TRANSPARENCY INTERNATIONAL EU

# TWO SIDES OF THE SAME COIN?

## INDEPENDENCE AND ACCOUNTABILITY OF THE EUROPEAN CENTRAL BANK

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# LIST OF ABBREVIATIONS

| | |
|---|---|
| **ANFA** | Agreement on Net Financial Assets |
| **APP** | Asset Purchase Programme |
| **BCBS** | Basel Committee on Banking Supervision |
| **BRRD** | Bank Recovery and Resolution Directive |
| **CBI** | Central bank independence |
| **CGO** | Compliance and Governance Office |
| **CJEU** | Court of Justice of the EU |
| **CRD** | Capital Requirement Directive |
| **CRR** | Capital Requirement Regulation |
| **EBA** | European Banking Authority |
| **ECB** | European Central Bank |
| **ECON** | Economic and Monetary Affairs Committee |
| **EDIS** | European Deposit Insurance Scheme |
| **EFSF** | European Financial Stability Facility |
| **EFSM** | European Financial Stabilisation Mechanism |
| **ELA** | Emergency Liquidity Assistance |
| **EMU** | Economic and Monetary Union |
| **EP** | European Parliament |
| **ESCB** | European System of Central Banks |
| **FOLTF** | Failing or likely to fail |
| **FSB** | Financial Stability Board |
| **FT** | Financial Times |
| **GDP** | Gross Domestic Product |
| **GHOS** | Group of Governors and Heads of Supervision |
| **HICP** | Harmonised Index of Consumer Prices |
| **JST** | Joint Supervisory Teams |
| **LTRO** | Long-Tern Refinancing Operations |
| **MEP** | Member of the European Parliament |
| **MNB** | Hungarian Central Bank |
| **MPS** | Monte dei Paschi di Siena |
| **NCA** | National Competent Authority |
| **NCB** | National Central Bank |
| **NIS** | National Integrity System |
| **NPL** | Non-performing loans |
| **OLAF** | EU Anti-Fraud Office |
| **OMT** | Outright Monetary Transactions |
| **PSPP** | Public Sector Purchase Programme |
| **QE** | Quantitative Easing |
| **SMP** | Securities and Markets Programme |
| **SRB** | Single Resolution Board |
| **SREP** | Supervisory Review and Evaluation Process |
| **SRM** | Single Resolution Mechanism |
| **SSM** | Single Supervisory Mechanism |
| **TFEU** | Treaty on the Functioning of the EU |
| **TI** | Transparency International |

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# TABLE OF CONTENTS



# EXECUTIVE SUMMARY

This report is published at a time when the ECB faces a major dilemma. Because political inertia has to date prevented the establishment of a sustainable institutional architecture for the Eurozone, the ECB's role in safeguarding the euro is as indispensable as ever. The ECB emerged as the decisive actor in the euro crisis, with an extraordinary degree of latitude thanks to the statutory independence enshrined in the EU treaties: Governing Council members may not seek or take instructions from member state governments or European authorities to protect it from political interference. At the same time the ECB faces a significant decline in public trust, which alongside its expanded responsibilities put considerable strain on its accountability.

The relationship between the ECB's independence, its mandate, and its accountability lies at the heart of this report. This arrangement is intended to ensure the legitimacy of a body that has deliberately been placed outside of democratic politics. Given its independence, the ECB's accountability consists of answerability rather than democratic control: The President and the Chair of the Supervisory Board must report to the European Parliament and to the Council. Yet the extraordinary measures taken by the ECB since 2008 have tested the ECB's mandate to breaking point, raising the question if its accountability framework is well adapted to this new era of highly interventionist central bank policies.

If independence is one side of the coin, the flipside is a narrow mandate. Following the example of the German Bundesbank, the Maastricht Treaty enshrined the principle of central bank independence and an unambiguous price stability mandate in EU constitutional law. Only if doing so does not interfere with price stability may the ECB also "support the general economic policies in the Union." With the establishment of the Single Supervisory Mechanism in late 2014, the ECB now also has the objective to contribute "to the safety and soundness of credit institutions and the stability of the financial system."

The first decade after the creation of the euro in 1999 was plain sailing for the ECB, and the robustness of this institutional arrangement was hardly tested. That changed radically in 2008, when the collapse of Lehman Brothers plunged the world into a global financial crisis. In the euro area, where it led to mutually reinforcing banking and sovereign debt crises, the ECB emerged as the dominant force in European economic governance.

Again, there are two sides to the coin when it comes to ECB crisis management. On the bright side:

- The ECB assumed the role of lender-of-last-resort to the banking system, which, although not specified in the Treaties, has historically been a core function of central banks.
- After Mario Draghi vowed "to do whatever it takes to preserve the euro" in 2012, his Outright Monetary Transactions programme brought years of financial market speculation against several Member States to an end.
- By launching its own version of quantitative easing, the expanded asset purchase programme, the ECB saw off the deflationary threat and contributed towards the recovery in weaker economies that today seems to be gaining pace.

