Is there a need to change accountability practices of the European Central Bank (ECB) now that it has new tasks regarding prudential supervision?

Name: Amparo Dashorst
Student number: 1377353
Tutor: dr. B. van Riel
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# TABLE OF CONTENTS

## Introduction

01

## 1. Broadening of the range of duties of the ECB: what does this mean with regard to the financial stability?

04

1.1 The main purpose of the SSM

04

1.2 Macro-prudential supervision

06

1.3 Shift in ECB accountability

08

## 2. The concept of accountability: what will this imply for the independence of the ECB?

09

2.1 General concept of accountability

10

2.2 Monetary accountability and independence

12

2.3 Independence

14

2.4 Transparency

15

2.5 ECB’s instruments – accountability

16

2.6 The role of the EP regarding accountability practice

18

2.6.1 Monetary Dialogue

18

2.7 Interinstitutional Agreement and Memorandum of Understanding

19

2.7.1 Code of Conduct

20

## 3. Prudential supervision: the differences and design of accountability of the ECB

21

3.1 ECB independence and different objectives

21

3.2 Governing council of the ECB: two responsibilities – one body

24

3.3 Operating on different levels of governance

25

3.4 Implications on the accountability framework

26

## Conclusion

29

## Literature

33
### Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>EBA</td>
<td>European Banking Authority</td>
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<tr>
<td>ECB</td>
<td>European Central Bank</td>
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<td>ECJ</td>
<td>European Court of Justice</td>
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<td>EMU</td>
<td>Economic and Monetary Union</td>
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<td>ESA</td>
<td>European Supervisory Authorities</td>
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<td>ESFS</td>
<td>European System of Financial Supervision</td>
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<td>ESM</td>
<td>European Stability Mechanism</td>
</tr>
<tr>
<td>ESCB</td>
<td>European System of Central Banks</td>
</tr>
<tr>
<td>ESRB</td>
<td>European Systemic Risk Board</td>
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<td>EP</td>
<td>European Parliament</td>
</tr>
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<td>HICP</td>
<td>Harmonised Index of Consumer Prices</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>MEP</td>
<td>Member of the European Parliament</td>
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<td>NCA</td>
<td>National Competent Authority</td>
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<td>NCB</td>
<td>National Commercial Banks</td>
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<td>SRF</td>
<td>Single Resolution Fund</td>
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<td>SSM</td>
<td>Single Supervisory Mechanism</td>
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<td>SRM</td>
<td>Stability Resolution Mechanism</td>
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<td>TEU</td>
<td>Treaty on European Union</td>
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<td>TFEU</td>
<td>Treaty on the Functioning of the European Union</td>
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**Introduction**

Following the global financial crisis of 2007, the architecture of banking supervision in the euro area revealed points of weakness.¹ This crisis showed how rapidly problems in one European country's financial system could spread among other Member States and even threaten the stability of the entire European banking system. Due to the lack of cooperation among national authorities and the absence of common resolution mechanisms, this led to exceptional high banking costs and possible bailouts. To solve these weaknesses, the European Union made a fundamental political decision to introduce the Single Resolution Mechanism (SRM), which will provide resolutions (rescue plans) through financial support of the centralized Single Resolution Fund (SRF) to prevent bank failure.² It the SRM will complement the Single Supervisory Mechanism (SSM), which was published in a legislative proposal in September 2012 by the European Commission.³

The SSM refers to the European Central Bank (ECB) and the national supervisory authorities of all EU Member States and participating Member States whose currency is not the euro.⁴ Hereby the ECB and the national central banks (NCB) of all Member States of the euro zone form the European System of Central Banks (ESCB).⁵ The ECB will have the final supervisory authority over ‘significant’⁶ banks (based on size and relative importance in the Member States, and cross-border activities). National supervisors, supporting the ECB on supervisory matters, supervise less ‘significant’ banks, meaning that the cooperation or working-relationship between the ECB and the national supervisors must be safeguarded.⁷

This new SSM will divide the ECB tasks into a monetary function and a supervisory function. Hereby the ECB and the national central banks (NCBs) of all Member States of the euro zone form the European System of Central Banks (ESCB).⁸ The debate involving the ECB independence and its new integrated supervisory tasks alongside monetary policy raises a number of questions. This particularly relates to central bank independence, since the possibility of trade-offs between monetary policy and supervisory tasks could lead to conflicts of objectives. Hence, reputational

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⁵ Protocol (No. 4) on the statute of the European system of central banks and of the European Central Bank in TFEU.
⁸ Protocol (No. 4) on the statute of the European system of central banks and of the European Central Bank in TFEU.
risks are significant challenges and threats, which need to be overcome. Moreover, when executing the two tasks during crisis situations within the euro zone, the ECB must have a high incentive to improve its accountability practise towards the European public to strengthen its credibility. Therefore, the existing accountability framework of the ECB must be critically reviewed. Thus the ECB could take certain extra measures to maintain its high standard of accountability. Based on the legal base of the SSM, Council Regulation (EU) no 1024/2013 and a literature overview, this thesis will approach the main question: **Is there a need to change accountability practices of the ECB now that it has new tasks regarding prudential supervision?**

Before answering this main question, the answers to three sub-questions will be provided:

The first sub-question is: What exactly does the broadening of the range of duties of the ECB regarding financial stability mean? With respect to financial stability, the ECB must fulfil its mandate of ensuring price stability, which aims at an inflation rate below or close to 2% on the medium term. Due to the new supervisory tasks, the main objective of macro- and micro-prudential supervision is to enhance and safeguard financial stability within the euro zone and individual financial stability of individual central banks. Based on Council Regulation (EU) No 1024/2013, the financial stability will be described as well as the influence on the accountability of the ECB.

The second sub-question is: The concept of accountability: what will this imply for the independence of the ECB? The general concept of accountability will be discussed, followed by the current accountability framework of the ECB, focussed on monetary accountability. The ECB accountability depended on its monetary performance for which it was held accountable, derived from its independence granted by the EP. An important element of accountability is transparency, whereby accountability could be enhanced. Even though the EP has the power to hold the ECB accountable for the execution of its tasks, the ECB uses instruments such as annual reports and publication of meetings, to enhance its accountability practises. In addition, the ECB improves its transparency practises by means of the 'Monetary dialogue'. However, due the new supervisory tasks, the cooperation between the EP and the ECB is determined by the Interinstitutional Agreement on the cooperation on procedures. Furthermore, The Memorandum of Understanding was agreed by the Council and ECB, which must give more insight in the ECB accountability.

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practices.

The third sub-question is: What are the differences between accountability towards monetary policy and financial stability, prudential supervision and what does this imply for the design of accountability framework of the ECB?

The addition of its new supervisory tasks will also broaden the ECB main objective of maintaining price stability, which could cause a conflict of interest within the ECB and on multi-level governance, to which it is held accountable by the EP and the Member States. The aim is to reason why there is a need to change the accountability practices of the ECB now that it has new tasks regarding prudential supervision. The conclusion will give an answer on how to improve the accountability of the ECB.

This thesis, being the final proof of my Master International Studies, is based on the literature on ECB accountability published in recent years. Based on the fact that this thesis is based on literature research, the existence and accessibility of empirical sources which examined the role and actions of the ECB from an economic perspective, provided a challenge, and must be kept in mind in reading this study.

My interest in this research is based on the fact that the overall tendency towards a more united European concept is well under way. A Bank Union, European legislation and all discussions in this regard also play a role with regard to the (lasting) impact of the ECB, which is why accountability is imperative. The manner in which accountability must be organized will be a process which will need to be fine-tuned over time, whereby it is imperative to ensure credibility, the absence of high costs resulting from failures in other EU countries with a long history of financial instability and to avoid a future banking crisis.
1. Broadening of the range of duties of the ECB: what does this mean with regard to the financial stability?

