

# **United or Divided We Stand? Perspectives on the EU's Challenges**

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**THE EUROPEAN CENTRAL BANK'S ACTIVISM AND THE EUROZONE CRISIS:  
BETWEEN STRATEGIC OBJECTIVES AND TREATY RESTRICTIONS**

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## **1. Introduction**

The euro-crisis literature has so far focused on various aspects pertaining to the transformation of the Eurozone's institutional architecture towards intergovernmentalism as well as the use of various novel instruments involving the interplay between EU law and international law. However, less attention has been paid in assessing the specific involvement of individual Union institutions in the formation and implementation of financial crisis measures. This paper aims to fill this gap in the scholarship by assessing the involvement of the European Central Bank (ECB) as a political actor in the context of the Eurozone crisis and its possible implications on the EU's constitutional order.

During the crisis, the ECB's response to the liquidity needs of certain Member States suffering from the sovereign-debt problems received various criticisms. On the one hand, several observers attacked the ECB's decisions to retain and on occasions even increase the liquidity provision to seemingly insolvent Member States by suggesting that they were based on 'political criteria'. By prioritizing the prevention of the (Gr)exit of a Member State from the single currency, the ECB was accused of failing to respect the strict rules of monetary policy. Others, interestingly, criticized the ECB that by declaring its readiness to freeze the provision of Emergency Liquidity Assistance (ELA) (and subsequently doing so) it exercised political pressure to individual Member States to agree to the austerity measures constituting the pre-condition for receiving financial assistance. In other words, both the acts of retaining or cutting-off the ELA provision, were considered (at least by some observers) as constituting policy-driven acts. One may observe an underlying contradiction in this criticism; yet, it is only phenomenal. These positions essentially reflect the conflicting interests among the various stakeholders (lenders and creditors) and their efforts to pressure the ECB to use its discretionary powers to favor their respective objectives.

The above give rise to the question whether the ECB has assumed a political role in the EMU and if so, how was this exercised and what impact may have on the constitutional balance of the EU. Yet, before answering these questions, we must first address certain fundamental issues: What it means for an institution and specifically the ECB to be 'political'? Is an 'apolitical' ECB possible? Can an institution be more, less or even too political?

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The ECB President Mario Draghi has argued that the ECB is a rules-based and not a political institution.<sup>1</sup> Professor Dr Martin Selmayr,<sup>2</sup> Head of Cabinet of Commission President Jean-Claude-Juncker, recently interpreted Draghi's position as meaning that the ECB is a rule-based institution in the exercise of monetary powers and deliberately non-political when is active outside the field of monetary policy, i.e. in supporting the general economic policies of the Union under Article 127(1) TFEU. He then discussed to what extent the ECB's involvement in the course of the crisis, specifically during the negotiations for the third programme of Greece, could be regarded as 'too political' to conclude that '[w]hat may have appeared to be a political decision was [...] a very rules-based manner of sticking to the Treaties and not going beyond the legal mandate of the ECB'.

We submit that conceptual distinctions such as (a) rules-based/apolitical or political and (b) less-political or too-political not provide much assistance in examining institutional roles. In particular, point (a) relies on the assumption that the ECB's role could theoretically be purely technocratic, rule-based, apolitical and independent. By definition, the ECB's monetary policy measures as well as its contribution in supporting the general economic policies of the Union do not involve a mere technical exercise. Such powers rather entail the selection among various options - each of which causing different political effects; in other words they reflect the prioritisation of certain values, interests and rights. Moreover, point (b) accepts that the ECB's role is inherently political but attempts to analyse it by assessing the size of the political component therein. Even if one accepted that the quantification of the political element in policy-making was theoretically possible, the lack of an objectively defined point of reference implies that such an analysis does not rest on solid foundations.

Our paper suggests that instead of asking whether the ECB is a political or too political institution, the question should be formulated as follows: Did the ECB exceeded its mandate by (ab)using its powers based on policy considerations that fall outside its competence? To succeed that, the paper analyses two interlinked aspects: (a) the assumption of the *de facto* role of Lender of Last Resort by the ECB, and (b) the ECB's involvement in economic policy matters by virtue of (i) its participation in the Troika and close cooperation with other EU institutions and informal bodies (ESM, Eurogroup).

## **2. ECB and Emergency Liquidity Assistance**

### **2.1 The rationale**

There are two basic types of liquidity provision tools for credit institutions: First, the liquidity that targets the entire banking sector and is offered equally to all credit institutions. Second, the liquidity that targets individual credit institutions, known as

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<sup>1</sup> ECB press conference of 5 March 2015, answer to a journalist.

<sup>2</sup> Martin Selmayr, 'Keynote Speech - How Political Are the Institutions of Economic and Monetary Union?', in ECB Legal Conference 2015, *From Monetary Union to Banking Union, on the way to Capital Markets Union, New opportunities for European integration*, 1-2 September 2015 (December 2015), pp. 261-275.

the Emergency Liquidity Assistance (ELA). During the crisis, both types of liquidity assistance were widely implemented towards calming the markets and addressing the liquidity difficulties of the European banking sector. The ELA tool is distinguished from the ordinary liquidity provision operations in the Eurozone in the following ways: First, the ELA is officially provided by the NCB of the Member State of the receiving credit institution in question and not by the ECB. Second, ELA is provided for the purpose of covering temporary liquidity needs and cannot be used as a permanent mechanism of liquidity provision. Third, the types of collateral that are acceptable for ELA-provision are of lower quality than the ones normally offered.

