Rulebook.

5.3.1. Introducing of the SSM and the Proposals of the European Commission for conferring supervision tasks on the ECB and the new EBA

In 2012, the heads of Eurozone decided at a high-level meeting, based on Article 127(6) TFEU to introduce a SSM under the control of the ECB. Thus, created was the first step at the Banking Union, which purpose is to harmonise the substantive regulation and to implement a single supervision within the ESFS. On the basis of the resolution from the meeting and the recommendations of the de Larosiere Report, the Commission issued in September 2012 two proposals for regulations – one conferring specific tasks on the ECB[145] and another concerning the amend-

145 Commission, 'Proposal for a Council Regulation conferring specific tasks on the ECB

ment of the EBA-Regulation,[146] as well as a schedule for the establishment of Banking union.[147]

The first proposal granted the ECB with the competence to take final decisions regarding bank supervision issues. The ECB should take over the role of the national supervision authorities. It gained unlimited powers of intervention in respect of all credit institutions, requesting information, carrying out investigations or inspections, or imposing sanctions.[148] The national supervision authorities retained competence over all tasks that have not been conferred on the ECB, regarding to the consumer protection, fighting money laundering, and the supervision of banking institutions from third party states.[149] The imposition of sanctions was divided amongst the ECB and national authorities.

Initially, the ECB has to supervise systemically important credit institutions, and after the one-year transitional term it shall take over the supervision of other institutions.

In order to separate the supervision from the monetary policy, inside the ECB was created, a Supervisory Board responsible for planning and executing bank supervision tasks, according to Article 18(2) and 19(1) of the ECB-Regulation. The members of the ECB-Governing Council have to elect a chairperson of the Supervisory Board[150]

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146 Commission, 'Proposal for a Regulation of the European Parliament and of the Council amending Regulation 1093/2010
147 Commission, 'Communication from the Commission to the European Parliament and the Council: A Roadmap towards a Banking Union'
148 Article 19-12, 15 ECB-Regulation.
149 Article 4(4) ECB-Regulation.
150 Article 26(1)(3) SSM-Regulation.

from the ECB Directorate, and a vice-chairperson from the members of the Executive Board.[151] However, this raised the question whether there was sufficient division between the banking supervision and the monetary policy, when a member of the Governing Council (which determines the monetary policy of the EU)[152] was able to influence the decisions of the Supervisory Board.

The EU-MSs outside the Eurozone were given the option to join the SSM, if they meeting the necessary requirements.

The Commission also made a proposal for amending the EBA-Regulation. The Regulation seeks to adapt the procedure modalities and tasks of the EBA to the newly formed supervision structures, including the ECB as a banking supervisory authority.

151 Article 19(2) ECB-Regulation.
152 According to Article 12.1. ESCB.

5.3.2. Requirements of the European Parliament

The proposals of the Commission have met criticism from some quarters.[153] The European Parliament objected in October 2012 to certain suggestions, regarding the strict division between monetary, political and supervisory functions of the ECB, and the equitable treatment and representation of the euro and non-euro area-MSs participating in the SSM.[154] The Parliament demanded amendments regarding the types of supervised credit institutions and the collaboration between the ECB and national supervisory authorities. Moreover, the Parliament insisted that a Board of Appeal from the decisions of the ECB should be created. Furthermore, in order to protect the interests of the MSs which are not part of the SSM, the qualified majority for decisions taken by the Board of Supervisors of the EBA must include at least half of the SSM-MSs and half of the MSs not taking part in it.[155]

153 Cf. Andrea Eriksson, 'Einheitlicher Europäischer Bankenaufsichtsmechanismus' 6, 19; 'Weidmann macht Front gegen Bankenaufsicht unter Dach der EZB' *FAZ* (Frankfurt/Main 27 September 2012). See also submission of Deputy Meister and others and the CDU/CSU party as well as Deputy Wissing and others and the FDP party on (2012), BT-Drs. 17/10781; discussions at the session of the German Bundesrat (19 October 2012) BR-Drs. 546/12 and the protocol of the meeting of 19 October 2012 (631 EC) 11 et seq. A matter of discussion was the supervision of small credit institutions, which lacking systemic relevance, although such institutions may create systemic risks for the Eurozone.