The financial economic crisis of 2007 showed that the integrity of the single currency, the euro, and the internal European market was negatively pressured by the fragmentation of the financial sector. The creation of the SSM is clearly linked to this crisis, aimed to break the ‘vicious circle’ between the bank and sovereign debt crises. Problems in the banking sector caused problems in public finances and vice versa; the troubled banking sector caused an economic crisis, leading to high deficits and banks refusing to buy government bonds of ‘dubious solvability’ from Member States, such as Greece, Ireland, Portugal and Spain. Furthermore, some governments used public funds to prevent banks from collapsing, whereas other governments, such as those of the aforementioned countries, did not have the funds to rescue their banks and requested financial assistance from the European Union. In countries where troubled banks did not have this option, the financial buffers diminished. The lack of overall trust in potentially insolvent banks increased because investors lost confidence in the recovery of these banks. Consequently, the interest rates of troubled banks for borrowing money increased, causing a distrust towards these countries, ending in a vicious circle.

1.1 The main purpose of the SSM

The main purpose of the SSM is to ensure the safety and soundness of the European banking system. Once the SSM is implemented, it could be a step forward towards a Banking Union. The SSM Regulation provides that the ECB will be primarily responsible for licensing, monitoring and composing prudential regulations by ex-ante control for euro zone banks. In addition the ECB will – by the implementation of the SSM in November 2014 - ensure the soundness of the credit institutions by conducting supervisory reviews and investigations. This will give the ECB the right to impose administrative penalties and demand fixed value capital buffers of credit institutions. Due to the SSM, the financial stability will be restored and the occurrence of

12 S. Verhelst, 'Assessing the SSM: passing the point of no return', p. 9,10.
bailouts will be prevented by stimulating the EMU integration.\footnote{EU Commission, Memo, Banking Union: restoring Financial stability in the Euro zone (April 2014), p. 2.}
The SRM will apply to banks covered by the SSM and must ensure that resolution decisions will be effective and will ensure adequate coordination of all participating Member States. This will minimise negative impacts on financial stability and it is anticipated to be more effective than the diversity of national resolution authorities. The supervision of the national resolution authorities will be transferred to a European level, whereby the ECB will be the lender of last resort and the establishment of the SSM will be an important milestone towards a banking union in Europe, by introducing a single rulebook, thus completing the economic and monetary union (EMU). \footnote{(CON 2012/96), Opinion of the ECB (November 2012), p. 1}
Therefore it is of great importance to intensify the integration of banking supervision in the European Union (EU), restore financial stability and lay the foundation for economic recovery. \footnote{Council Regulation (EU) No 1024/2013, (64).}

The ECB will provide analytical, statistical and administrative information for the European Systemic Risk Board (ESRB) to support the macro-prudential supervision, whilst the European Supervisory Authorities (ESAs) - a European Banking Authority, a European Securities and Markets Authority, and a European Insurance and Occupational Pensions Authority - will be responsible for micro-prudential supervision. The ECB is entrusted to supervise the European financial system as a whole. \footnote{V. Constâncio, Vice-President of the ECB, speech at ECB-CFS-CEPR conference, (September 2010) http://www.ecb.europa.eu/press/key/date/2010/html/sp100927_3.en.html}

The SSM will involve a supervisory system including both the national supervisors and the ECB as well as monetary policy-making, under one roof. The SSM proposal includes the ‘Supervisory Board’ which would be responsible for the ECB’s supervisory tasks. The board, consisting of six members, a Chair and Vice Chair, four representatives of the ECB and ‘representatives of national central bank or other national competent authority’.\footnote{European Commission (2012b), Proposal for a Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions. 12 September 2012, COM(2012) 511 final, December.http://ec.europa.eu/internal_market/finances/docs/committees/reform/20120912-com-2012-511_en.pdf.}
The Governing Council consists of 6 members of the Executive Board, including the President and the Vice-President, and the NCB’s 17 governors. The ECB Governing Council is the decision-making body of the ECB, and has the responsibility to adopt guidelines, take decisions concerning the Euro system, and formulate monetary policy. \footnote{Council Regulation (EU) No 1024/2013, (64).} In addition it will delegate decision-making power to the Supervisory Board. The Supervisory Board consists of a Chair and Vice Chair, elected by the Governing Council (Chair is chosen from the Executive Board), 4 representatives of the ECB, 17
representatives of the euro area NCB’s or other national competent authorities and potentially 9
other representatives from non-euro area countries. Its main task is preparing decisions and taking
decisions if decision-making power is delegated by the Governing Council.\footnote{21} Thereby the European
Council (EC) and the European Parliament (EP) agreed upon establishing the SSM.\footnote{22} This will be
conferred on the European Central Bank (ECB) by the SSM Regulation, adopted in accordance with
the Treaty on the Function of the European Union (TFEU), Article 127(6). Member States have the
responsibility for banking supervision of their individual banks.\footnote{23}

1.2 Macro- and micro-prudential supervision

The European financial architecture consists of monetary stability, financial stability by macro-
prudential supervision and financial supervision by micro-prudential supervision.

The main focus of micro-prudential supervision is to safeguard the soundness of individual
financial institutions and prevent them from taking too much risk. However, due to the crisis of
2007, the stability of individual financial institutions alone was not enough to ensure the stability
of the European financial system as a whole. Therefore the development of a complementary
macro-prudential financial supervision was mandatory.\footnote{24} Macro-prudential supervision involves
assessing the possibility of the occurrence of a shock in the financial system, between financial
institutions and markets and how to react to systemic risks.\footnote{25} As mentioned above, the ESRB will
be responsible for the macro-prudential supervision of the financial system within the EU, while
the ESAs will fulfil the micro-prudential responsibilities.\footnote{26} However micro-prudential supervisors
typically target single institutions and tend to neglect risks beyond their focus. Nonetheless this
type of risks may be negligible for the individual institution, and therefore could be a weak link
within a banking system.\footnote{27} The ESRB must interpret macro-prudential regulation to control and
monitor systemic risks within the financial system such as contagion between banks and between
banks and shadow banks, which usually do not have a banking licenses and which are therefore
not subjected to the same regulations as licensed banks.\footnote{28} The referred to ‘contagion’ could also be

\footnote{21} T. Beck, ‘Monetary policy and Banking Supervision: Coordination instead of separation’ part of the compilation PE
(December 2012), p. 7.
\footnote{23} Council Regulation (EU) No 1024/2013, p. 64.
\footnote{24} ECB ‘Micro- versus macro-prudential supervision: potential differences, tensions and complementarities’ in ECB
\footnote{25} J.C. Trichet, ‘Macro-prudential supervision in Europe’, in text of the second city lecture (2009)
\footnote{26} V. Constâncio, Vice-President of the ECB, speech at ECB-CFS-CEPR conference, (September 2010)
\footnote{27} M.K. Brunnermeier ‘Financial Crises: Mechanisms, prevention and management’, Draft 1, at Princeton University
\footnote{28} ESRB, ‘Principles for the development of a macro-prudential framework in the EU in the context of capital
an example of an effect on micro level with consequences on macro level. In addition, the ESRB will improve the interaction between micro- and macro-prudential analyses to improve the effectiveness of systemic risk assessment. The NCBs and supervisory authorities will provide systemic instruments to national authorities to respond appropriately to threats to their own national financial stability.\textsuperscript{29} Although national authorities have micro-prudential supervision over their own banks, the ECB will have the authority to offer macro-prudential instruments, such as capital buffers, at national level.\textsuperscript{30} This means that the ECB will also have the authority to provide individual macro-prudential supervisory powers.\textsuperscript{31}