The legal basis for the ECB's involvement in ELA-related activities is not clear and to some extent may be doubtful. In fact, the prospects of transferring the ELA competence at EU level, i.e. from the NCBs to the ECB/SSM, in light of the centralisation of banking supervision has given rise to a heated debate in the literature. While a detailed analysis of this debate falls outside the scope of this paper, we shall outline some central aspects. The key question here is whether the liquidity provision to individual banks serves primarily to safeguard price stability or financial stability. On the one hand, linking ELA with price stability implies that ELA falls within the ECB's exclusive monetary policy competence. On the other, if ELA is fundamentally linked with financial stability, this implies a stronger tie with economic policy tasks. A third way, could perhaps be to see price stability, the primary objective of the ECB, and financial stability<sup>3</sup> as complementary objectives.<sup>4</sup> This is because price stability requires not only a functioning monetary policy transmission channel but also a stable banking and financial system.<sup>5</sup>

It is hard to argue that there is no relation between liquidity provision to credit institutions and financial stability. The short-term objective of ELA-provision is to prevent the liquidity problems of a systemically relevant credit institution to contaminate the wider banking system. From a long-term perspective, by covering the liquidity needs of the credit institutions, ELA gives time to both banks and Member States facing a sovereign debt crisis to keep lending to firms and households as well as adjust and improve their economies.<sup>6</sup>

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<sup>3</sup> Given the lack of a unanimously accepted definition of financial stability, we adopt the following working definition of the concept: 'A financial system is in a range of stability whenever it is capable of facilitating (rather than impeding) the performance of an economy, and of dissipating financial imbalances that arise endogenously or as a result of significant adverse and unanticipated events (Garry Schinasi, 'Defining Financial Stability', IMF Working Paper, WP 04/187, 2004, p. 8).

<sup>4</sup> The economic literature does not adopt a unanimous approach on the exact relationship between price stability and financial stability. On the one hand, it is argued that a monetary policy with a narrow focus on price stability would compromise the stability of the financial system. The diametrically opposite view suggests that a monetary policy that maintains price stability would also promote financial stability and lessen the need for a lender-of-last-resort intervention (e.g. Anna Schwartz, 'Financial Stability and the Federal Safety Net' in William S. Haraf and Rose Marie Kushneider (eds.) *Restructuring Banking and Financial Services in America*, American Enterprise Institute, 1988, pp. 34-62, 53).

<sup>5</sup> Gerhard Illing, Philipp König, 'The European Central Bank as Lender of Last Resort', *DIW Economic Bulletin*, 9.2014, p. 16.

<sup>6</sup> Philippine Court-Thimann and Bernhard Winkler, 'The ECB's non-standard monetary policy measures: the role of institutional factors and financial structure', 28(4) *Oxford Review of Economic Policy* (2012), pp. 765-803, 783.

The interrelation between economic and monetary policy, was discussed extensively by the ECJ in *Gauweiler* where the emphasis was placed on objectives rather than the effects. The impact of *Pringle* in the ECJ's ruling is significant in this respect. The ECJ in *Pringle* considered that an economic policy measure, in that case the ESM, cannot be treated as equivalent to a monetary policy measure for the sole reason that it may have indirect effects on the stability of the euro.<sup>7</sup> The same reasoning was applied in *Gauweiler*, only in that case regarding a monetary policy measure (OMT programme). The ECJ took the view that any effects on economic policy, such as its capability of contributing to the stability of the euro area, cannot lead to it being regarded as an economic policy measure. Focusing on objectives rather than effects allows the same action to be considered either as part of economic or as part of monetary policy depending on the entity that undertakes it and its objectives. This results in the fusion of the two policies and, as *Pringle* and *Gauweiler* indicate, grants immense discretion to all political actors involved, principally the EU and the Member States. The interconnectedness and interdependence between economic and monetary policy allows for institutional discretion but works mostly to the advantage of the ECB whose broad powers to pursue monetary policy objectives may have substantial and widespread spillover effects in economic policy.

The purchase of government bonds in the secondary market is essentially a measure of economic policy when undertaken by the ESM,<sup>8</sup> but a measure of monetary policy when done by the ECB under the OMT programme. The ECJ justifies such difference in the classification of this activity on the basis of the different objectives pursued in each context. Overall, as Hinarejos rightly argues, the ECJ's approach reflects the evolution from the original, rule-based conception of EMU to a "more policy-oriented EMU that rose out of the crisis."<sup>9</sup> Moreover, according to Piqani, this judgment reveals the "artificial nature, from an economic point of view, of the divide between monetary policy and economic policy that the Treaties impose."<sup>10</sup> Such artificial division is apparent also from a competences aspect. While monetary policy remains under the exclusive competence of the Union under Article 3(1)(c) TFEU, economic policy remains with the Member States and is only "coordinated" at EU level pursuant to Article 119(1) TFEU. Considering, however, the role of the ECB and the Commission in the monitoring and supervision of the macroeconomic adjustment programmes as discussed in *Pringle*, as well as the ECB's powers under the OMT programme, the Union institutions appear to do far more than coordinating the Member States' economic policies.

In light of the above analysis and the Court's approach in *Gauweiler* with regard to the ECB OMT programme, ELA could be considered (by analogy) to fall within monetary policy, notwithstanding its significant effects on economic policy. Yet, as we shall discuss below, the ECB's participation in ELA-related decisions indicates a deeper involvement in policies mainly aiming to safeguard financial stability, a task primarily conferred upon the Member States.