154 Council, Cover Note EUCO 156/12 Conclusions [2012] CO EUR 15 CONCL 3.

155 Parliament Report, in relation to Art. 44 of the EBA-Regulation.

5.3.3 Political Agreement in the European Council

A political agreement on the establishment of the SSM was reached in December 2012 in the ECOFIN.According to the agreement, the ECB has to undertake the supervision only of significant credit institutes.[156] The supervision of significant institutes or direct supervision will be conducted via joined supervisory teams JSTs.[157] For financial conglomerates supervisory colleges (SCs) were created.[158] In addition to the JSTs and SCs[159] there are crisis management groups (CMGs) and Cross-Border Stability Groups (CBSGs), responsible for the management and resolution of global systemically important financial institutions (G-

156 Article 5(4)(a) ECB-Regulation, or Article 6(4) SSM-Regulation, Article 39 Regulation 468/2014. Some of the requirements such institutions are: to have revenue 30 billion Euro or 20% of national GDP (unless the total value its assets is below 5 billion) or with significant relevance to the domestic economy or have required or received public assistance from European Financial Stability Facility (EFSF) or European Stability Mechanism (ESM).

157 JSTs include experts from the ECB and the NCAs. The JSTs have to perform supervisory review and evaluation, measuring the risk exposure, systemic risk and risk revealed by stress test (Article 290 CRR) according to Article 3 Regulation 468/2014.

158 SCs include experts from the ECB and NCAs where these significant entities have brunches. See Article 9 Regulation 468/2014 and Article 97 CRD. Covered are also brunches in the non Eurozone-MSs, as well as credit institutes from non Eurozone-MSs with brunches in the Eurozone (Article 4 SSM-Regulation). For the last cases the ECB shall exercise the power of home authority according to Article 17 Regulation 468/2014.

159 The chairmen of the JSTs and the SCs are from the ECB. Cf. Article 9 Regulation 468/2014 and Article 116 CRD.

SIFIs) and financial groups.[160] The supervision of not significant credit institutes or indirect supervision remains subject to the NCAs. However, the ECB can itself directly exercise the supervision of other institutes at any time.[161] For this purpose created inside the ECB were divisions responsible for: significant, less-significant as well as horizontal supervision (teams linking JSTs and NCAs) und for all credit institutes under the SSM-supervision.[162] The ECB is responsible for the effective and harmonious functioning of the SSM and has to issue guidelines and instructions for the supervision of the credit institutions to the NCAs.[163]

Changed was also the supervisory decision-making process of the ECB. Near the existing Governing Council, Executive Board and General Council, added had been three new bodies: Supervisory Board, Mediation Panel and Administrative Board of Review.

The Supervisory Board has to plan and execute the supervisory tasks conferred upon the ECB.[164] It has to provide full draft resolutions to the Governing Council. Thus, the Governing Council continues to have decision-making

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160 Guide to Banking Supervision 2014.

161 Cf. Article 6(4) SSM-Regulation. Thomas Gstädtner, EU-Bankenunion - Qualität wichtiger als das Zeitplan!, in: Wie ist das Konzept der EU-Bankenunion zu bewerten? (2013), 1, (8). However, for some this is a breach of Article 5(3) TEU, the principle of subsidiarity.

162 ECB, Guide to Banking Supervision, 13.

163 Article 6(5)(b) 2024/201.

164 Article 19(1) ECB-Regulation. To guarantee its independence from ECB monetary policy, its members have to confirm the ECB-Code of Conduct, See Code of Cunduct.

powers in respect not only of monetary policy but of the supervision.

The Mediation Panel has to resolve differences of views expressed by the MSs, regarding the objection of the Governing Council to a draft decision by the Supervisory Board.[165]

Through the Administrative Board of Review Panel, any legal or natural person can object the decision of the Supervisory Board.[166]

The EU-MSs also agreed on the amendment to the EBA-Regulation. The MSs-authorities still in control of market and solvency supervision, whereas the EBA-task become to execute the coordination procedure for the SSM.