The main focus of the ECB is maintaining price stability, achieved by relying solely on the interest rate instrument. In particularly when in a specific situation a low or even a falling inflation occurs, the monetary policy tool is too 'blunt' and the lack of information of this specific situation, emphasizes the limitations of the monetary policy tools to aim for financial stability.\textsuperscript{32}

The risks referred to above could be the trade-off is between macro- and micro-prudential policies. The initial approach to financial stability was based on the fact that safe individual financial institutions would result in a safe overall system. Since price and financial stability influence the economy at large (macro level) and sound financial institutions are aimed at individual financial institutions (micro level) to protect individual depositors and policyholders, it could be that financial institutions can behave in a way that collectively undermines the system and as such that micro policies can be destructive at the macro level. An example is that if an individual bank sells an asset, if from their perspective the price of risk increases, this could result in other banks acting in the same manner. This will result in a lower asset price, enhanced correlations and volatility.\textsuperscript{33} This means the ECB will carry out the defined supervisory tasks to protect the stability of the financial system of the EU as a whole, whereby it will implement specific tasks relating to the supervision of credit institutions within the participating Member States.

\textsuperscript{29} ‘European SSM for banks – a First step on the road to a banking Union’ in Deutsche Bundesbank, Monthly Report No. 13 (July 2013), p. 27.
\textsuperscript{30} ‘European SSM for banks – a First step on the road to a banking Union’, p. 27.
\textsuperscript{31} Council Regulation (EU) No 1024/2013, Art. 5.
\textsuperscript{32} L. Papademos, ‘Financial stability and macro-prudential supervision: objectives, instruments and the role of the ECB, speech at the CFS conference (September 2009), p. 3.
1.3 Shift in ECB accountability

The ECB specific tasks relating to prudential supervision of credit institutions are necessary to ensure a coherent and effective implementation of the EU policy, whilst other tasks will be carried out by the national authorities of Member States.\(^{34}\) Therefore the soundness of large credit institutions is important to ensure the European financial stability. Nonetheless smaller credit institutions could also threaten the financial stability. Hence the ECB should have the supervisory authority of all credit institutions of participating Member States.\(^{35}\) Thus the ECB will have direct supervision over 140 ‘significant’ banks (with approximately 80% of all bank assets) of the 6,000 banks in the euro zone.\(^{36}\) However, national authorities have their own responsibility within the supervisory tasks of the ECB. National Supervisors have to share their expertise and must provide (national) information resources which will give the SSM adequate 'in-depth' knowledge about the specific legal and actual circumstances in each of its Member States.\(^{37}\)

To safeguard the financial stability, the ECB should be able to implement early intervention or ex-ante actions. Therefore the ECB must coordinate early intervention actions with the participating national authorities. For this reason the ECB and the national authorities must share the same ideas of responsibilities and competence, in case of crises.\(^{38}\) This implies that the ECB has a significant responsibility to ensure the financial stability of the EU. The change of supervisory tasks – from Member States level to European level – must be accompanied by adequate accountability and transparency requirements. Therefore the ECB is accountable for the implementation of these supervisory tasks, whereby it is held to inform the European Parliament and the European Council. These bodies of the EU are democratically legitimised institutions and represent the European citizens and the Member States.\(^{39}\)

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34 Council Regulation (EU) No 1024/2013, p. 64.
2. **The concept of Accountability: what will this imply for the independence of the ECB?**

The ECB’s accountability consists of legal, institutional and practical aspects, focussed on democratic accountability. It is focussed on the ECB’s relations with elected bodies, in particular the EP, as directly elected representatives of the European citizens. In a democracy, all policies affecting the European community must be legitimised by the will of the people. Thereby the representatives could hold the ECB’s provisions accountable for its performances.  

Since the establishment of the SSM Regulation, it has been subjected to discussions to what extent the ECB is accountable. To cite the Council Regulation (EU) No 1024/2013; ‘The ECB has the responsibility to safeguard financial stability in the EU, and it shall use its supervisory powers in the most effective way. Any shift of supervisory powers from the Member State to the Union level, should be balanced by appropriate transparency and accountability requirements. The ECB should therefore be accountable for the exercise of those tasks towards the EP and the EU Council as democratically legitimised institutions representing the citizens of the Union and the Member States.’

To guarantee the monetary stability in the EU, the ECB has been granted political independence. Therefore it is crucial that this (political) independence needs to be balanced with accountability. The ECB has the legal and political obligation to justify its decision-making process to the EU public and their elected representatives. Through transparency, the ECB could enhance its democratic legitimacy and credibility.

The ECB is considered to be one of the most independent central bank in the world. It has fully operational and financial independence but most conspicuously target independence. Due to the supervisory decision-making process, there is a need for the extension of the practice of supervisory accountability in contrast to accountability of monetary policy. One of the main reasons is that the ECB will have the direct supervision over 140 ‘significant’ banks in the eurozone. Therefore the focus on ECB accountability towards national governments and European institutions is broadened.

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2.1 General concept of accountability

There are multiple definitions of accountability. A short overview concept of accountability will follow: Bovens, Curtin and 't Hart asses the concept of accountability in European democratic governance in their book *The real world of EU accountability, what deficit?*. It provides a systematic analytical framework, whereby accountability is the cornerstone of legitimacy. The central discussion is focused on the lack of public or democratic accountability that may jeopardise European democratic legitimacy. 45 Accountability within the American political discourse is often seen in a broad sense and used as a normative concept, as specific norms for evaluating the active behaviour of public actors or agents. 46 Thereby accountability is focussed on the performance of an actor, who has a 'a way of responding' or 'sense of responsibility' and his or her willingness to act in a fair and transparent way. Difficulties appear when standards of accountable behaviour are formulated, because those standards differ from time, type of actor and place. There is no consensus on this broad sense of accountability. 47 However, discussions within the European political discourse are more focused on the narrow concept of accountability as a mechanism. 48 Thereby accountability is considered to be a social mechanism, an institutional relation in which an actor can be held accountable by a forum. 49 The focus of accountability is on how institutions operate, not as in a broader concept, on the behaviour of public agents. It means that the definition of accountability implies a relationship between an actor – an individual or more specific a public institution – and an (accountability) forum, a minister or a parliament or court. 50 In case of political forms of supervisory accountability, the actor-forum relation could be explained as principal-agent relation, whereby the forum is the principal, such as the EP and the actor is the agent, such as the Supervisory Board. 51 Furthermore the accountability process will occur; the actor is obliged to explain and justify his or her conduct regarding tasks and the forum has the possibility to pose questions and judge, which could lead to consequences for the actor. 52

In this narrow sense, accountability is retrospective, whereby actors are accountable to a forum

51 Ibidem.
after the fact has occurred. It means that accountability takes effect when the decision is made. Thus this is not only focused on formal procedures of accountability, but it also gives an overview of how these procedures are implemented whereby the concept of accountability could be evaluated as social relationships.