And yet, each of these achievements has its flip side:

- As the lender-of-last-resort, the ECB stopped accepting Greek government bonds as collateral, forcing Greece's banks to borrow from their national central bank under the Emergency Liquidity Assistance (ELA) procedure. Since ultimate control over the maximum lending ceilings under ELA remains with the Governing Council, the latter could use this control to exert significant pressure on the Greek government in its negotiations with the Troika of international creditors. The ECB did not publically communicate its ELA fine-tuning decisions. The fact that the ECB is part of the Troika, alongside the European Commission and the IMF, while being responsible for Greece's monetary policy, reinforces the political dimension of these 'technical' tasks.
- The success of President Draghi's Outright Monetary Transactions announcement was preceded by secret letters from the ECB to the Prime Ministers of Spain and Italy, which made support from a similar bond-buying programme conditional on specific reforms to be achieved within a timeline dictated by the ECB. A 2011 letter to the Irish Finance Minister threatened to end ELA if Ireland did not submit to a bailout programme, which brought intrusive reform conditionality and goes far beyond the ECB's narrow mandate.
- Finally, quantitative easing constitutes a monetary policy experiment, the distributive, financial and macroeconomic consequences of which vastly exceed conventional monetary policy. In the week ending 17 March 2017, the balance sheet of the Eurosystem showed assets worth almost four trillion euro – € 3,856,913,000,000.

These developments amount to a significant expansion of the ECB's role in the governance of the euro area. This leads to two fundamental concerns: central banks have been overburdened, and this is putting a severe strain on the institutional arrangement that underpins the ECB's partial exemption from the principle of democratic accountability.

In addition to the uneasy balance between independence and accountability, this study presents a systematic overview of the ECB's integrity framework. Improvements are needed in how conflicts of interest are managed; in particular, members of the Governing Council do not presently file public declarations of interests and assets, a standard precaution in economic and political institutions. Adjustments also need to be made to the Ethics Committee, which is chaired by a former ECB President and therefore not as impartial as it should be.

A particular risk is posed by the phenomenon of the revolving door. Many Executive Board members have gone on to accept posts in private finance, even while none of these highly accomplished civil servants had significant professional experience in the private financial sector prior to their Executive Board tenure. The behaviour of an institution's leadership matters in setting an example to staff. Banking supervision presents a particular risk in this regard, and uneven cooling-off periods should be strengthened to ensure the integrity of the euro area's new Single Supervisory Mechanism, including a transparent procedure to assess whether a particular post-office employment is in line with cooling-off periods.

Detection of conflicts of interest, corruption and other wrongdoing is also hampered by the outdated whistleblowing framework, which does not compare well to international best practices aimed at encouraging prospective whistleblowers to file reports. In the absence of an institutionalised mechanism for anonymous reporting, only two informants came forward in 2016, reflecting how difficult it will be to create a culture conducive to integrity. The ECB should adopt a new and public whistleblowing procedure with the option of anonymity.

Lastly, in view of the ECB's discretion in supervisory practices, the wide-ranging impact of its purchases of private-sector securities, and its role in global regulatory bodies such as the Basel Committee on Banking Supervision, a much higher level of transparency is needed on the ECB's meetings with lobbyists. An encouraging step in the right direction is the recent publication of Executive Board diaries with a three-month delay. But the ECB should go further and join the EU Transparency Register, and prohibit meetings with unregistered private interests. While meetings of individual banks with ECB supervisors pertain to regular supervision, it is clear that meetings with the European Banking Federation and national banking associations fall firmly within the scope of the transparency register.

Although significantly more ground is covered in the full report, this selective overview illustrates the key argument: While the ECB has done more than any other actor to save the financial and economic system of the euro area from collapse, its crisis-related activities went well beyond what its architects had envisioned as the central bank's role, and require greater scrutiny.

The fact that the ECB repeatedly finds itself in situations in which its decisions can precipitate the disorderly exit of a euro area Member State points to fundamental structural flaws in the Eurozone. Our case study on the provision of ELA to Greek banks in 2015 shows that this type of ECB overreach is firmly built into the institutional architecture of EMU, allowing the ECB to use its power over monetary policy to exert pressure on Member State governments. This may happen again: Not only are Greek banks still borrowing under ELA, its volumes also increased in February 2017 after a period of relative calm, in the context of yet another standoff between Greece and its creditors over a review of its third 'bailout'. The second case study on the re-capitalisation of Monte dei Paschi di Siena equally shows that the ECB has been drawn into highly political decision-making that belies its technocratic image. Often this has been done with the tacit support of national and EU-level political institutions, which are all too keen to shirk their responsibilities and let unelected technocrats to do the 'dirty work' for them. Here, the ECB should assert itself and not let its political counterparts off the accountability hook.

The ECB's accountability framework is not appropriate for the far-reaching political decisions taken by the Governing Council. This can be mitigated in part by greater transparency in the ECB's decision-making procedures. Making the single currency resilient and therefore sustainable will however require a more fundamental reform of Eurozone governance in general and of ECB accountability arrangements in particular. This should be addressed in the context of the current debate on deepening EMU by 2025.