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<sup>7</sup> *Gauweiler*, op. cit., paras 95-96. *Pringle*, op. cit., paras 56 and 97.

<sup>8</sup> *Pringle*, op. cit., para 141.

<sup>9</sup> Hinarejos Alicia.

<sup>10</sup> Piqani Danrika.

## 2.2 Regulatory framework

By definition ELA is a mechanism that relies more on institutional discretion rather than on a rule-based model and this becomes even more apparent in times of crisis. The provision of ELA is not governed by the Treaties or the ESCB's Statute. The only publicly known regulatory instrument is the so-called 'ELA Procedures'<sup>11</sup> document which provides for a procedural framework regarding the ECB Governing Council's role on the provision of ELA to individual credit institutions as well as the obligations of the NCBs in this context. In general terms, there are no detailed and uniformly applied criteria as to when and to whom ELA should be granted. Instead, the ELA provision is subject to the wide discretion of the central banks. The rationale of this model is to prevent the rise of possible moral hazard.<sup>12</sup> If credit institutions knew in advance the specific terms and conditions accompanying ELA they may be more ready to undertake risks as a result.

In general terms, NCBs act in dual capacity; on the one hand they are operational arms of the ESCB when undertaking acts under the instructions or within the scope of competences of the ESCB. On the other, they are national agents when acting for any other matter that falls outside the scope of the ESCB.<sup>13</sup> In this latter case, NCBs non-ESCB functions fall under Article 14.4 Statute for which they are solely responsible and liable. As stated above, the NCBs have been understood to be exclusively competent for ELA provision.

The exercise of non-ESCB powers on behalf of the NCBs is not unlimited. The ECB Governing Council has the right to *veto* such decisions of the NCB if it considers that it '*interferes with the objectives and tasks of the ESCB*'.<sup>14</sup> Such a decision is taken in the Governing Council by a majority of two thirds.<sup>15</sup> In assessing whether ELA provision may indeed interfere with the objectives and tasks of the ESCB, the NCBs are obliged to forward certain information to the ECB depending on the size of ELA that is wished to be granted.<sup>16</sup> It follows that, although ELA is provided by the NCB, under the terms of Article 14.4 ESCB Statute, the ECB has the decisive power as to

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<sup>11</sup> The document entitled 'ELA Procedures' was initially made public on 17 October 2013 following a decision of the ECB's Governing Council on 16 October 2013. See ECB's External Communication 'Publication of the procedures governing the provision of emergency liquidity assistance', 18 October 2013. It appears that this instrument is not legally binding but its specific legal nature is unclear. According to one view, it could be considered an equivalent to agreements taking the form of a Memorandum of Understanding (Rosa M. Lastra, 'Reflections on Banking Union, Lender of Last Resort and Supervisory Discretion', in ECB Legal Conference 2015, 1-2 September 2015 (December 2015), pp. 154-173, 168).

<sup>12</sup> ECB Monthly Bulletin, 10th Anniversary of the ECB, p. 123.

<sup>13</sup> Rosa M. Lastra, 'The Division of Responsibilities Between the European Central Bank and the National Central Banks Within the European System of Central Banks', 6 Columbia Journal of European Law (2000), pp. 167-180, 168; Rosa M. Lastra, 'Lender of last resort and banking union' (Chapter 6) in Juan E. Castañeda, David G. Mayers and Geoffrey Wood (eds.) *European Banking Union, Prospects and Challenges* (Routledge, 2016), pp. 109-128.

<sup>14</sup> Article 14.4 Statute. The basic objectives of the ESCB are provided for in Article 127(2) TFEU and Article 3(1) Statute.

<sup>15</sup> ELA Procedures, op. cit.

<sup>16</sup> ELA Procedures, op. cit.

whether ELA will be provided to a specific financial institution. Irrespective of whether ELA provision is attributable to the ECB or whether the ECB can be held liable for ELA-related acts, it is clear that the Governing Council of the ECB has the power to object to the ELA-provision or to refuse to exercise its *veto*. This shows that the ECB's role in ELA-provision is highly powerful.

Notwithstanding the absence of a clear regulatory framework, From a combined reading of two primary sources containing a comparatively more extensive description of the rules governing the ELA-provision, namely the 'ELA Procedures' document and the ECB's 2007 Monthly Bulletin,<sup>17</sup> ELA is provided under the following core conditions:

First, there must be *exceptional circumstances*.<sup>18</sup> Second, the receiving counterparty must be: (i) an *individual credit institution*<sup>19</sup> or *groups* of the same;<sup>20</sup> (ii) facing *temporary liquidity problems*, i.e. it cannot obtain liquidity through either the market or participation in monetary policy operations and (iii) *solvent*. Third, *adequate collateral* must be provided towards safeguarding the repayment of the ELA.

Notably, a credit institution meeting the above criteria would not necessarily and automatically be granted access to liquidity assistance. Additional factors could also be taken into consideration, in assessing whether ELA-provision is justified in a given circumstance, in particular the need to '*prevent or mitigate potential systemic effects on financial institutions, including repercussions for market infrastructure such as the disruption of payment and settlement systems*.'<sup>21</sup> This illustrates that ELA-provision is subject to the wide discretionary powers of the central banks.<sup>22</sup> Yet, the particular weight of these factors and how should be balanced with the above conditions is still unclear.