However, Bini-Smaghe and Gros have another definition of the concept of democratic accountability. In addition, they emphasize the necessity of democratic control, as ex-post control, in which ex-ante control of a democratically elected body is in compliance with the interpretation of accountability.\(^53\) The concept of accountability is the concurrence of openness to criticism and questions about prior and future affairs of the democratically elected body. Ex-ante control could be considered as an independent instrument which could be beneficial for evaluating governmental behaviour, that leads to ex-post accountability. Hereby, the control must be subjected to strict procedures and rules in compliance with its prior policy objectives. In other words, the process of the ECB monetary policy in maintaining price stability could be prior customized based on government preferences, while the initial content of the constitutional function of the monetary policy itself is not determined in advance.\(^54\) The ex-post accountability refers to ‘instruments’, such as assessments or evaluations after a decision is made, the democratically elected body is given to hold the ECB accountable, and to the extent to which the central bank reacts. Hereby the ECB accountability could be measured by a qualitative assessment of the ECB’s reaction to such control.\(^55\) In addition, transparency could enhance accountability as this improves and facilitates the control over a central bank.\(^56\) The ECB accountability must be defined properly, whereby independence is based on the rules related to its boundaries. Therefore ex-ante control will provide the possibility to delegate power. The ECB must pursue its statutory goals by following its bank mandate and regulations, whereby it will not be influenced by political governmental interests. This implies that accountability could be considered as a complementary as well as a mandatory element of independence.\(^57\)

De Haan et. al. claim that a central bank in a democratic society will preserve its accountability as long as powers of unelected officials (officials who are not elected by the EU public but are nominated by others, like the President of the Supervisory Board) will be monitored by democratically elected public bodies, such as the European Parliament and/or the government. The European Parliament embodies the representation of democratic interest and could hold the

\(^55\) Ibidem.
central bank directly accountable. The central bank could also be held accountable to the
government, which is directly accountable to the European Parliament. Moreover the European
Parliament must have the instrumental power to monitor the performance of a central bank, such
as revoking the central bank policy decisions. Within this concept, central bank independency will
be preserved. However, if a central bank – on the long term – does not comply with adequate
policy implementation, it will lose its political credibility and support, leading to losing its
independency.58

2.2. Monetary accountability and independence

In the book The European Central Bank the concept of democratic accountability is explained. The
definition of ECB accountability is first of all the fulfilment of the ECB mandate but also relates to
the manner how it achieved this mandate. Due to the primary objective of the ECB – maintaining
price stability – decisions involving, for example, changes in the interest rate, must be explained as
well as the rationale behind that decision. The primary objective consists of three main features.
First, the decisions about the explicit definition and ranking of objectives of monetary policy.
Second, the disclosure of the actual monetary policy and third, the question who has the final
responsibility of monetary policy. 59

The definition of De Haan, et. al. describe that the accountability of a central bank starts from a
legislative point of view. The choice of a single objective is a less complex task of monitoring ECB
performance than with the new supervisory tasks.60

Firstly the objectives of monetary policy of the central bank are taken into consideration.
This includes prioritising the monetary objectives and the given definitions of the objectives. The
primary goal of the ECB is clearly defined in the Statute of the European System of Central Banks
(ESCB). The primary objective of the ESCB, comprising of the ECB and national central banks (NCBs)
of EU Member States, ‘shall be to maintain price stability’, which is formulated in the Treaty on the
Functioning of the European Union (TFEU).61 It is important that prioritised objectives are clearly
stated in the ECB mandate and not prioritised by the ECB itself. The main reasons are the potential
democratic political interests of elected bank executives and the lack of a yardstick to which a
central bank could be held responsible for its monetary policies. Therefore democratic

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61 TFEU, Art 127.
accountability is a specific form of accountability.  

The second feature is the disclosure of accountability. De Haan, et. al. claim that central bank officials could be held accountable for their behaviour when supporting certain monetary policy decisions. This includes regular reports of past performances and new plans for monetary policy, which must be in line with the monetary objectives. In particular, if no clear monetary objective is formulated, the reliability of a central bank depends on the central banks statement. The law should include the description of certain procedures about explaining monetary policy. Other possibilities are publishing reports and summaries of minutes of meetings, and the opportunity to ask questions during press conferences of the ECB. The ECB is held to publish a quarterly statement of its activities, whereby the ECB itself may decide upon how it will implement its future monetary policy plans. However, the Treaty of the European Union (TEU) and the ECB statute do not elaborate on the contents of these reports. 

The third feature is final responsibility, whereby three issues will be discussed: the relationship between ECB and EP, the introduction of an override mechanism and a dismissal procedure for an ECB governor. In case of the ECB, the function of the EP is to monitor the ECB. The national parliament should have the ultimate responsibility for monetary policy and therefore it should have the ability to change the legal base of the national central bank. This also includes an override mechanism for the government as an instrument to change central bank policy. Nonetheless, such legal powers could threaten the central bank’s independence, by elected politicians and their personal political agendas. To go a step further De Haan et.al. would be in favour for a dismissal procedure for a central banker, which could hold an individual responsible for monetary policy making. However, the power of national parliaments towards the ECB is limited by the ESCB, which could only be changed by an amendment, approved by all countries. Therefore De Haan et.al. advocate that the EP should have the exclusive power to change the statute of the ESCB and thus function as a parliament. However this mechanism would not be appropriate for the ECB because the ECB Governing Council is collectively responsible for policy-making.

64 Statute of the ESCB, Art. 15.  
68 O. Issing, 'The Eurosystem: transparent and accountable, or Willem in Euroland' in Journal of common market studies vol. 37, p. 506.
2.3 Independence

Taking ECB’s independence and performances into consideration, it has been mostly criticised. The institutional independence is formulated in Art. 7 of ESCB Statue, referring to Art. 130 TFEU, ECB’s independence, ‘ECB’s tasks and duties, described in the Treaty and the Statute of the ESCB and the ECB, neither the ECB, nor a national central bank…..nor decision-making bodies shall take instructions from Union institutions or related bodies’. 69 In addition, it prohibits institutions, governments and bodies from (political) influence on the decision-making process of the ECB and NCBs. The independence is also related to personal independence for members of the ECB’s decision-making bodies, the ECB’s Executive Board Members, who can only be appointed for a period of maximum eight years. The NCB governors can be appointed for a renewable term of five years. 70 The dismissal procedure applicable to members of the ECB and NCB governors could hold individuals accountable for their actions during their appointment. If a member does not fulfil his or her job in an adequate manner or professional misconduct is ascertained, the European Court of Justice (ECJ) has the power to sentence this individual to 'compulsorily retirement'. 71

However, as determined in the Maastricht Treaty, the ECB as an institution, can be held accountable for its monetary policy. The performance of a central bank could be measured by the performance of the execution and implementations of policies. However, the tools to preserve price stability over the medium term are limited. The 'standard measure' of price stability is based on an inflation of 'below 2 percent, but close to 2 percent over the medium term'. This also means that lowering interest rates cannot be lower than zero. As described by Bovens, Curtin and 't Hart, when an actor is held accountable by a forum, the actor is held responsible for its performance. In case of misconduct, sanctions may be a suitable measure to pressure the ECB to fulfil its tasks properly. 72

Although Bini-Smaghi, Gros, and De Haan claim that sanctions could improve the performance and accountability of the central bank, the specific characteristics of instruments of monetary policies, such as the transmission mechanism, i.e. the process by which changes in interest rate of a central bank are transmitted through the financial system to the real economy, make it more difficult to determine whether sanctions are effective. Due to the transmission process of the ECB’s monetary policy, the price level is affected over the medium term, whilst short-term random economic shocks, i.e. changed oil prices, to the price level make an appropriate

69 Statute of the ESCB and of the ECB (2011), Art. 7.
70 Statute of ESCB, Art. 11.2 & 14.2.
71 Statute of ESCB, Art. 11.4 & 14.2.
response to the monetary policy difficult. Due to the complexity of the transmission mechanism the ECB should have direct control on influencing the price stability, but in practice it will have a delayed effect on the price stability mechanism. Unexpected shocks caused by changes in commodity prices, are beyond ECB’s influence and control and future prospect performances.  
Therefore, measuring central banks performances must be closely reviewed by the EP to ensure that the central bank acts within the limits of its mandate. This implies that assessing ECB’s performance must be evaluated by inflation statistics over a period of approximately two years and using a formal sanction mechanism would be too extreme. Thus the ECB accountability relies heavily on the transparency of ECB policies execution.