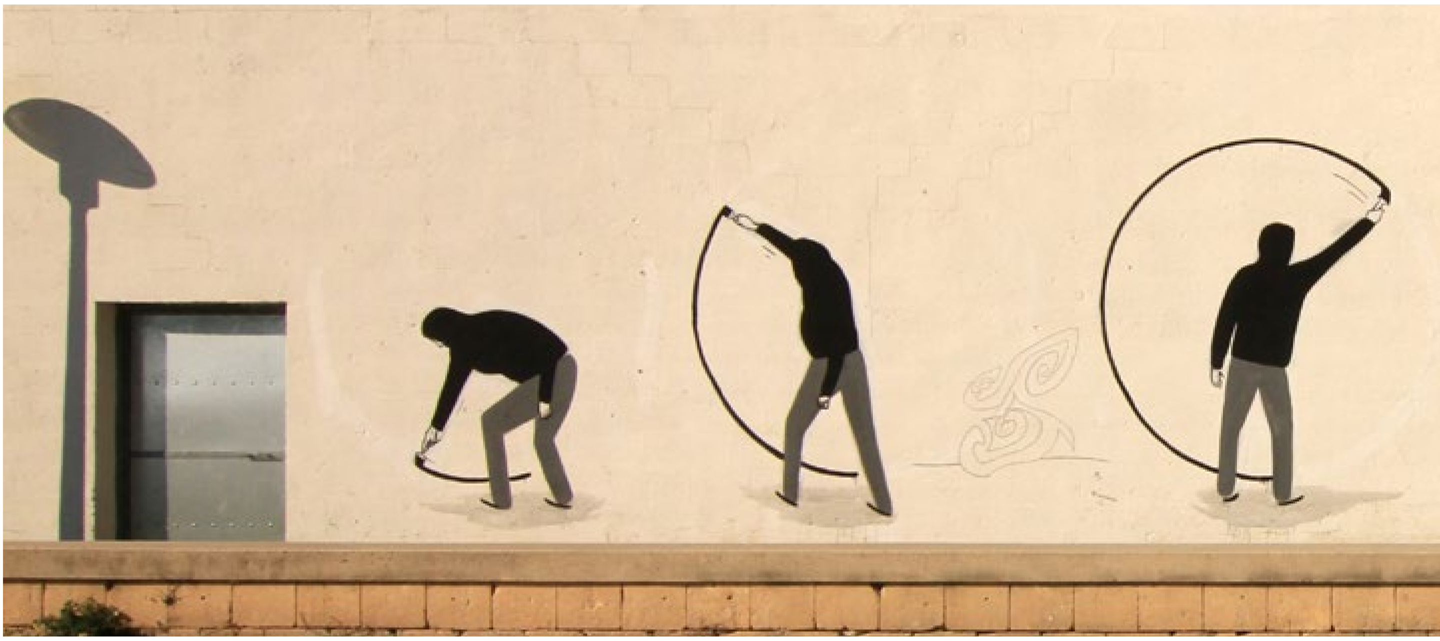
# KEY POLICY RECOMMENDATIONS

## INDEPENDENCE

- ✓ Any ECB communications to national governments that state conditions in exchange for supportive monetary measures should be co-signed by the President of the Eurogroup and the European Parliament. In addition, such communication should be public.
- ✓ To avoid mission-creep and secure political backing, the ECB should seek an agreement with the European Parliament and Eurogroup that outlines the political approval procedures for measures that go beyond its mandate but could help avert or contain a crisis.
- ✓ The ECB should no longer play a substantive role in the Troika and should have no formal role in the negotiation and monitoring of the conditions for receiving 'bailout' funds. This is at odds with its narrow mandate and the fact that it is responsible for the monetary policy of the country under surveillance.
- ✓ The ECB should not shy away from publically countering politically motivated statements that are factually wrong or misleading. Exaggerating the extent to which the ECB's work is 'purely technical' stands in the way of engaging in public debates about the euro.

## TRANSPARENCY

- ✓ The ECB should make it a rule to publish its decisions, recommendations, and opinions. Any exceptions should be explained proactively to the European Parliament.
- ✓ The ECB should join the EU Transparency Register and require that private interests falling under its scope must register before being eligible to meet members of ECB governing bodies and other staff with decision-making prerogatives, unless these meetings are required in the context of banking supervision or to safeguard financial stability. Meetings should be published within two weeks.
- ✓ The ECB should update its access to documents regime, reducing the number of exceptions to disclosure. It should clarify that 'administrative tasks' include decisions relating to the supervision of banks.
- ✓ With regard to monetary policy, the ECB should make its voice heard not only among experts and financial market participants but also among representatives of the 'real economy' and the general public.
- ✓ We endorse recent calls for ECB banking supervisors and national supervisors to improve the disclosure of bank-level supervisory data, thereby following international best practice.



## ACCOUNTABILITY

- ✓ In light of the ECB's expanded roles, its accountability framework should be reviewed by a high-level commission established by EU finance ministers and the European Parliament. The membership of the commission should include representatives of civil society affected by ECB policies, for example trade unions and consumer groups."

- ✓ The European Parliament should be given confirmation power in the appointment process for Executive Board members. The purpose of such parliamentary hearings should be to determine the competence and integrity of candidates in a non-partisan way.

- ✓ The ECB should publicly report to the European Parliament on any positions its representatives take in meetings of international bodies, such as the Basel Committee on Banking Supervision. These organisations have a major role in setting standards and legislation for banks worldwide.

- ✓ The ECB should create a public version of the tool it uses to provide an overview of the supervision of Eurozone banks, the SSM Supervisory Dashboard Pilot. This will allow the public to assess whether ECB banking supervision is achieving its objectives.