5.3.4. Problematic issues

Despite the attained agreement in the ECOFIN, the introduced SSM raises some problematic questions.

5.3.4.1. Article 127(6) TFEU

The question of whether supervision should be subject to the control of the ECB and more specifically whether Article 127(6) TFEU is a suitable basis for conferring supervisory 'specific tasks' on the ECB remains a matter of de-

165 Article 24(5) SSM-Regulation.

166 Article 25 SSM-Regulation. The Supervisory Board shall take into account the consideration and make new draft to the Governing Council. However, the request of review does not have suspensory effect according to Article 25(8) SSM-Regulation.

bate.[167] The provision of Article 127(6) TFEU deals with the monetary policy of the EU, and it should be considered as granting limited competence to the ECB with the right of veto in respect of bank supervision.[168] Thus, Article 127(6) TFEU is not a sufficient basis for transferring all banking supervision to the ECB. Based on a grammatical interpretation of Article 127(6) TFEU, it refers to 'specific' and not to 'the' or to 'all' supervisory functions. In accordance with a historical interpretation, the MSs at the treaty negotiations of Maastricht, rejected the demand of the governors of the CBs for participation of the ECB in banking supervision, and as a compromise the possibility of participation was adopted in Article 127(6) TFEU, provided the Council unanimously agrees to such participation.[169] Moreover, regarding the teleological interpretation of Article 127(6) TFEU, it can be concluded that the provision seeks to rule out the entire transfer of banking supervision to the ECB.[170] The ECB was granted direct powers of supervision, investigation and sanctions under Article 8 of the proposed ECB-Regulation. The wording 'one or more' does not include all such institutions, therefore it cannot be considered to be full banking supervision by the ECB. In

167 Thomas Berschens and Ruth Sigmund, 'Juristische Bedenken gegen Euro-Bankenaufsicht wachsen' *Handelsbatt* (Düsseldorf, 20 October 2012) 15. According to the opinion of the legal service of the European Council, the ECB 'oversteps' the possibilities under the EU Treaties. Therefore, the EBA must be subject to the ECB.

168 Stefan Glatzl, *Geldpolitik und Bankenaufsicht im Konflikt*, (Nomos 2009), 257.

169 Stefan Glatzl (n 168), 257.

170 Andrea Eriksson (n 153), 29.

any case, certain supervisory powers remain with the supervisory authorities of the MSs, while the ECB is mainly focused on the systematically important credit institutions, whereas the other remains under the supervision of MSs-authorities. Therefore, the proposed Regulation can be based upon Article 127(6) TFEU in the sense of 'effet utile'.

Furthermore, it is debatable, whether the Supervisory Board can be established along with the Governing Council, and the Executive Board. Concerning the division of monetary policy from supervision, the provision raises doubt in respect of the primary objective of price stability of the ECB according to Article 127(1) sentence 1 TFEU, and the decision-making power of the Governing Council. During the negotiation process in the ECOFIN, it was found that the establishment of a supervisory body was in breach of Article 13(2) TEU.[171] The decision-making bodies of the ECB, in accordance with Article 129(1) TFEU and Article 9.3 ECB-Statutes, are the Governing Council and the Executive Board.[172] As there is no provision for an amendment of these bodies, and their procedures or voting rules, the Commission's proposal exceeds the powers held by the Council pursuant to Article 127(6) TFEU.

On the other hand, a conflict of objectives between the monetary policy and supervisory functions should be avoided. Under the two current bodies this cannot be guaranteed. In this regard, Article 127(6) TFEU can be understood in the sense that the transfer of 'specific tasks' of

171 Andrea Eriksson (n 153), 29, Opinion of the legal service of the European Council dated 9 October 2012.

172 According Article 45.1. ESCB-Statue, the General Council is the third ECB decision making body.

banking supervision to the ECB provides the Council with an opportunity to introduce such a body for this purpose. Thus, the Supervisory Board will not have the power to take decisions itself, but rather it will prepare decisions which are reserved for the Governing Council.