While the requirement that the counterparties are solvent is well-established when conducting monetary policy operations,<sup>23</sup> the interpretation of the 'solvency' requirement for ELA-provision raises is quite problematic. This is because that in times of crisis, i.e. when ELA often comes into play, it appears to be hard to distinguish between illiquidity and insolvency. As Rosa Lastra explains, a 'situation of illiquidity (i.e., lack of liquid funds) can be an indication of technical insolvency (i.e. lack of liquid funds) can be an indication of technical insolvency (i.e. value of

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<sup>17</sup> ECB' Monthly Bulletin, 'The EU Arrangements for Financial Crisis Management', February 2007, pp. 73-84, 80.

<sup>18</sup> Such circumstance is for example when there is an apparent systematic risk in the broader banking sector.

<sup>19</sup> Although, according to the 'ELA Procedures', emergency liquidity can be provided to all types of financial institutions, as it appears, it has only been used to cover temporary illiquidity of banks.

<sup>20</sup> In the early times, it appears that the scope of the ELA was wider as it was aimed to target both 'institutions and markets' (ECB Annual Report, 1999, p. 98).

<sup>21</sup> ECB' Monthly Bulletin, 'The EU Arrangements for Financial Crisis Management', February 2007, pp. 73-84, 80-81.

<sup>22</sup> Rosa Lastra suggests that such discretionary power assists in preventing the increase in moral hazard which would exist should the central bank be obliged to lend in all cases (Rosa M. Lastra, 'Central Bank Independence and Financial Stability', 18 Revista de Estabilidad Financiera (2010), p. 63).

<sup>23</sup> See Section 2.1 of Guideline ECB/2000/7 of 31 August 2000 on monetary policy instruments and procedures of the Eurosystem, OJ L 310 of 11.12.200, p. 1 as amended.

liabilities exceeds market value of assets) or can quickly turn into insolvency if assets are sold as a loss value'.<sup>24</sup> More importantly, the urgent need to take hastily decisions that sometimes arises in times of crisis prevent the proper assessment of the financial condition of the receiving credit institution, in other words whether it is in fact illiquid or insolvent.<sup>25</sup>

## **2.3 ELA provision and the Cypriot banking crisis**

### **2.3.1 Introduction**

During the early phase of the euro crisis, the ELA tool was used primarily for individual banks. As the crisis escalated and several Member States exhausted their fiscal capacity, entire banking sectors could no longer rely on their respective national authorities for a bail-out in case of insolvency. Suffering from a significant sovereign debt crisis, several Member States had themselves applied for external multilateral financial assistance and subjected to macroeconomic adjustment programmes. As result, the source of capital support was no longer at national level and the banking sector was placed under intense supervisory scrutiny.<sup>26</sup> In essence, several banking sectors became dependent on ELA which was then the sole channel for liquidity provision.<sup>27</sup> This caused the transformation of ELA in two ways. First, it increased the duration of ELA-provision, hence raising questions as to whether it remained means for covering merely temporarily illiquidity or more permanent financial needs. Second, the scope of ELA-provision was extended from individual banks to entire banking systems. The first aspect is illustrated by examining the provision of ELA in the Cypriot banking sector below.

### **2.3.2 The Cypriot crisis**

In October 2011, it became apparent that Popular Bank, one of Cyprus's largest banks, was no longer able to provide sufficient collateral to seek funding from the ECB's monetary policy operations. As a result, it requested ELA and the latter was granted by the CBC with the approval of the ECB. Yet, Popular Bank's debt problems kept deteriorating. Eventually, in June 2012 the Government of Cyprus, being no longer able to finance Popular Bank's debt, submitted a formal request for assistance from the ESM. Negotiations between the Cypriot Government and the 'troika' commenced and in November 2012 a draft MoU was produced.

Following the passing of several pieces of legislation in Cyprus, on 21 January 2013, the Euro Group welcomed the progress that had been made in implementing the measures agreed with the troika and stated that an agreement on a financing

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<sup>24</sup> Rosa M. Lastra, 'Central Bank Independence and Financial Stability', 18 *Revista de Estabilidad Financiera* (2010), p. 63.

<sup>25</sup> Weenink, H., & Schulze Steinen, P., 'State aid in the financial services sector' *Journal of International Banking Law and Regulation* (2008), pp. 514-522, 521.

<sup>26</sup> Peter Praet, 'The ECB and its role as lender of last resort during the crisis', Speech at the Committee on Capital Markets Regulation conference on the Lender of last resort - an international perspective, Washington DC, 10 February 2016.

<sup>27</sup> At its peak, the Greek banking system was borrowing €127 billion euro, or 71% of the country's GDP. Mario Draghi, Speech at the Università Cattolica del Sacro Cuore, Milan, 5 November 2015.

programme was expected to be reached soon. Based on this statement, the ECB extended the provision of ELA to the Popular Bank until 21 March 2013. On 16 March 2013, the Euro Group agreed on a financial assistance programme for Cyprus and set the conditions under which the ESM would lend up to €10 billion to Cyprus. The main condition was the implementation of a bail-in plan in the Cypriot banking sector. This plan faced the resistance of the Cypriot parliament and the latter eventually rejected it on 19 March 2013 which led to the temporary closure of the banks. In light of the rejection of the plan by the Cypriot parliament, the ECB decided to retain the existing level of ELA provision for a few days, until 25 March and to consider an extension only if an EU/IMF programme was agreed that would ensure the solvency of the Cypriot banking sector. The Cypriot parliament eventually adopted Law No. 17/2013 on the Resolution of Credit and Other Institutions which conferred the power upon CBC to implement a bail-in. Following this, on 25 March 2013, the Euro Group reached an agreement on a financial programme for Cyprus which provided for a slightly diverse version of the bail-in plan that has been previously rejected by the Cypriot parliament. In short, Popular Bank would be solved and be split into a good bank and a bad bank, the latter to be run down over time. The good bank would be folded into Bank of Cyprus and take €9bn of ELA with it. BoC would be recapitalised through a deposit/equity conversion of uninsured deposits with full contribution of equity shareholders and bondholders.