- ✓ The ECB should be the official "lender of last resort" to all significant Eurozone banks under its supervision, taking over this role from national central banks. This will simplify the process and thereby increase both transparency and accountability.

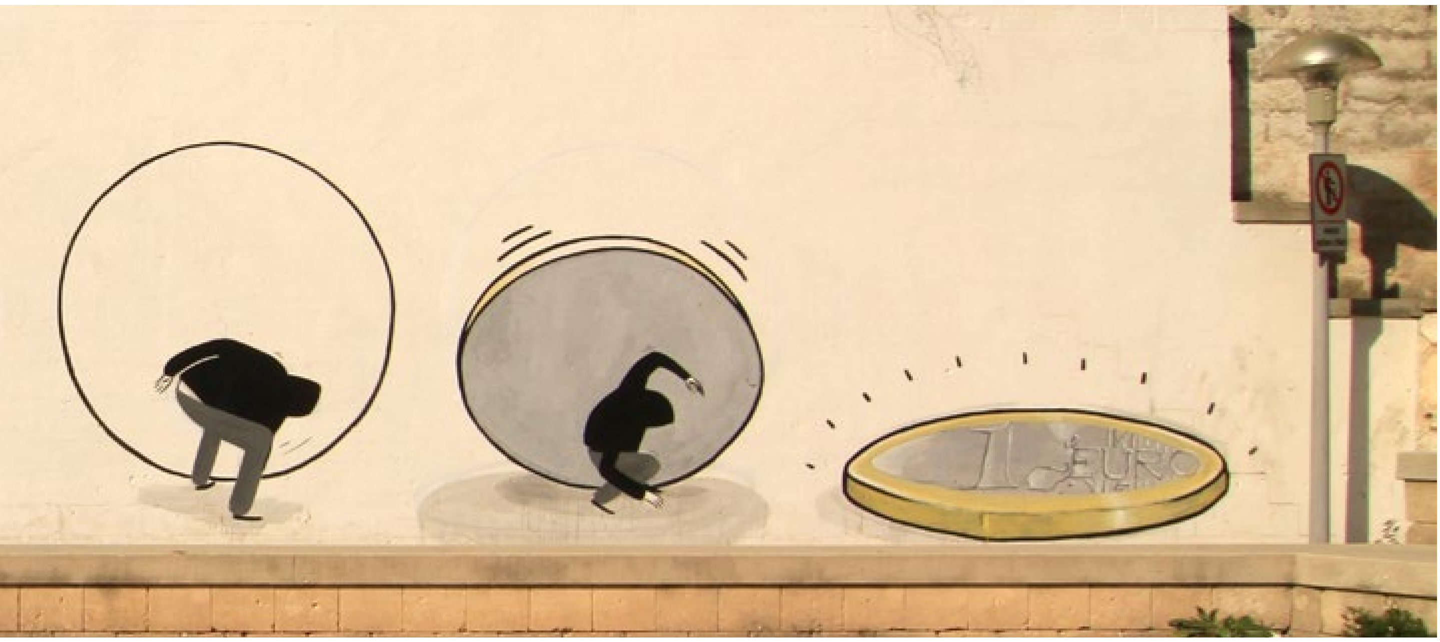
## INTEGRITY

- ✓ The ECB should overhaul its whistleblowing framework, adopting a clearly identifiable and public whistleblowing policy, which sets out in detail how reports will be investigated and includes the option to report anonymously. It should also follow best practices to encourage prospective whistleblowers to come forward.

- ✓ Members of the ECB Governing Council and senior ECB officials should be subject to a cooling-off period of two years, as foreseen in the EU Staff Regulation and the soon to be adopted Code of Conduct of European Commissioners. A formal and transparent procedure should be instituted to assess post-office employment for senior ECB executives, overseen by the Ethics Committee, rather than the Executive Board.

- ✓ Members of the Governing Council and in particular the Executive Board should file public declarations of interests and assets.

- ✓ The five-member Audit Committee currently consists exclusively of former or current central bank governors and (vice) presidents. Bringing in at least one outside member would strengthen the capacity of the Committee to perform its important control function.



# BACKGROUND

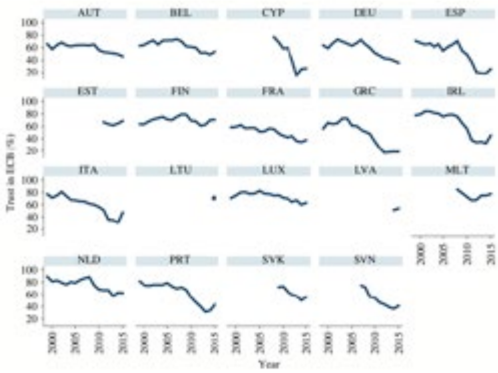
**Created with the introduction of the single currency in 1999, the first decade of the ECB was plain sailing. The 2008 financial crisis laid bare structural flaws in the euro area's institutional architecture, and required drastic action by the ECB, whose remit was expanded to include banking supervision, surveillance of reforms in 'bailout' countries, and unconventional monetary policy experiments. This section also details the ECB's structure and its governing bodies, the Executive Board, Governing Council, and Supervisory Board, as well as the Eurogroup, its imperfect fiscal counterpart.**