2.4 Transparency

However, the concept of accountability of the ECB differs from the concept of transparency, even though these are doubtlessly interrelated. Accountability could be achieved through transparency. Firstly, accountability is considered as the political foundation of the legitimacy on which the ECB and its policies are based on, whilst transparency is the economic instrument in pursuing increasing the effectiveness of the ECBs policies. Ambtenbrink et al. state that transparency is one of the pillars of accountability. The term transparency of the ECB is considered to be a crucial component of its monetary policy framework. It emphasises the necessity of effective communication and adequate interaction with the society. The ECB could justify its behaviour during a decision-making process. The openness about its rationale behind their decision-making process to the public improves the evaluation process of its performance. The ECB could only be held accountable based on its own previously referred to statements. Nonetheless, transparency is also often defined as a synonym for accountability, however, Bovens et. al. consider transparency as a critical instrument to evaluate organizational performance. An important component of ECB monetary policy framework is transparency. On the one

74 Ibidem
hand, transparency could be defined as a one-dimensional notion, whereby ECB provides information only. The assumption is that this information will automatically ensure transparency and no transmission friction will occur. On the other hand, transparency in a broad sense of the word, is aimed at the public’s understanding of the ECB monetary policy. Therefore the concept of transparency provides a central bank with the opportunity to improve and enhance the public’s understanding of the monetary policy-making. In particular democratic accountability requires high-quality information, rather than the frequent publishing of information which is difficult to understand by the public. Bini-Smaghe and Gros agree with this. In the concept of De Haan, et.al. transparency goes beyond the fulfilment of a given reporting requirement. He emphasizes the obligatory role of the ECB in providing ‘a more subtle form of accountability’ as it accomplishes it’s monetary duty. In particular an independent central bank, which is autonomous, without governmental influence, and no income distribution objectives, must be cautious and prudent with regard to sharing bank information with (external) shareholders. Notably the euro zone is considered to be a highly decentralised economy, whereby the ECB decision-making process could be interpreted as unclear by the European public. Therefore transparency could avoid secrecy and suspicion towards the ECB.

2.5 ECB’s instruments - accountability

The ECB uses different instruments, procedures and methods to ensure its extended accountability practices such as reporting obligations of policy performance and hearings, and exchanges of views and provisions concerning non-policy performance. In Council Regulation No 1024/2013, Art. 20 ‘accountability and reporting’ describes to whom and in which manner the ECB will be held accountable. The ECB is held accountable by the EP and the EU Council. It will provide an annual report of the execution of the ECB supervisory tasks to the EP, the EU Council, the Commission and the Eurogroup. The Eurogroup consists of finance ministers of all EU Member States, who supervise the coordination of the economic policies within the EU.

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83 J. de Haan, S.C.W. Eijffinger, S. Waller, The European Central Bank, p. 84.
86 Statute of the ESCB, Art. 15
Moreover, it is responsible for the support of economic growth and financial stability. The Chair of the Supervisory Board of the ECB will present the annual report to the EP and the Eurogroup, including the representatives of the participating non-EU states. These bodies have the possibility to request a hearing of the ECB in which they could elaborate on the practice of its supervisory tasks. The ECB will reply orally or in writing to the questions of the EP and upon request the Chair of the Supervisory Board of the ECB will be present at a confidential meeting with the President of the EP.

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<td>* Quarterly reports</td>
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| Selection of other principal communications by the central bank | * Monthly press conference of the President (immediately after the Governing Council meeting) |
| * Monthly Bulletin |

ECB’S INSTRUMENTS – OVERVIEW

With regard to the legally required reports, the ECB is obliged to publish and clarify an annual report in front of the EP, which must also be addressed to the EU Commission and the EU Council. In addition, the ECB must publish its quarterly reports. Moreover, on its own initiative the ECB publishes their Monthly Bulletin and provides additional information on the official ECB website, including press conferences, working papers and other publications.

88 Eurogroup Portal, the official way to the euro area, Euro Group, http://www.eurozone.europa.eu/eurogroup/
90 Memorandum of Understanding between EU Council and ECB on the cooperation on procedures related to the SSM, section I Accountability (2013).
91 Ibidem.
2.6 The role of the EP regarding accountability practice

The testimonies before the EP are an important aspect of accountability. The President of the ECB will present the ECB Annual Report to the EP. Subsequently the EP will analyse the ECB report, whilst performing an ex-post assessment. Moreover the President of the ECB will present his quarterly testimonies, to elaborate on the ECB policy decisions and to respond to questions of members of the Committee on Economic and Monetary Affairs. Moreover, written questions of the Members of the Parliament (MEP) are voluntary answered by the ECB, which are published in the Official Journal of the European Communities. It is customary that the ECB’s Vice-Chair of the Executive Board will represent the annual report on behalf of the ECB before the EP. As mentioned above, these testimonies will be published on the ECB’s official website and in the ECBS Annual Report.

However, the ECB does not publish the minutes of the meetings of the ECB and EP, nor the vote counts of the decision-making process. The main reason is that National Governors as part of the Governing Council, must vote independently for the European policy, preventing the external pressure of national governments to vote in their national favour. As stated in the Statute of the ESCB, the meetings are confidential, only the Governing Council may determine the publication of the final decision.

This article could be interpreted more broadly; the prohibition of publishing ECB and EP minutes could be presented in a different form, such as ‘a summary of the minutes’, which will inform the public and exclude information on individual votes. In addition, a press conference after each monthly meeting of the Governing Council will improve the ECB’s rationale of decision-making.

2.6.1 Monetary Dialogue

The central bank accountability incorporates the final responsibility for monetary policy. The view taken by De Haan et. al. is based on the solid relationship between European Parliament and central bank. The EP is an institution which has the power to hold the ECB accountable for its decisions and tasks. Therefore the ECB and EP have a close relationship which includes a dialogue.

The Monetary Dialogue is the informal designation of the quarterly meetings of the ECB and EP. As described, during these meetings the ECB President will present the ECB’s report and answer

93 Memorandum of Understanding between EU Council and ECB on the cooperation on procedures related to the SSM, section I Accountability.
95 Statute of ESCB, Art. 10.4.
MEP questions.

Since 2011, the ECB Annual Rapport includes an article on several topics of the dialogue between ECB and EP, describing the ECB’s accountability to the EP. This will improve the dialogue as a whole and therefore contribute to the ECB’s accountability. This also includes publishing an overview of the MEP’s written questions and the answers of the ECB in the Official Journal of the European Union.\(^7\) In addition, media could enhance ECB’s transparency by providing a live stream of the dialogue and transcripts of hearings, similarly as the ECB press conferences. It would be beneficial if the ECB must actively promote their Monetary Dialogue. Schedler\(^8\) agrees, a central bank is required to notify the public of its policy decisions and share the rationale behind it, whilst the EP has the right to hold the ECB accountable for its decisions and imposing sanctions on the ECB if it does not fulfil its mandates.\(^9\) Thus it establishes a dialogic relationship and accountable and accounting actors, which will lead to a positive incentive to initiate a public debate.\(^10\) Nonetheless the power of the EP is limited by the ECB independence. Therefore emphasizing the necessity of the Monetary Dialogue could be considered as an instrument to support and improve democratic accountability of the ECB, especially in the current changes of the ECB’s tasks.\(^11\)

2.7 Interinstitutional Agreement and Memorandum of Understanding

On 12 September 2013, the ECB and the EP agreed upon an Interinstitutional Agreement on the cooperation on procedures and the fulfilment of democratic accountability of the SSM. This Agreement clarifies the actual and workable implementation of the provisions regarding accountability. This includes the guidelines and parameters for the cooperation between the EP and ECB to investigate and to hold confidential dialogues between both bodies. These are conferred in a confidentiality agreement, signed by all participating Member States. After every (adhoc) meeting and verbal discussion the ECON will receive a summary from the Supervisory Board. In November 2013, the SSM Regulation and the Interinstitutional Agreement stated that the ECB will assume its full supervisory tasks on 4 November 2014.\(^12\) In addition the Memorandum of Understanding was created to provide provisions to strengthen the relationship between the EU Council and the ECB.\(^13\) The Memorandum includes the following: accountability

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\(^13\) Memorandum of Understanding between EU Council and ECB on the cooperation on procedures related to the
agreements, reports, hearings and exchanges of views, responding to questions, and selection and appointment procedures of the Chair and Vice Chair of the Supervisory Board.