In addition, by authorising the ECB as a banking supervisory authority, some counter-arguments should be considered: the hierarchical relationship with the EBA; the differences between euro and non-euro EU-MSs, as well as EFTA-MSs; the priority of the task under Article 127(1) sentence 1 TFEU; the lack of democratic legitimatisation in the event of interventions and the formation of a super-authority.[173]

5.3.4.2. Competences of the ECB, the ESRB and the EBA

A further issue of the Commission's proposals is related to the competencies of the ECB, the ESRB and the EBA. When making a comparison between the ESRB and the ECB, it is apparent that both institutions have similar functions concerning the macro-prudential supervision of the Eurozone-MSs, and the associated information-gathering. Nevertheless, according to Article 5.1 and 5.2 ESCB-Statue

173 The issue related to the ECB as a super-authority can be seen as a two sides of the coin. On one hand, a super-authority will produce bureaucracy with related risk of misconduct. See in this regard Donato Masciandaro, Back to the Future? Central Banks as Prudential Supervisors in the Aftermath of the Crisis, ECFR, 114, 117. On the other hand, this functional facilitation will enable the role of the ECB bodies and panels to cooperate inside, exchanging views and information. ECB is a central European supervisory authority and beside this function it is involve as a resolution authority.

unlike the ESRB, the ECB can directly collect the statistical data required to exercise its functions from the national authorities, with the support of the national CBs. The ECB in comparison with ESRB has greater access to information, without being involved in the procedure of information acquisition, as Article 15 ESRB-Regulation envisages for the ESRB. In contrast to the ECB, the ESRB does not have legal personality, which means that the ESRB is capable of taking action only through the ECB. The ECB is hierarchically subordinate to the ESRB, whereas according to the proposal of the Commission and in practice the ECB is more in the public eye. This could lead to the possibility of ESRB becoming a forum for dialog led by the ECB and the ESRB-leadership, and decision-making could be dominated by the ECB and Banking Union concerns.[174] In addition for the first five years of its creation the ESRB is chaired by the President of the ESB.[175]

As far the EBA was introduced as a central European banking authority, a question arises about the ECB's role in respect of supervision. The ECB replaces the EBA as a Eurozone banking supervisor.[176]

The de Larosiere Report envisaged only mediation functions of the ECB when dealing with conflicts between the NCAs,[177] whereas according to Article 33(2) Banking

174 Eilis Ferran and Valia Balis (2013) 'The European Single Supervisory Mechanism', JCLS 255, 285.

175 Article 5 ESRB-Regulation.

176 Dooley Kristen et al., Developments in Banking and Finance Law, (2012) Review of Banking and Finance Law, 1, 16. The EBA has never be granted with investigating authority and relies entirely on the data its members.

177 De Larosiere Report (n 139), 49, para 170,

Directive[178] this power is granted to the Commission.[179] The Commission likewise has the last word when it comes to drafts relating to the binding technical standards of the EBA[180] and the RRP. According to the ECB-Regulation, the ECB only takes over the role of the national supervisory authorities within the Eurozone, whereas the harmonization of the banking sector in the EU and the introduction of a uniform supervisory practice will remain under the control of the EBA. Thus, on a European level, the ECB will have the same relationship towards the EBA as towards the national authorities of the non-Eurozone MSs. In terms of hierarchy, the ECB is under the EBA. In order to differentiate the functions of both authorities, a suggestion was raised to leave the operative supervision of credit institutions to the ECB, whereas decisions on the permission, dissolution or restructuring of institutes would be reserved for the EBA.[181] A similar idea for the division of banking supervision between the ECB and the ESM.[182]

178 Currently Article 154(2) of the CRD IV.

179 CRD IV.

180 Article 10(1)(8), Article 15(1)(7) EBA-Regulation or Article 10 to 15 Regulation 1093/2010.

181 Matthias Herdegen 'Europäische Bankenunion: Wege zu einer einheitlichen Bankenaufsicht' (2012), WM 1889, 1897.

182 Matthias Herdegen (n 181), 1897ff. The ESM is an international organisation created in accordance with the international law that can assume such functions. If the ESM does not represent the national authorities of the MSs in the EBA, an amendment of secondary EU law will be required. An integration of the functions and powers currently held by the EBA with banking supervision by the ESM will require an amendment of the TFEU.