With the introduction of the euro in 1999, the European Central Bank (ECB) assumed competency for monetary policy in the euro area. Its statute guarantees a degree of political and operational independence that is unrivalled among the world's leading central banks. The flipside of the scope of the ECB's independence has been the narrowness of its mandate, which is to maintain price stability. Only to the extent that doing so does not imperil this primary objective is the ECB to "support the general economic policies in the Union".[1] The relationship between the ECB's mandate and its independence and accountability lies at the heart of this report. In addition, there is another dimension to the ECB's single mandate that we cannot discuss in detail, but that we will mention here: A single (or, more precisely, hierarchical) mandate focused on low inflation constitutes a political choice that has distributive consequences. The ECB, which is mandated to place price stability above all else, has less flexibility to fight unemployment than for instance the Federal Reserve, whose dual mandate encompasses both price stability and maximum sustainable employment, benefiting a wider range of society.

The first decade was mostly plain sailing for the ECB. Advanced industrial economies experienced positive and stable growth rates and low and stable inflation rates. Indeed, there was a fairly established consensus among academic economists and central bankers that the institutional innovation of central bank independence was at least partly responsible for this so-called "Great Moderation".[2] By contrast, the going got much rougher during the decade that followed the failure of US investment bank Lehman Brothers in September 2008. As one former member of the Governing Council put it, "the euro area crisis has been a nightmare for the ECB."[3] Instead of inflation, the primary threat has been deflation. Operating at the effective lower bound of the short-term interest rate, the ECB followed other central banks in adopting unconventional balance sheet policies. The fiscal and distributional consequences of its asset purchasing programmes in particular have taken the ECB into uncharted economic and political territory. Arguably even further from what the authors of the Treaty had envisioned was the ECB's involvement, as part of the "Troika", in the drive to impose reform requirements on so-called programme countries. Moreover, the political decision to integrate the Single Supervisory Mechanism (SSM) into the existing institutional structure of the ECB has given the ECB authority over banking supervision. Together, these developments amount to a significant expansion of the role of the ECB in the macroeconomic and financial governance of the euro area. In light of that expansion, many observers share two fundamental concerns – that central banks have been overburdened, and that this overburdening is putting a strain on the institutional arrangement that underpins the partial exemption of independent central banks from the principle of democratic accountability. The latest Annual Report of the Bank of International Settlements does not mince words in this regard:

> *During the Great Moderation, markets and the public at large came to see central banks as all-powerful. Post-crisis, they have come to expect the central bank to manage the economy, restore full employment, ensure strong growth, preserve price stability and fool proof the financial system. But in fact, this is a tall order on which the central bank alone cannot deliver. The extraordinary measures taken to stimulate the global economy have sometimes tested the boundaries of the institution. As a consequence, risks to its reputation, perceived legitimacy and independence have been rising.*[4]

**Figure 1**: Evolution of trust in the ECB by euro area member country



**Source**: Farvaque et al. (2016).
Data from Eurobarometer survey.[5]

The expansion of the ECB's role in economic governance in the euro area is a particularly striking instance of this broader phenomenon. Notwithstanding secondary legal acts, the Maastricht Treaty and the Treaty on the Functioning of the European Union (TFEU), which includes the ECB Statute (hereinafter "the Treaties"), are virtually the same today as they were two decades ago, as regards economic governance.[6]

Unease about the resulting divergence between institutional reality and underlying legal framework is evident both among experts and among the general public. For instance, the ECB's first chief economist has warned that "[w]hen central-bank mandates exceed price stability … their independence may seem increasingly out of place in a democratic society."[7] At the same time, public trust in the ECB – as well as in other national and European institutions – has eroded in almost all member countries of the euro area. Survey data from the Eurobarometer, presented in Figure 1, shows trust levels falling significantly, especially during the years of the euro crisis, roughly between 2010 and 2014. These developments have sparked a lively and controversial debate about the political legitimacy of the Economic and Monetary Union (EMU).[8] The scope of the present study is narrower – it takes a close and steadfast look at the independence, transparency, accountability, and integrity of the ECB.

## THE GOVERNANCE STRUCTURE OF THE ECB

Since the introduction of the euro in 1999, the ECB has been responsible for conducting monetary policy in the euro area. It forms the core of the Eurosystem, which also comprises the national central banks (NCBs) of the 19 countries that have adopted the euro. The Eurosystem and the remaining nine EU Member States that have not (yet) adopted the euro together form the European System of Central Banks (ESCB). Figure 2 visualises this structure.

**Figure 2**: The ECB, the Eurosystem, and the European System of Central Banks


The main decision-making body of the ECB is the Governing Council. It consists of the governors of the NCBs of the 19 euro area countries, plus the six members of the Executive Board (the President, the Vice-President and four additional members).[9] The Governing Council formulates monetary policy, sets interest rates, and takes the administrative decisions necessary to complete the tasks entrusted to the ECB. In the context of the ECB's new responsibilities related to banking supervision (see below), the Governing Council also adopts the complete draft decisions proposed by the Supervisory Board under the non-objection procedure. The Executive Board is responsible for the current business of the ECB and for the implementation of monetary policy.[10]

The Governing Council holds monetary policy meetings every six weeks, and usually holds a meeting on other matters in between. It follows a collective decision-making procedure that requires a qualified majority of two thirds of the votes.[11] The accession of Lithuania as the 19th member of the euro area in January 2015 triggered a system of rotating voting rights among NCB governors. The governors of the five largest economies share four votes, the remaining 14 governors share 11 votes.[12] In light of the possibility that the rotation may influence the outcome of important votes – such as (potentially) the Governing Council decision to revoke the waiver on Greek government bonds in February 2015 (see Case Study II: ELA) – we note that a reduction in the size of the Governing Council would be desirable.