2.7.1 Code of Conduct
Due to the new supervisory task of the ECB, a comprehensive framework for transparency and accountability was created to improve the European banking sector. Certain measures were taken.\(^\text{104}\) Based on *The Code of Good practice on Transparency in monetary and financial policies* by the IMF in 1999 it created a solid basis for pursuing transparency and accountability within the ECB institution.\(^\text{105}\)

In March 2014 the Supervisory Board announced that new Rules of Procedure and Codes of Conduct were formulated. The latter *Code of Conduct for the Members of the Supervisory Board* is focussed on the matters of conflict of interest within the Supervisory Board. Although the SSM Regulation does not include a Code of Conduct for the members of the Supervisory Board specifically, the realization of adopting some ethical rules of their job performances is considered to be a necessity. Not only will the Supervisory Board be subjected to a Code of Conduct, the Governing Council and Executive Board will develop their own ethical codes. Before the implementation of these Codes, the ECON Committee will be informed by the ECB of their pursuit of their accountability.\(^\text{106}\)

The ECB considers this Code as an adequate guide in maintaining their integrity for its internal governance and financial management.\(^\text{107}\) This will improve the operation of the transmission mechanism which will lead to more transparent and efficient market expectations. Thus the ECB actions will be in line with the public expectations.\(^\text{108}\)

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104 IMF, European Union: publication of financial sector assessment program documentation technical note on issues in transparency and accountability, (March 2013), p. 8
3. Prudential supervision: the differences between accountability towards monetary policy and prudential supervision and design of accountability of the ECB

The existing literature set forth different views on the integration of supervision within the ECB alongside monetary policy. Nonetheless, significant challenges and risks need to be overcome, in particular conflicts of objectives and reputational risks and central bank independence. Combining the monetary and supervisory tasks within the ECB institution raises questions about the ECB’s independence. The new supervisory tasks of the ECB as formulated in the SSM Regulation imply a conflict between its monetary policy objectives and its supervisory responsibility. However, the benefits of combining the two tasks could also have a positive effect on the overall functioning of the European banking system.

3.1 ECB independence and different objectives

Lastra and Hüpkes et. al. claim that supervisory independence is different compared to monetary independence. Differences appear in the fundamental designs of both objectives, such as the goals, means, employers and the concept of supervision. When both types of independence are compared, the monetary stability involves one instrument, being monetary policy, whilst supervisory independence has multiple goals, including micro- and macro-financial stability, consumer protection, prevention of money laundering. This implies the use of several instruments such as macro-supervision, crisis management, etc. applicable to different institutional bodies such as national authorities, national central banks, supervisory agencies, etc.

The monetary and prudential objectives can be quantified and achieved differently. Price stability is quite easily quantified; the consumer price inflation in the euro zone is measured by the Harmonised Index of Consumer Prices (HICP). This HICP will provide for inflation rates, which will be maintained by the ECB below or close to 2% on the medium term. Decisions of the ECB to adapt the interest rate occur on monthly basis and is then implemented uniformly by national authorities.

central banks. The accountability practices is clear and strict and the ECB is focussed on inflation and a general economic prospective. However, supervision is a more active process with a 'hands-on' practice, which involves a process of collecting a broad range of different types of information from individual banks. In particular during crisis, decisions regarding individual banks and the interpretation of rules and guidelines become a crucial part of the accountability practices of the ECB. 114

There is a possibility that in a crisis situation, a central bank with supervisory responsibilities could be tempted to resolve financial supervisory problems with liquidity, which will be in conflict with the objective of price stability.115 For example, low interest rates would support economic stability in times of high inflation, which is consistent with monetary policy objectives. This will be stabilise the financial system with healthy and solvent banks and will enhance the transmission of monetary policy, which contributes to macroeconomic stability. 116

But in time of crisis, supervisors tend to close a bank due to moral hazard concerns. However, based on the fear of losing systemic stability and the increased risk of contagion from a monetary perspective, the corresponding bank could be saved, regardless of any occurrence of moral hazards. 117

Beside the possibility of moral hazards, the ECB will act as lender of last resort, since it is de facto responsible for mirco- and marco-prudential supervision. This means that the ECB as lender of last resort could financially support troubled banks with direct liquidity funds or indirect by adapting interest rates. Nonetheless, low interest rate will result in low cost for banks but it could cause higher inflation and it will conflict with its monetary policy objective. 118

In addition Hüpkes et.al. agree, it is more difficult to measure ECB’s supervisory performance by its SSM Regulation than to measure the performance of monetary authorities. It means that ECB’s performance of monetary policy, focussed on maintaining price stability, could be measured against its stated objective. For its supervisory performance, prioritizing multiple objectives are often hard to measure and require specific instruments. 119

In addition, referring to De Haan et. al.

118 T. Beck and D. Gros, ‘Monetary policy and banking supervision,’ p. 35.
prioritizing the ECB’s monetary policy differs from its supervisory tasks. As Hüpkes et.al. emphasize, the priorities of the monetary policy are clear and numerical, whilst priorities of supervisory tasks may change among multiple objectives. Moreover Abrams and Taylor point out that an institution with several objectives might tend to the improper allocation of resources and neglect one of its tasks. The downside is that there could also be a fear that the ECB, with its supervisory powers, will become too powerful, as a consequence of limited accountability, to elected legislators and governments. This fear is emphasized by the limited legitimacy of the EP.

The occurrence of tension between transparency and confidentiality is higher for the ECB’s supervisory tasks then for its monetary task. The supervisory tasks involve more regulatory decisions - including prudential supervisory rules, formulate reports, disclosure requirements, organizational guidelines and rules of conduct - and protecting public interests, whereby ECB’s transparency towards the public must be carefully balanced against financial stability considerations, whilst monetary policy involves an adequate decisions-making process, protecting price stability. In case of a crisis, the ECB has to make decisions concerning individual banks on a regular basis. This requires the interpretation of supervisory rules, how the decision-making process is evolved, and how the rules are applied. The fiscal implications of monetary policy are more diffuse, and will have financial effect on the whole euro zone, and as a result, side-effects of standard monetary policy operations. In contrast with supervision, fiscal implications are more direct and concentrated in one single Member State (in case of bank failure and closing of a bank). Therefore it is a significant political challenge to accept the fiscal consequences of supervision on national as well as on European level. Therefore the introduction of the SRM was mandatory to complement the SSM. In addition, in case of loss of credibility of the ECB as a prudential supervisor, this could also negatively influence its credibility regarding monetary performance. This means that bank stability must be critically judged while monetary stability could be more easily reached through transparency.