5.3.4.3. Democratic Legitimacy

Another problem concerns the ECB democratic legitimacy by performing supervisory tasks. The independence of the ECB is guaranteed through Article 130 TFEU. A systematic interpretation of the TFEU permits the independence of the ECB in respect of its monetary functions. The granting of functions and powers that are not to be independently exercised should necessitate an amendment of the TFEU.[183] Dispensing with political responsibility and reviews is at odds with the principle of democracy under Article 2(1) TEU.

The functioning of the EU is founded on representative democracy according to Article 10(1) TEU. Any form of independent exercise of sovereign rights on the part of independent bodies of the EU requires special justification by the Parliament, the Council or the Commission. In respect of the monetary policy functions of the ECB, such a justification is based upon the independence of CBs and currency stability. However, despite Article 19 SSM-Regulation, there is no such justification for the independence of the ECB, where supervisory functions and the stability of the banking system are concerned.[184] Particularly in respect of bank supervision, there is no tension between the interests of stability and the monetary functions of the ECB. Consequently, a transfer of banking supervision to

183 Matthias Herdegen (n 181), 1894.
184 Matthias Herdegen (n 181), 1894.

the ECB is, in light of its independence, contrary to the principle of democracy.[185]

5.3.4.4. Scope of Supervision

A further issue arises to the ECB's scope of supervision. Under the new regulation, the supervisory powers of the ECB are restricted in principle to the Eurozone-MSs. Therefore, UK institutions are not included, despite the fact that the head offices of some of the largest institutions are located there. MSs outside of the Eurozone can establish close cooperation between their supervisory authorities and the ECB under Article 7 of the SSM-Regulation. Nevertheless, they do not have as great influence on the decisions in the Supervisory Board as the Eurozone-MSs. Such a divided Supervisory Board would result in system failure to a certain extent. The reason is that in a mainly harmonised financial sector, companies would be subject to differing supervisory mechanisms side-by-side.[186]

5.3.2. Proposal of the European Commission for a SRM

In May 2013, at a meeting of the ministers of finance of the Eurozone it was discussed whether, a new structure supported by the ESM, can take over bank resolution in the Eurozone.

In light of the discussion, in July 2013, the Commission proposed a Single Resolution Mechanism (SRM) for the

185 Cf. Matthias Herdegen (n 181), 1894, see also Hugo Hahn and Ulrich Häde, *Währungsrecht*, (2nd edn, Beck 2010), 112.

186 Matthias Herdegen (n 181), 1894.

Banking Union. The system has to recapitalize credit institutions, which have difficulties, via a resolution fund. The SRM works in such a way that the ECB, as a bank supervisor, would first signal when a bank has severe financial difficulties and needs to be resolved.[187] As a second step, a Single Resolution Board (SRB) consisting of representatives of the ECB, the Commission and the national authorities where the bank has its headquarters would prepare the resolution of the bank. On the basis of the SRB's recommendation, or on its own initiative, the Commission has to decide whether to place a bank into resolution. Thus, the final say would be with the Commission. The legally binding discretionary decision will be with a democratically legitimate body.[188] If the Commission decides to place a bank into resolution, the national resolution authorities would be in charge of the execution the resolution plan.

The EU-MSs reached an agreement in April 2014 for the establishment of a SRM.

187 This assessment will be conducted by the ECB Supervisory Board for the banks subject to the SSM and by the national resolution authorities for banks not member of the SSM. See Stefano Micossi, Ginevra Bruzzone and Miriam Carmassi 'The New European Framework for managing Bank Crises' (2013) CEPS 21, 29.

188 René Höltsch 'Brüssel forder Berlin heraus. Die EU-Kommission hat einen Gesetzesvorschlag zur Europäisierung der Bankenabwicklung vorgelegt' (Brussels 11 July 2013) NZZ.