At the end of 2015, the ECB had 2,871 staff (2,650 full-time equivalent approved headcount positions).[13] The share of women in senior management positions was 19 per cent (24 per cent across all management positions). The ECB has set itself the target of increasing both shares by nine percentage points until 2019.[14]

**Figure 3**: The six members of the Executive Board and the Chair of the Supervisory Board

**Mario Draghi**
President

**Vitor Constâncio**
Vice-President

**Benoît Cœuré**

**Sabine Lautenschläger**

**Yves Mersch**

**Peter Praet**

**Danièle Nouy**
Chair of the
Supervisory Board

## ECB BANKING SUPERVISION

The Single Supervisory Mechanism (SSM) became operational in November 2014. First announced in June 2012, the establishment of a single European supervisor became the key component of Banking Union, and was a decisive precondition for the establishment of the European Stability Mechanism.[15] Politically, the road towards the SSM proved rocky. The idea of a European supervisory function had been discussed as early as 2009, in the de Larosière Report. The creation of the European Banking Authority (EBA) marked a first but insufficient step in that direction. In light of these difficulties, integrating the SSM into the existing institutional and legal structure of the ECB proved the most feasible option. As a result, the ECB assumed the task of prudential supervision of credit institutions.
In legal terms, this was achieved via a legislative act by the EU, the SSM Regulation, in conjunction with Article 127(6) TFEU, which allowed the transfer of supervisory powers to the ECB.[16] Today, the term "Single Supervisory Mechanism" refers to the system of banking supervision in Europe that comprises the ECB and the national supervisory authorities of the 19 participating member countries of the euro area.[17] Following the ECB's terminology, this report will speak of "the ECB" when referring to the monetary authority or the overall organisation, while using the term "ECB Banking Supervision" when referring specifically to the supervisory arm.

The Supervisory Board is entrusted with the planning and execution of the supervisory tasks conferred upon the ECB. It prepares in particular complete draft decisions and submits them to the Governing Council for adoption under the non-objection procedure. It consists of the Chair (Danièle Nouy), the Vice-Chair (chosen from among the members of the ECB's Executive Board, currently Sabine Lautenschläger), four ECB representatives, and the 19 representatives of national supervisors. The Supervisory Board inter alia prepares decisions concerning micro- and macroprudential capital requirements, the significance status of supervised banks, the granting or withdrawal of banking licences, and enforcement measures and sanctions on significant banks. The decision-making procedure is explained in the Independence in law section.

While decisions made by the ECB are legally binding on all banks under the SSM, these banks fall into two groups – significant entities directly supervised by ECB Banking Supervision, and less significant entities supervised by the national supervisors.[18] The supervision of the currently 126 significant banks is carried out by Joint Supervisory Teams (JSTs). Each significant bank has a dedicated JST that comprises staff of both the ECB and the national supervisors.

## A WORD ON THE EUROGROUP

This study maintains that in some important cases, crisis management-related decisions and actions by the ECB are desirable, but may fall outside the ECB's narrow mandate, or would be inappropriate decisions to take for an institution with the high level of independence and consequently limited accountability of the ECB. In these situations, additional political buy-in would increase the political legitimacy of ECB actions. The report also advocates reviewing the legal accountability framework of the ECB in light of recent changes in the economic and institutional environment. Given that ECB decision-making happens at the supranational level, and since the limitations of decentralised accountability are well known, accountability and political buy-in should equally be situated at the supranational level.[19] However, while the co-legislators – the Council of the EU and the European Parliament – are the natural fit for this task, an important caveat applies to the euro-area version of the Council.

The Eurogroup consists of the finance ministers from the 19 member countries of the euro area. It is a body that exercises significant political power and constitutes the closest substitute for the absent 'fiscal counterpart' to the monetary authority. However, a major caveat applies: The Eurogroup is not a formal institution at all, but rather an informal club that is merely recognised by Protocol No. 14 to the Lisbon Treaty. As such, it has no formal decision-making structures, no rules of procedure, no accountability at the European level, and only publishes summaries of 'decisions' taken. Minutes are not available, attributable or otherwise. Therefore, to the extent that we advocate giving additional roles to the Eurogroup, we do so on the understanding that it will be made a formal EU body, with clear accountability at the European level, meaning to the European Parliament. A model could be the Foreign Affairs Council, whose dedicated President is a hybrid Vice-President of the Commission, facilitating the fulfilment of executive roles, given that executive rather than legislative tasks dominate the agenda of the Eurogroup.

In part due to the limitations of the Eurogroup, we will recommend giving it new tasks only conjointly with the **European Parliament**. In the context of these recommendations, 'European Parliament' does not necessarily stand for the plenary of parliament as a whole; rather, the Parliament's Economic and Monetary Affairs (ECON) Committee, or even a (yet to be created) euro area sub-committee could play that role.