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123 T. Beck, ‘Monetary policy and Banking Supervision: Coordination instead of separation’ part of the compilation PE (December 2012), p. 7.
125 T. Beck and D. Gros, 'Monetary policy and banking supervision', p. 35.
3.2 Governing council of the ECB: two responsibilities - one body

As stated in the SSM Regulation, Council Regulation 1024/2014, ‘the tasks conferred on the ECB by this Regulation shall neither interfere with, nor be determined by, its tasks relating to monetary policy….or in relation to the ESRB or any other tasks.’ The ECB will report to the EP and the Council. The tasks within the ECB institution must be separated as well. This also includes the operational functioning of the Governing Council, as final decision-making body, which must have strictly separated meetings and agendas. To ensure the separation between monetary policy and supervisory tasks, the ECB created a mediation panel. The differences of views between an authority of a participating Member State and the ruling of the Governing Council regarding the draft decision of the Supervisory Board will be discussed by the mediation panel. However, Beck stresses the possible occurrence of conflict of interests of bodies within the ECB. The SSM involves a supervisory system including both the national supervisors and the ECB, and the monetary policy-making under one roof. From the institutional perspective it could raise questions about the performance of representatives in the Supervisory Board and the Governing Council. As mentioned before both bodies will have representatives from all euro zone NCB’s. This means that one Member State could have two individual representatives at the ECB, a national representative (governor) at the Governing Council and another individual within the Supervisory Board. These two individuals have their physical offices in the ECB building and mutual contact between these representatives cannot be ruled out. Therefore strict separation between the two tasks is not possible. Due to the composition of the Supervisory Board, consisting of members of the Governing Council, the ECB’s supervisory tasks must be administratively separated from its monetary tasks to protect ECB’s primary objective which is maintaining prices stability.

128 Ibidem.
130 Ibidem.
3.3 Operating on different levels of governance

The ECB must operate on different levels of governance – national, regional and international level, whereby ECB accountability must consist of a multi-dimensional model of accountability.\(^{131}\) The principal-agent relation, described by Curtins et. al. for the monetary policy is a ‘single principal-agent relation’ whereby the ECB will only be held accountable for its monetary objective by the EU union.\(^{132}\) Due to the broadening of its supervisory tasks the ECB must report to a broader range of principals of Member States as well.\(^{133}\) This means an emphasis on supervisory tasks, which often involves issues that are highly political, such as closing or rescuing a bank.\(^{134}\)

Based on the legal perspective, monetary policy differs fundamentally from supervision. This means that supervision could directly infringe the property rights of individuals and corporations, whereby individual institutions (and countries) should have the right to appeal against decisions. By contrast, monetary policy decisions (changing interest rates) rarely involve judicial review.\(^{135}\) However in case of crisis, the ECB must react adequately to stress situations, whereby national authorities have limited time to initiate an appeal procedure. Apart from the fact that (more) political discussions will slow down the decision-making process, this could also affect the ECB political independence.

Therefore, this mechanism for ECB’s supervisory tasks should have strong accountability provisions which should be included in the SRM. The supervisory scope must ensure democratic accountability which must be extended to national parliaments, not only to the EP and the Council of Ministers.\(^{136}\) Therefore Lastra stresses the need for accountability at a national level.\(^{137}\)

Moreover, implementation of the ECB’s macro-supervision and regulations will interfere with national policy decision-making. This implies that the ECB accountability framework is limited – such as hearings and verbal explanation – and therefore does not sufficiently provide for its new supervisory tasks.\(^{138}\)

However the supervisory scope is limited: The SSM will only supervise the euro zone Member States and the non-euro zone Member States who choose to participate with regard to the SSM.

\(^{131}\) R. Lastra, ‘Accountability and governance banking union proposals’, p. 4.
\(^{135}\) T. Beck and D. Gros, 'Monetary policy and banking supervision', p. 35.
\(^{136}\) K. Alexander, ‘Should the European Central Bank become a bank supervisor?’ in Banking Law (April 2013) http://financialsentiments.wordpress.com/2013/04/03/ecb-bank-supervisor/
\(^{137}\) R. Lastra, ‘Accountability and governance banking union proposals’, p. 4.
The SSM has only supervisory authority over credit institutions. Other financial bodies such as insurance firms and non-related financial stability tasks, will remain a national competence. In addition, as mentioned earlier, the ECB will have the final supervisory authority over ‘significant’ banks. National supervisors, supporting the ECB on supervisory matters supervise over less ‘significant’ banks, meaning that the cooperation or working-relation between the ECB and the national supervisors must be safeguarded. However safeguarding the cooperation between the ECB and national authorities is a difficult task. The priority objective of national supervisors is to protect the interests of their own country, rather than the financial stability of the European banking system. Specifically in times of crisis, national supervisors have a strong incentive to keep capital and liquidity within their borders. In addition, due to the national competence of supervision of less 'significant' banks, only the national central bank of a Member State will possess information of the current financial status of a bank. Therefore the ECB’s Governing Council will have difficulties obtaining information of these banks to form an unbiased opinion on the degree of financial market stress as a whole, and taking measures to respond at crisis situations.

3.4 Implications on the accountability framework

Even though the ECB is developing the SSM framework to support accountability, Lastra emphasizes that the accountability arrangements of the ECB of its prudential supervisory tasks are still insufficient. Based on Art. 130 TFEU, the independence of the ECB is consistent with the ECB’s monetary tasks and responsibilities, having limited mechanisms of accountability, - hearings before the EP, annual publications and public interviews, etc. – whilst supervisory responsibilities are more complex. Therefore the implementation of the prudential supervision of the ECB will create an even more powerful independent institution.

Alexander agrees with Lastra, the ECB’s independence is considered to be a credible and strong institution for maintaining price stability. Due to the SSM, this credibility will be extended, which enhances its effectiveness in its supervisory tasks of financial institutions. However, their

143 T. Beck, 'Monetary policy and Banking Supervision', p. 8.
144 R. Lastra, 'Accountability and governance banking union proposals', p. 4,
146 K. Alexander, ‘European Bank Resolution and the role of the ECB in Bank supervision’, p. 8-10
concerns are that the ECB’s independence is not appropriate for exercising banking supervision powers. In particular the influence of supervisory powers could have a direct effect on economic policy, which would question the ECB’s accountability towards Member States and EU institutions. Bini-Smaghi argues that supervision could have immediate fiscal implications, in particular for monetary policy. In case of a possible mistake, the impact of fiscal consequences could be bigger. Based on the economic perspective, an increase in interest rates could be beneficial for the ECB to preserve its inflation target, but it could have a negative effect on (national) banks with regard to the short-term debt. It also means that national banks could not pay higher interest rates for short-term loans, which could negatively influence the banks financial stability. On the one hand, central banks combining monetary objectives and supervisory functions in one governmental body have higher inflations then central banks with separated bodies. On the other hand, an increase in interest rates could cost a government much more than a bank rescue operation.