5.3.3. Proposal for a Single Rulebook

Besides SSM and SRM, the third pillar of the European banking union is the single rulebook implemented in 2014. The book consists of legal rules ensuring security for the bank market and guarantees for the depositors. An important role in the operation of the rulebook is given to the EBA, which will be responsible for specifying technical aspects of the book, the supervisory convergence, and guaranteeing its uniform implementation across the EU. The rulebook includes a core set of standards, applied in a harmonised manner throughout the EU by all supervisors.[189] Nevertheless, it raises the question of when and where harmonised EU financial regulation reaches its limit, and if 'stringency' prevails over 'efficiency'?[190]

5.6. Assessment

The reforms in the European banking sector gave the ECB additional central supervisory function, besides its primary monetary responsibility. Despite the advantages of the reform such as: centralisation of the supervision on union level, institutional integration and unification of the law, there are also some drawbacks. It is questionable, if the ECB equally can combine its primary objective of price stability with its role as a bank supervisor.

189 See Jonathan Faull, Director General, European Commission, Some Legal Challenges in Eilis Ferran (n 174), 25.

190 Eilis Ferran, 'Crisis-Driven EU Financial Regulatory Reform', (2012) SSRN, 1.

Furthermore, regarding the monetary policy, it is questionable, how well the ECB can protect its primly task: price stability and at the same time supporting deficit problems of some euro-MSs?[191] The ECB has to take care and not discriminate the currency interest of other EU-MSs.[192] The creation of a super-authority is another controversial issue which leads to a further problem related to the lack of democratic legitimatisation by the ECB supervisory intervention. Controversial was, how far the Article 127(6) TFEU gives the ECB such legitimating. The supervisory role of the ECB is restricted to the Eurozone-MSs. The ESRB is responsible for the macro-prudential supervision of EU-MSs. The Board does not have any decision binding power and can take action through the ECB. In this regard, there is a tension that the supervision in the European banking sector still with different intensity.

In comparison with the UK, where the BoE covers the whole financial sector, the ECB macro-prudential supervision comprises the banking sector. The de Larosiere Report, recommended that the supervision at the EU level should be through regulator which encompasses all areas of the financial market, and not to be restricted to the banking sector.[193] The authorisation of the ECB as a central supervisor replaced the model of one financial authority.

Another issue is that, despite the new attempt for harmonisation in unification, the EU financial system remains

191 As a legal basis for such funding created was the new Article 136(3) TFEU.
192 Article 1 par. 4 SSM-Regulation.
193 De Larosiere Report (n 139) 45, para 153.

quite fragmental, with central supervision at supra-national level to some extent, and decentralised supervision through the principle of country of origin and mutual recognition on the MSs level.[194]

In addition, whereas EU monetary policy is conferred on the supra-national level by the ESCB, responsibility in terms of economic policy remains with the MSs, which causes further imbalance to the EU integrity.

194 Problems with application both principle result in supervisory gaps, double control and overlapping competences, regulatory arbitrage and distortion of competition.

6. Conclusion

The emergency of the global financial crisis has lead to a new approach of thinking on all issues related to monetary policy and banking supervision.[195] The view of separation of both policies has been abolished and through the new reform-agenda the CBs became involved in these both functions. An advantage of this integrated approach is that CBs can consider the effect of their action of the hole economy.[196] However, the complexity of the issue has the disadvantage related to the contrary interest between monetary policy and banking supervision.[197] By conducting monetary and supervising functions the CBs became super-authorities with many responsibilities, what leads not only to growing bureaucracy, but also to concentration, instead of

195 Howard Davies, David Green, reviewed by Rakesh Mohan, 'Banking on the Future: The Fall and Rise of Central Banking' (2011) Journal of Economic Literature, 730, 733.

196 Example is, the Fed actions by the Great Depression in 1929 when fixing the capital market with high interest rate. However, the effect on the economy was worse. Ben S. Bernanke (7), 21, 23. The Fed did not supply the market with liquidity and do not act as a LLR.