This report covers both the monetary and the supervisory arm of the ECB. It is divided into four main parts, respectively focusing on the independence, transparency, accountability, and integrity. Each of these parts falls into two sections, the first on the rules as laid down in the law, the second on the implementation, monitoring, and enforcement of these rules in practice. The first three parts begin with short primers on the meaning and purpose of independence, transparency, and accountability in the specific context of central banking.  Where the report refers to specific ECB decisions and policies, these references serve to illustrate the procedural questions that are the primary concern of this report.

# INDEPENDENCE IN LAW

**Central bank independence is meant to guard against political interference in monetary policy. The ECB is one of the most independent central banks in the world, in a number of dimensions presented here. Independence poses challenges for democratic oversight, a problem which was originally addressed by giving the ECB a narrow mandate. Folding banking supervision into the ECB led to the need for 'Chinese walls' to separate this area from monetary policy-making.**

The concept of central bank independence (CBI) refers to the protection of the central bank from influence or interference by political actors. In the euro area, these include political actors at both the national and at the European levels. A key component in the monetary architecture of most advanced capitalist societies, the institution of CBI has been a relatively recent innovation – most central banks gained independence only during the 1990s.[20] Three remarks on the concept of CBI will provide some context for the following discussion of the independence of the ECB.

First, independent central banks have an exceptional status in democratic societies. The central bank is generally the only branch within the executive that is exempt from the principle of democratic sovereignty, be it electoral or parliamentary. From the perspective of democracy, then, CBI comes at a cost. But this loss of democratic – or "input" – legitimacy is balanced by a gain in "output legitimacy" – independent central banks have been shown to perform better in controlling inflation. A combination of empirical and theoretical arguments helped establish the economic consensus that only independent central banks could effectively control inflation – the price stability record of the uniquely independent German Bundesbank; theoretical economic arguments that only CBI would prevent governments from abusing monetary policy to boost short-term growth for electoral gains; and empirical studies confirming the hypothesised positive correlation between CBI and inflation control.[21,22] In short, it is important to understand that CBI, which comes at a democratic cost, is never "an end in itself" but "a tool for achieving the primary objective of price stability".[23]

Second, the literature on CBI distinguishes between political and operational independence. Political independence is defined as protection of the central bank from influence by elected politicians; operational independence as the ability of the central bank to use the instruments of monetary policy with autonomy.[24] While price stability in emerging market economies has been shown to benefit from the presence of both political and operational independence, in advanced economies it is mostly operational independence that matters.[25]

Finally, CBI is complex. Legal independence differs from actual independence, and the latter especially may be difficult to measure.[26] CBI is also not a dichotomous, but a continuous variable:[27] A central bank may be more or less independent, and its position on that continuum varies according to political and economic circumstances. Moreover, in light of the experience of the financial crisis of 2008 and its aftermath, students of the political economy of central banking have challenged the very concept of CBI, arguing that "[p]ure separation from the political process was never a possibility, whatever the law said or says".[28]

To summarise, CBI constitutes an exception from democratic principles that is justified by its beneficial effects on price stability; price stability has been correlated with operational independence but not with political independence (in advanced economies); and in practice no central bank can ever be fully independent from other political actors. The remainder of this section will review the legal underpinnings of the ECB's independence. The following section will discuss how that framework has fared at a time when the ECB has – de jure or de facto – taken on responsibilities beyond inflation control.

## GENERAL LEGAL FRAMEWORK FOR INDEPENDENCE

The political independence of the ECB is codified in articles 130 and 282(3) of the Treaty on the Functioning of the European Union (TFEU). Given the structure of European law, this means that the ECB's independence is enshrined at the constitutional level.[29] Due to their fundamental importance for the remainder of this report, it is worth quoting in full:

**Art. 130 TFEU**

> *When exercising the powers and carrying out the tasks and duties conferred upon them by the Treaties and the Statute of the ESCB and of the ECB, neither the European Central Bank, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Union institutions, bodies, offices*

*or agencies, from any government of a Member State or from any other body. The Union institutions, bodies, offices or agencies and the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the European Central Bank or of the national central banks in the performance of their tasks.*

**Art. 282(3) TFEU**

*The European Central Bank shall have legal personality. It alone may authorise the issue of the euro. It shall be independent in the exercise of its powers and in the management of its finances. Union institutions, bodies, offices and agencies and the governments of the Member States shall respect that independence.*

These provisions are unique in that they make all actors involved "co-responsible" for protecting the ECB's independence.[30] Both Member State governments and EU institutions are prohibited from seeking to influence the ECB, which in turn is instructed not to take instructions from anyone. The ECB's independence is further strengthened by the status of monetary policy as an exclusive competence of the Union.[31]

The requirement for central bank independence extends to the NCBs, including those outside of the euro area, with the exception of the Bank of England.[32] In its Convergence Reports, the ECB evaluates the compliance of those ESCB members that have yet to join the euro area with the convergence criteria of the Maastricht Treaty, including in the area of central bank independence.