In order to have an effective monetary policy, accurate and timely information improves the performance of the ECB overall, in particular during a crisis, the assessment of a possible dysfunction of the transmission mechanism could prevent monetary policy failure as well as improving its new macro-prudential regulation. It means that the data collection on behalf of supervisory analyses could also provide information for early-warning tools in assessing credit developments for assessing the macroeconomic policy such as micro- and macro-prudential supervisory tasks. Therefore it could enhance the quality of information regarding the functioning of the banking sector as a whole. Ioannidu agrees with Coeuré, that due to supervision it could enhance the accuracy of economic forecasting, whereby the execution of its monetary policy will be more effective. Not only the prudential supervisory tasks will benefit from additional information, but the monetary policy-making as well, it will even improve the understanding of the effects of monetary transmissions channels on monetary policy. However, the separation of monetary policy and supervisory tasks is determined by the Council Regulation 1024/2013. Another benefit would be the interaction between monetary and supervisory tasks, however only

147 Ibidem.
if the objectives of both tasks are clearly defined and separate instruments are used by the ECB and the national supervisors. 154 This is included in Council Regulation 1024/2013 in ‘macro-prudential tasks and tools’, quote: ‘the measures aimed at addressing systemic or macro-prudential risks provide for’, which is an important design feature of the SSM. 155 Specifically, in times of crisis, a single institution could also prevent conflicts and coordination problems of its monetary and supervisory tasks, which is a mandatory requirement in a multi-level governance within the eurozone. 156

As Ioannidou points out, the occurrence of ‘conflicts’ within a single institution are genuine. This will not be resolved by an institutional rearrangement. This means that an improved form of accountability could overcome conflicting goals, because of less friction during a decision-making procedure. Thus it will result in a more effective resolution mechanism, whereby a central bank could safeguard its monetary policy, by preventing risk-taking incentives of banks. 157

Alexander claims that ensuring the ECB’s independence with regard to the new banking supervision, implies the creation of a more elaborate accountability mechanism. This mechanism should find a balance in legitimate regulatory objectives between the ECB and the participating Member States. For example, companies and individuals must be consulted before they are subjected to audits and they must be made aware of certain regulatory rules and measures. Therefore independence and accountability framework should be broadened to create an adequate accountability mechanism for the bank supervisor. 158

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156 Ibidem.
Conclusion

Following the latest financial crisis which started in 2007, the financial regulation and supervision have since been at the centre of attention in the European Union. The existing financial framework was incapable to sufficiently respond to the crisis, which called for a modified approach, the creation of new regulations and bodies and the shift of power to European level. The introduction of the new supervisory tasks for the ECB in 2012 was granted the competence to supervise the credit institutions of all euro zone Member States and the participating countries. This led to the creation of the Single Supervisory Mechanism (SSM), which will be implemented in November 2014. Although there was a need for regulatory reforms to restore the financial stability within the euro zone and improvement of banking regulation, important issues regarding the ECB independence were raised. Some referred to authors claim that the separation of monetary tasks and prudential supervision can influence or harm the independence of the ECB.

Broadening the range of duties of the ECB include macro- and micro-supervision and the ECB as lender of last resort, which involves supervision of the European Banking System and individual national central banks of Member States within the euro zone. It will prevent bank failures by early interventional actions by ex-ante and ex-post control and direct financial support by the SRM through the SRF to euro zone banks.

The primary objective of the ECB is to maintain and safeguard the monetary policy of price stability. The new supervisory tasks differ from the monetary policy. The ECB now faces a more complex situation, having more objectives to which it is held accountable, which could cause a trade-off between micro- and macro prudential tasks. Prudential supervision requires a different approach to decision-making on multi-level governance, in particular in time of crisis.

The ECB as an institution will house two separated tasks under one roof. Fear exists that the monetary objective will be undermined by the supervisory objectives. Due to multiple objectives of the supervisory tasks, prioritising its objective, primarily maintaining price stability will encounter interference by its new tasks. In particular, in case of crisis, macro- and micro-supervision must ensure the stability of European financial system, whilst in a normal situation, inflation policy could be considered as an adequate manner to preserve financial stability.
In addition, the monetary objective of maintaining price stability is considered to be a univocal objective, using a clear set of rules and measures, whilst supervisory objectives are diverse and subject to specific individual decision-making processes. In this sense the ECB will be held accountable for its rationale behind its decisions by the EP and the Member States of the euro zone. Therefore transparency and openness of the decisions-making process is highly important. In case of public distrust, the ECB could lose its credibility.

The supervisory responsibilities are complex, when compared with monetary responsibility, because prudential supervision is subjected to multi-level governance, whereby decision-making processes involve interaction with multiple actors, such as the ECB, National Supervisors and the EP. In particular, prudential supervision on national level (i.e. closing an individual bank) will have a direct (and indirect) effect on national economic policy-making. In case of a crisis, the direct decisions on national economic policies could have far-reaching implications, such as fiscal implications and moral hazard in particular on national level. The ECB will opt for an increase of interest rates, whereby the ECB’s inflation target will be preserved resulting in negatively impacting national banks with short-term debt, thus endangering the financial stability of banks within the euro zone. Moreover, supervision could causing political debate which could negatively influence the ECBs independence. In addition, national authorities tend to put national interest above the overall financial stability. In particular, in times of crisis, national supervisors have a strong incentive to keep capital and liquidity within their borders.

Within the ECB institution, having two representatives (one for monetary, the other for supervisory tasks) from one Member State operating within one institution, could lead to a conflict of interest. It could lead to ‘two-headed’ representatives within the Governing Council of the ECB. This also implies the complexity of the decision-making process, which is often highly political, and focussed on individual supervision of banks. Therefore the ECB could be involved in more political discussions, which will affect ECB political independence. During times of crisis, this will slow down the decision-making process, losing precious time that is needed to ensure financial stability within the euro zone.

One could also view this as positive, focussing on the benefits of combining the monetary and supervisory tasks. The information obtained for prudential supervision could improve the execution of the monetary tasks, such as analysing data, in order to better assess the functioning of the European banking sector as a whole. However the exchange of information could prejudice the ECB independence.
In answer to the question, 'Is there a need to change accountability practices of the European Central Bank (ECB) now that it has new tasks regarding prudential supervision?' it is evident that the ECB must preserve and even broaden its democratic accountability practices. The ECB will become a strong institution with the primary objective of price stability and the new objectives of its supervisory tasks. In particular due to the fundamental differences between the monetary and supervisory tasks during 'normal' times and 'crisis' times. Therefore it is important that the ECB will be and continue to be fully accountable to the EP, which will have the instrumental power to monitor the performance of the ECB.

In addition to the prudential supervisory tasks of the ECB, which includes individual supervision of national banks, a strong accountability framework at national level must be put in place. Especially to ensure the ECB’s political independence, when prudential supervision decision-making takes place, it must be aware of the possible political implications on national level. Therefore, stronger cooperation and intensifying transparency practice between the ECB and Member States of the euro zone could strengthen the accountability framework. This implies that there is a need for accountability at a national level.

Furthermore, to ensure ECB’s independence, the possibility of political interference must be minimized. Various external legal challenges arise as a result of this, which could be dealt with by an appeals system established within the ECB, based on ex-post control. However, due to the supervisory authority of the ECB, the ECB could infringe property rights of individuals of Member States, an important issue, which needs a proper legal framework. In particular in times of crisis, the preliminary adoption of legal provisions to prevent political interference could enhance the accountability framework.

The accountability provisions in the original proposals are insufficient. The ECB must maintain operational as well as monetary independence when implementing monetary policy in relation to its supervisory tasks. Strong accountability procedures are advisable, especially since the addition of supervisory tasks could raise the question of conflict of interest. To maintain the credibility of the ECB, these procedures must be firmly in place. The broadening of the tasks of the ECB has been widely covered by the press and media as well as by experts, referred to above, in the field of finance and economics. However, the implementation of the SSM will be in November 2014, and therefore it is too early to determine whether this supervisory mechanism is an adequate reliable tool or not. Only time will tell. This thesis is limited by the scope of accountability, whereas other important factors, such as supervisory risk assessment, as included
in the SRM could have a significant impact on broadening the accountability of the ECB. The SRM complementing the SSM could be an interesting topic for new research.
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