197 Alexander Wellerdt (10), 88. The interest rate reductions, loan programmes, the purchase of asset-backed securities or government bonds can lead to the recapitalisation of credit institutes, which are classified to be in risk of default by the banking supervision. Otherwise, the high interest rate brings down the inflation, but cause recession and high unemployment rate.

counterbalancing the power between different agencies.[198] Another issue is that some of the supervisory functions overlapped with the other authorities.

Consequently, it has been argued that the reputation of CB is more likely to suffer than to benefit from the joint conduct of these opposed policies.[199]

The three CBs which have been discussed in this piece represent different approaches of regulation. For instance, the UK supervisory function is separated between two different regulators. By the US functional approach there are: multiple authorities, different markets and multiple laws, oppositely to the EU model with single authority, single market and single law. In this regard, the UK "twin picks model" is between these two approaches, more closer to the EU model.

By comparing the three systems, it can be seen that the CB functions are organised in a different way. For example, a characteristic feature of the US financial system is that some of the Fed supervisory functions are transferred to other outside the Fed authorities. The Fed monetary policy is divided between the FRB, which conducts the discount

198 Whereas, the UK twin peaks approach to financial regulation runs the risk that one conflict of interest, between conduct-of-business and prudential supervision, is replaced by another, between prudential supervision and the conduct of monetary policy. In the US, the latter conflicts do not appear to have been a major concern, where the Fed has responsibility for monetary policy and the supervision.

199 See Charles Goodhart/Dirk Schoenmark, (17), 548. For that reason, for instance, the Federal Reserve Bank of New Zealand (1994) decided to reduce its involvement in a banking supervision.

rate and the reserve operations; and the FOMC, which performs the open market operations.[200] The US-banking oversight is shared between the FRB and the FSOC. In the UK, the supervision is split inside the BoE between the FPC and PRA. The newly created FCA outside the Bank is responsible for market integrity and consumer protection, what shows some similarity to the US-model. Oppositely, in the EU, the ECB-General Council has the final say in monetary and supervisory decisions.[201] However, the specificity of the European supervision model is that, it is divided from different integrated intensity between the ESRB, the ECB, and the national CBs. Furthermore, the ECB is responsible only for the banking supervision, whereas the BoE and the Fed cover the oversight for the whole financial sector. Concerning the RRP, in the UK and the US, the CB have to consult with the Treasury, while in the EU the final decision is by the European Commission.

Therefore, by the BoE[202] and the Fed, the Treasury still have strong influence of their policy. Both CBs have to consult with the Treasury for monetary, supervisory policy, RRP and by acting as a LLR.[203] Differently, according to Article 130 TFEU, Article 7 ESCB-Statue, the ECB is a po-

200 FOMC.

201 According Article 26(6) SSM-Regulation the decision of the Supervisory Board come into force until the Governing Council does not object them.

202 The BoE through the MPC can receive orders from the Treasury "in public interest" and by "extreme circumstances".

203 S 13(3)(B) FRA. Furthermore, regarding the independency, the Fed through its chairman has to give a quarter annual report for the US-Congress.

litically,[204] organically, functionally and financially independent authority of sovereign MSs.[205]

Consequently, along with the similarity of their dual monetary/supervisory function, the three CBs have differences conditioned from the characteristics of their regulatory systems. The advantages and the disadvantages of one or another system depend on their individual circumstances. However, weighing up the pros and cons of different approaches, it could be assumed that a possible alternative will be a combination of an integrated approach, with separate authorities for the monetary policy and supervision.

204 The political independence of the ECB is guaranteed through the TFEU and ESCB-Statue only regarding its primary task: maintaining the price stability.

205 Rosa M. Lastra, 'Evolution of the European Central Bank', (2011) The European Union Law Issue, 1260, 1278 f. Organically is evidenced by number of guarantees of appointment or removed procedure its governing bodies. The functional independency is guaranteed through Article 130 TFEU, as well as OLAF case, judgment of the European Court C-11/00 from 10 July 2003, I-7221. Its staff is also elected with fixed term. Financially, the ECB has its own budget and the ECB is prohibit to finance public sector deficit, according 21(1) ESCB-Statue. The political independence of the ECB is only regarding its primary task: maintaining the price stability.

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