Should the Cypriot Government failed to agree on a plan with its creditors by the set deadline, the ELA would have to be repaid on 26 March 2013. An obligation to repay ELA on 26 March would lead to the bankruptcy of the Popular Bank and eventually of Cyprus as well given the latter's inability to repay the insured deposits in that bank.

It appears that in the Cypriot case the provision of ELA to the Popular Bank was quite extensive. In fact, Popular Bank's total debt to ELA increased from €3,8 billion in May 2012 to €9,6 billion on 3 July 2012, an amount which was about 60% of Cyprus's GDP. Despite those figures, the ECB continued to provide ELA to the Popular Bank until March 2013. The size as well as the duration of ELA provision in Cyprus raises concerns as to whether ELA was used in this case as the primary means of managing the country's financial crisis instead of covering only temporary illiquidity needs.<sup>28</sup>

### **2.3.3 The 'prospect of a financial rescue package': A new condition for ELA-provision?**

The above narrative of the events that led to the Cypriot bail-in illustrates an interesting change regarding the rules governing ELA-provision. Until then, ELA was provided to credit institutions which were assessed as temporarily illiquid, yet solvent. As analysed above, the solvency of the credit institution is a requirement for the granting of ELA.

Yet, it appears that in late 2012 the ECB did not object to the provision of ELA to the Popular Bank despite that there were apparent reasonable concerns on its ability to

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<sup>28</sup> ECB, Monthly Bulletin, February 2007, p. 81.

repay it. Indeed, it was reported in the press that Mr. Hens Weidmann, the Governor of Bundesbank, had expressed his concerns that the decision to continue providing ELA to the Popular Bank despite the latter's insolvent status put the ECB at risk and was violating its duties. The view that the collateral offered by the Popular Bank may be inadequate for ELA provision was also endorsed by other members of the Governing Council.

The ECB's decision to retain the ELA provision was not unfounded. It appears that the ECB aimed to 'keep the bank alive until an agreement could be reached on a broad rescue programme with the Cyprus government'. In essence, ELA was provided 'for as long as the Governing Council judged that prospects were favourable for a positive outcome to the negotiations' between the relevant Member State and the Troika.<sup>29</sup> It follows that, in addition to the condition that the receiving institution must be considered solvent, the ECB introduced a new (alternative?) criterion in determining whether ELA should be provided, namely that there is a reasonable prospect of a financial rescue package. When such prospect appeared to be no longer confirmed, as seemed to be the case when the Cypriot legislature rejected the first bail-in plan on 19 March 2013, the ECB refused to expand ELA.<sup>30</sup>

According to the ECB's President, the rationale for such a novel condition (i.e. the prospects of a rescue package) goes as follows: The solvency of individual banks (or the entire banking sector in certain cases) as well as the availability of sufficient collateral, 'depended crucially on the prospects for success of the programme negotiations that were underway: if they failed, the value of the [...] government securities would have fallen, impairing the solvency of the banks and the quality of their collateral, excluding them from financing by the Eurosystem.'<sup>31</sup> What is important here is that, if the Cypriot government failed to implement the bail-in that was agreed at Euro Group level, the 'troika' whose integral part is the ECB would not have consented to the release of the financial assistance to Cyprus and the ECB would likely decide to cut-off ELA provision.<sup>32</sup>

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<sup>29</sup> Peter Praet, 'The ECB and its role as lender of last resort during the crisis', Speech at the Committee on Capital Markets Regulation conference on the Lender of last resort - an international perspective, Washington DC, 10 February 2016.

<sup>30</sup> Peter Praet, 'The ECB and its role as lender of last resort during the crisis', Speech at the Committee on Capital Markets Regulation conference on the Lender of last resort - an international perspective, Washington DC, 10 February 2016.

<sup>31</sup> Mario Draghi, Speech at the Università Cattolica del Sacro Cuore, Milan, 5 November 2015. See also Mario Draghi's statement at a press conference in 4 April 2013 where it explained the link between the ECB's decision to object the provision of ELA and the requirement for Cyprus to agree to an EU/IMF programme: *'Now, it so happened that in the absence of a programme, these banks would not have been solvent and viable. At that point in time the Governing Council assessed there was no programme in place, and that's why it had to do what it did. On all other occasions there was a programme in place. That's why when people ask us why we didn't do this on other occasions, the difference is that there was a programme in place, which led the Governing Council to assess that banks were solvent and viable. I don't think that the view that we are acting politically is actually correct. We have a mandate, which has been given to us by the legislators, and we are acting within that mandate.'*

<sup>32</sup> Landon Thomas Jr., 'Before a Bailout, E.C.B. Minutes Showed Doubts Over Keeping a Cyprus Bank Afloat', New York Times, 17 October 2014.

In short, Mario Draghi suggests that the solvency of a bank, a condition for ELA provision, is directly linked and depended on the prospects of the respective government agreeing to a financial programme. The failure of reaching an agreement on a rescue package would effectively lead to the collapse of the national banking sector. Yet, the interdependence between insolvency and prospects of a rescue package does not fully explain the role of these two components in the course of deciding whether ELA should be provided. At least two interpretations are possible. On the one hand, it could be argued that the ECB would consider the prospects of a rescue package as one of the factors employed in determining the solvency of the bank in question. In this sense, the basic requirement of the solvency of a bank is retained, however, the definition and the method of assessing it is now changed by introducing a new (and effectively decisive) criterion. Another interpretation could be that, in addition to the requirement of insolvency, the ECB introduced a new alternative condition for ELA provision. If a bank appears to be insolvent, then, instead of excluding ELA provision as a matter of principle, the ECB may still decide to provide ELA if the are reasonable prospects of succeeding a rescue package. According to this interpretation, insolvency would no longer be considered as a strict requirement for ELA provision.

Ultimately, the conditions for ELA provision can be better explained in political terms. The ECB has every reason to wish to avoid the blame for throwing a Member State outside the Eurozone. It could, in fact, be argued that the ECB has no mandate to take such a decision, namely to take a decision that would have the (direct or indirect) effect of a Member State abandoning the single currency. Martin Selmayr<sup>33</sup> suggests that for such a decision 'the ECB would need at least the full banking from the governments of the euro area countries'. In his view, 'only those who have the right to allow a Member State to join the euro can be said to be allowed to decide on the continued membership of a euro area country', and perhaps this option is doubtful if one interprets the Treaties<sup>34</sup> as providing for the irreversibility of the euro.

In any event, what appears to be clear from the above analysis is that in deciding whether ELA should be granted or not to an individual bank the ECB takes into account considerations which do not fall in the hard core of monetary policy operations. Yet, counterarguments may have some merit. One could, for example, argue that the exit of a Member State of the Eurozone poses a direct threat to the single currency; thus, the prospects of a Member State securing a rescue package is highly relevant for monetary policy.

### **3. The ECB's troika-related conduct**

#### **3.1 General framework**

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<sup>33</sup> Martin Selmayr, 'Keynote Speech - How Political Are the Institutions of Economic and Monetary Union?: The Cases of the European Central Bank and the European Commission' in *Proceedings of the ECB Legal Conference 2015* (ECB, Frankfurt am Main, 2015), pp. 261-275, 266.

<sup>34</sup> See Article 140(3) TFEU.

In addition to its primary role in safeguarding price stability through monetary policy operations, the ECB supports the general economic policies of the Union.<sup>35</sup> This is illustrated *inter alia* by the fact that the ECB participates in two institutions, whose main subject matter falls within economic policy, namely the Euro Group and the ESM.

The role of the ECB within Euro Group has recently become the subject of litigation before EU Courts. In *Mallis and Malli* the General Court dismissed an action against the Commission and the ECB seeking the annulment of the Euro Group Statement of 25 March 2013 outlining the main components of the Cypriot bail-in. The General Court rejected the applicants' argument that the Euro Group Statement was an act adopted by the Commission and the ECB. It held that no powers that currently belong to the Commission and the ECB have been conferred upon the Euro Group or the ESM.<sup>36</sup> Furthermore, the Court noted that the said Union institutions do not control or have the power to address binding instructions or recommendations to the Euro Group or the ESM.<sup>37</sup>

Moreover, the ECB is an integral member of the so called 'troika', a body that functions under the European Stability Mechanism, an intergovernmental framework for the provision of financial assistance to Member States. Besides the ECB, the tripartite body is comprised of the European Commission and the International Monetary Fund (IMF). More recently, in an attempt to provide more transparency and legitimacy to the work of the 'troika' it was agreed that the European Parliament will also oversight its activities; hence leading to a 'quartet'.

The Union case law had already approved long ago the use of Union institution outside the framework of the Treaties.<sup>38</sup> In *Bangladesh*<sup>39</sup> the Court recognised that there was nothing in the Treaty preventing 'the member states from entrusting the Commission with the task of coordinating a collective action undertaken by them on the basis of an act of their representatives meeting in the Council'. On this basis, the Court in *Pringle* upheld the legality of the use of the Commission and the ECB in the ESM context. For as long the subject-matter of an intergovernmental treaty falls outside the scope of an exclusive EU competence, the conferral of certain powers upon the Union institutions is compatible with the Treaties. The Court considered that the ESM was not a instrument of monetary policy.<sup>40</sup> Although the activities of the ESM could affect price stability - the main objective of monetary policy - the Court held that this was not its purpose.<sup>41</sup> In the Court's view, the ESM fell within the scope of economic policy, where clearly, the Union had no exclusive competence.<sup>42</sup>

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<sup>35</sup> See Article 127(1) TFEU.

<sup>36</sup> Para 43 and 47.

<sup>37</sup> Para. 43 and 47.

<sup>38</sup> Joined Cases C-181/91 and C-248/91 *Parliament v. Council and Commission* [Bangladesh], [1993] ECR I-3685; Case C-316/91 *Parliament v. Council* [Lome], [1994] ECR I-625.

<sup>39</sup> Joined Cases C-181/91 and C-248/91 *Parliament v. Council and Commission* [Bangladesh], [1993] ECR I-3685.

<sup>40</sup> *Pringle*, paras 53-57.

<sup>41</sup> *Pringle*, para 56.

<sup>42</sup> *Pringle*, para 60.

In addition to participating to the administration of the ESM, the main tasks of the ECB therein may be divided in two categories: (a) conducting assessments and (b) negotiating<sup>43</sup> (in liaison with the Commission) with individual Member States the conditionality accompanying the financial assistance to them as well as monitoring<sup>44</sup> the latter's compliance with the said conditionality.

### **3.2 The nature of the ECB's role in the 'troika'**

One of the main questions that the Court was asked to address in *Pringle* is whether the powers of the Union institutions in the ESM were compatible with their roles under the Treaties. The Court held that the powers of the ECB under the ESM did not alter its supportive role in the EU's general economic policy.<sup>45</sup> Moreover, it held that the ESM Treaty did not confer powers on the Commission and the ECB to adopt binding decisions.<sup>46</sup>

Yet, the legality of the ECB's powers does not mean that these are insignificant. The role of the ECB in negotiating the conditionality that would accompany the financial assistance to the relevant Member State is not clear given the absence of a detailed regulatory framework and the lack of transparency surrounding troika's work. On the one hand, it could be argued that the role does not entail more than providing technical advice and assistance to the Member States which have the ultimate responsibility for providing the financial assistance. Yet, this may not be the case. In his opinion in *Gauweiler* AG Cruz Villalón<sup>47</sup> highlighted some aspects of the active and distinct role of the ECB in this context. In particular, AG Cruz Villalón examined in its opinion the German Constitutional Court's argument that the ECB's significant involvement in the financial assistance programmes of Member States makes the ECB's OMT programme to fall within the sphere of economic policy and not that of monetary policy. AG Cruz Villalón first, found that the ECB actively participates in those financial assistance programmes. This becomes apparent from the rules of the ESM which in fact confers multiple responsibilities on the ECB in the course of a financial assistance programme, including participation in negotiations and monitoring.<sup>48</sup> Moreover, the experience of financial assistance programmes which have been implemented or which are still ongoing, amply demonstrates that the ECB's role in the design, adoption and regular monitoring of those programmes is significant, not to say decisive.<sup>49</sup> It follows, that the ECB is involved in the elaboration of the

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<sup>43</sup> Article 13(3) ESM Treaty. Pursuant to Article 13(3) ESM Treaty, should the ESM Board of Governors decide to grant, in principle, financial support to a Member State,<sup>43</sup> it: '*shall entrust the European Commission - in liaison with the ECB and, wherever possible, together with the IMF - with the task of negotiating, with the ESM Member concerned, a memorandum of understanding (an "MoU") detaining the conditionality attached to the financial assistance facility.*'

<sup>44</sup> Article 13(7) ESM Treaty.

<sup>45</sup> *Pringle*, paras 158, 162, 165. See Article 127(1) TFEU.

<sup>46</sup> *Pringle*, para 161.

<sup>47</sup> Paras 143-144 (footnotes omitted). For the Opinion of the Advocate General, see EU:C:2015:7.

<sup>48</sup> See, specifically Articles 4(4), 5(3) and (5)(g), 6(2), 13(1), (3) and (7) and 14(6) of the Treaty establishing the ESM.

<sup>49</sup> Beukers, T., 'The new ECB and its relationship with the eurozone Member States: Between central bank independence and central bank intervention', *Common Market Law Review* (2013) 50, Issue 6, p. 1588 et seq.

conditionality imposed on the State requesting assistance whilst, subsequently, it also takes part in the task of monitoring compliance with conditionality, which is crucial if the programme is actually to continue and eventually to come to an end.<sup>50</sup>

Notably, the ECB's role was not discussed by the ECJ in *Gauweiler*. Yet, from the AG's opinion it appears that the ECB has significant influence in the determination of both the timing of the financial assistance as well the terms for the provision of this assistance. In this sense, it influences the selection of specific policy measures that fall within the exercise of economic policy. This is also illustrated by looking into the role of the ECB in the Cypriot case. There appears to be evidence that the ECB's representative Mr. Asmussen, was among the various Euro Group participants that exercised pressure on Cyprus to agree to the bail-in plan.<sup>51</sup> Moreover, it seems that the ECB may have influenced the content of specific draft national legislation the issuing of which was a condition for the provision of financial assistance. In a press release a few weeks after the bail-in, the CBC stated that the 'troika', in which the ECB participates, 'asked for modifications' of the draft Resolution Law providing for the bail-in before its enactment.<sup>52</sup> Furthermore, as mentioned above, the ECB is empowered to monitor Cyprus's progress in terms of the implementation of the agreed macroeconomic adjustment programme.<sup>53</sup> Towards assessing the compliance of the Cypriot authorities with the terms and conditions of the programme, ECB's representatives visited Cyprus regularly in their capacity as members of the 'troika' and had frequent communication with the Cypriot authorities.<sup>54</sup>

Furthermore, the powers of the ECB as a member of the 'troika' may cause tension in two important aspects: first, its involvement in ELA provision and second, the exercise of monetary policy tasks, such as the OMT programme.

We have analysed above the decisive role of the ECB in ELA-provision. The ECB determines whether ELA should be provided in the Cypriot banking system as well as the point in time on which ELA would be cut-off, if necessary. Among the criteria that are taken into account for reaching a decision on ELA, the ECB does not only consider the solvency of the bank in question merely by looking into its own capacity in paying back the loans granted. It also assesses the likeliness of the respective government agreeing with its creditors on a macro-economic adjustment programme. Yet, the likelihood of agreeing to such programme depends, as we saw, on the progress of the negotiations between the relevant government and the 'troika' on the conditionality that shall accompany the financial assistance. Only once the 'troika' provides the 'green light' to the Member States, a programme may be concluded. In other words, the prior satisfaction of the 'troika', including the ECB, on the terms of the financial assistance is a *sine qua non* for the provision of financial assistance. In

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<sup>50</sup> Opinion of AG Cruz Villalón, *op. cit.*, para 144.

<sup>51</sup> See evidence of Mr. Sarris, former Minister of Finance of the Republic of Cyprus, to the relevant Parliamentary Committee of Inquiry. 'Final Report of the Parliamentary Committee of Inquiry into the Economy of Cyprus 2013' (28 September 2013), pp. 52-53 and 204-205.

<sup>52</sup> CBC Press Release of 15 April 2013.

<sup>53</sup> See also Article 1(2), Council Decision 2013/236.

<sup>54</sup> European Commission, 'The Economic Adjustment Programme for Cyprus - First Review', September 2013, pp. 3, 25, 27; European Commission, 'The Economic Adjustment Programme for Cyprus - Winter 2014', pp. 3, 7, 21, 25 et seq.

light of the above, the ECB appears to have the power to co-determine the prospect, the timing as well as the terms of the financial assistance. However, at the same time, the said prospects of financial assistance also affect to a great extent the ECB's decision to allow ELA provision. Hence, it can be argued that this brings the ECB in a position of conflict of interests. The ECB has the power not only to determine the conditions for ELA provision but also the power to influence whether the same conditions would be actually fulfilled. Furthermore, it may have other adverse consequences. Theoretically, the ECB may use its power in determining the likelihood, the timing as well as the amount of ELA to be provided in order to exercise pressure to the governments negotiating the conditionality of the financial assistance so that the latter agree with the terms proposed by the 'troika'.

In addition, the ECB's role in the troika may raise concerns in respect of its monetary policy tasks. In the course of examining the compatibility of the ECB's OMT programme in *Gauweiler* the AG Cruz Villalón noted that the ECB's troika-related powers may lead to a conflict of interest. This is because the ECB ends up with a “dual role”, as (i) holder of a claim the basis for which is a government bond issued by a State and (ii) supervisor and negotiator of a financial assistance programme applied to the same State, with macroeconomic conditionality included is problematic.<sup>55</sup> According to the AG's opinion, unilaterally making the purchase of government bonds subject to compliance with conditions which had not been set by a third party but by the same party has the following effect: The purchase of debt securities subject to conditions may eventually become another instrument for enforcing the conditions of the financial assistance programmes. It follows, that it is necessary to draw a distinction between (i) a measure intended to exclude ‘moral hazard’, such as a unilateral requirement to comply with the conditionality of a financial assistance programme, and (ii) a measure which, when considered in its context, includes the ECB as one of the institutions negotiating and, above all, directly co-supervising that conditionality.<sup>56</sup>

In light of the above considerations, the AG Cruz Villalón concluded that, should the OMT programme becomes activated, “to retain its function as a monetary policy measure, [it would] be essential for the ECB to detach itself thenceforth from all direct involvement in the monitoring of the financial assistance programme applied to the State concerned.”<sup>57</sup> In other words, there must be a “functional distance” between the two programmes.<sup>58</sup>

The AG Cruz Villalón was of the opinion that from a textual interpretation of the terms “in liaison with the ECB” in Articles 13 and 14 of the ESM Treaty it appears that the ECB could retain some passive and indirect involvement in those programmes. Nevertheless, while the ECB could keep being kept informed and even from express a view in this respect, it would not be possible to continue to take part in the monitoring of the financial assistance programme to which the Member State is subject when, at the same time, that State is the recipient of substantial assistance

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<sup>55</sup> Opinion of AG Cruz Villalón, op. cit., para 142.

<sup>56</sup> Opinion of AG Cruz Villalón, op. cit., para 146.

<sup>57</sup> Opinion of AG Cruz Villalón, op. cit., para 150.

<sup>58</sup> Id.

from the ECB on the secondary government bond market (under the OMT programme).<sup>59</sup>

#### 4. Conclusion

The paper examined the effects of the ECB's supranational activism on the EU's constitutional setting. It suggested that the ECB's enhanced role during the crisis led to the re-interpretation of the scope of its competences and set a new balance between monetary and economic policy under the Treaties in the ECB's favor. In this context, it highlighted the role of the CJEU in affirming the institutional empowerment of the ECB.

Furthermore, the paper analysed two interlinked aspects, namely (a) the assumption of the *de facto* role of Lender of Last Resort by the ECB, and (b) the ECB's involvement in economic policy matters by virtue of (i) its participation in the Troika and close cooperation with other EU institutions and informal bodies (ESM, Eurogroup), and by extension (ii) the assumption of the role of bilateral negotiator with individual Member States in need of financial assistance and subsequent supervisor of the relevant macro-economic adjustment programmes. While its activities may fall within its mandate under the Treaties, it appears that, in exercising its tasks, the ECB increasingly takes into account policy considerations that fall outside of its traditional competence. This creates tension with its primary role in determining the monetary policy and may give rise to conflicts of interest.

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<sup>59</sup> Id.