That said, the rules do not attempt to erect a "Chinese wall" between the ECB and political bodies. Most notably, Art. 127(4) TFEU stipulates that the ECB "shall be consulted on any proposed Union act in its fields of competence". In its field of competence it may also provide unsolicited opinions to European or Member State bodies.[33] Moreover, representatives of the European Commission and Council may attend meetings of the ECB's Governing Council.[34] The Council of the EU may also submit motions for deliberations.[35] The ECB – generally the President – is invited to meetings of the Eurogroup, while "in practice, the Eurogroup President attends the meetings of the Governing Council."[36] Finally, the ECB is a statutory member of the Council's Economic and Financial Committee, the preparatory body of the ECOFIN Council formation.[37]

The Treaty framework also establishes limits to the ECB's independence. Most notably, the ECB can claim independence only when "exercising the powers and carrying out the tasks and duties" conferred upon it by the Treaty and by its Statute.[38] The primary task and duty of the ECB is "to maintain price stability".[39] Only when doing so does not conflict with that primary objective is the ECB supposed to also "support the general economic policies in the Union". The Court of Justice of the European Union, in its judgement on the applicability of EU rules on fraud prevention to the ECB, confirmed this construal of the ECB's independence as "strictly functional" and "limited to the performance of the specific tasks conferred upon the ECB by the EC Treaty and the ESCB Statute".[40]

Other provisions bolster the ECB's independence. First, the ECB has a legal personality distinct from that of the EU.[41] It therefore enjoys the right to enter into international legal agreements independently of the EU,[42] e.g. with other central banks, and can acquire property and be party to legal proceedings.[43]

Second, the ECB is the only body within the EU whose statute guarantees budgetary independence.[44] This is possible because monetary policy generates a profit that allows the central bank to operate as a self-financing public entity. It should be noted that the ECB's annual profit also means that there is – even during normal times – a fiscal dimension to monetary policy. The ECB transfers its annual profit – €1.08 billion in 2015, deriving from its lending operations and asset purchases[45] – to the national central banks, which in turn transfer their profits to their national treasuries, where they add to government revenue. The national central banks' shares in the ECB's profits are determined by their shares in the ECB's capital, which in turn reflect each country's share in the total population and gross domestic product of the EU.[46] The total amount of capital to be paid in by member countries is decided by the Governing Council.[47]

Third, the insulation of the ECB from political pressure is further strengthened by the prohibition of monetary financing of national governments.[48] This prohibition is designed to maintain the separation between monetary and fiscal policy, which is both a condition and a justification for the independence of the ECB. The question of monetary financing has been at the heart of a series of legal challenges filed against the ECB's unconventional monetary policies at the German Constitutional Court (see Independence in practice).

Fourth, the ECB Statute grants strong personal independence to the members of the ECB's Governing Council. While NCB governors are appointed in accordance with national legislation,[49] Art. 283(2) TFEU prescribes that the European Council makes appointments to the Executive Board by qualified majority. Executive Board members must be "persons of recognised standing and professional experience in monetary or banking matters". Executive Board appointments are fixed-term (eight years) and non-renewable.[50] The only body authorised to dismiss members of the Executive Board, at the request of the Governing Council or the Executive Board, is the Court of Justice of the European Union (CJEU).[51] NCB governors can be removed from office according national laws, but only in cases in which they can no longer fulfil their functions or are guilty of serious misconduct.[52] Dismissed NCB governors can appeal to the CJEU.

Fifth, the ECB holds its own legislative powers within its competence. The ECB has the right to issue legally binding regulations, within its competence and if the conditions laid down in Union law are fulfilled, and to sanction non-compliant actors if they violate legal requirements laid down in directly applicable Union regulations.[53] The power to sanction is particularly relevant in the context of the ECB's newly acquired competencies as a bank supervisor.[54] As regards banking supervision and the Single Rulebook, the right to legislate remains with the Council, upon consultation with the European Parliament, and the right to regulate rests with the EBA.[55]

While the NCBs are part of the ESCB with regard to functions conferred on the ECB by the Treaties, they are authorised to perform functions that remain unspecified in the Treaty framework. The performance of these functions happens "on the responsibility and liability" of the respective NCB and must be terminated if the Governing Council decides (by a 2/3 majority) that they "interfere with the objectives and tasks of the ESCB".[56] If an NCB fails to comply with its decision, the Governing Council can bring action before the CJEU.[57] Among the NCB functions not specified in the Treaty framework is the lender-of-last-resort function, including Emergency Liquidity Assistance (see Case Study I: ELA below).

## ECB BANKING SUPERVISION

The Basel Committee on Banking Supervision, a global standard-setting body, lists "operational independence" of the supervisor as the second of its "Core principles for effective banking supervision". Article 130 TFEU confers broadly the same level of independence to the ECB's supervisory arm as is guaranteed to its monetary policy arm. This is confirmed by Art. 19 SSM-R, which is largely identical to Art. 130 TFEU. There are, however, three noteworthy differences.[58]

First, Art. 19 SSM-R makes a distinction between the SSM as a whole (which includes the national competent authorities, or NCAs), and the Supervisory Board and the steering committee. The former "shall act independently" whereas the latter are subject to the stricter instruction to "neither seek nor take instructions from the institutions or bodies of the Union, from any government of a Member State or from any other public or private body." The less stringent requirement for NCAs takes account of the fact that under national laws some of them are subject to the superior authority of national finance ministries.

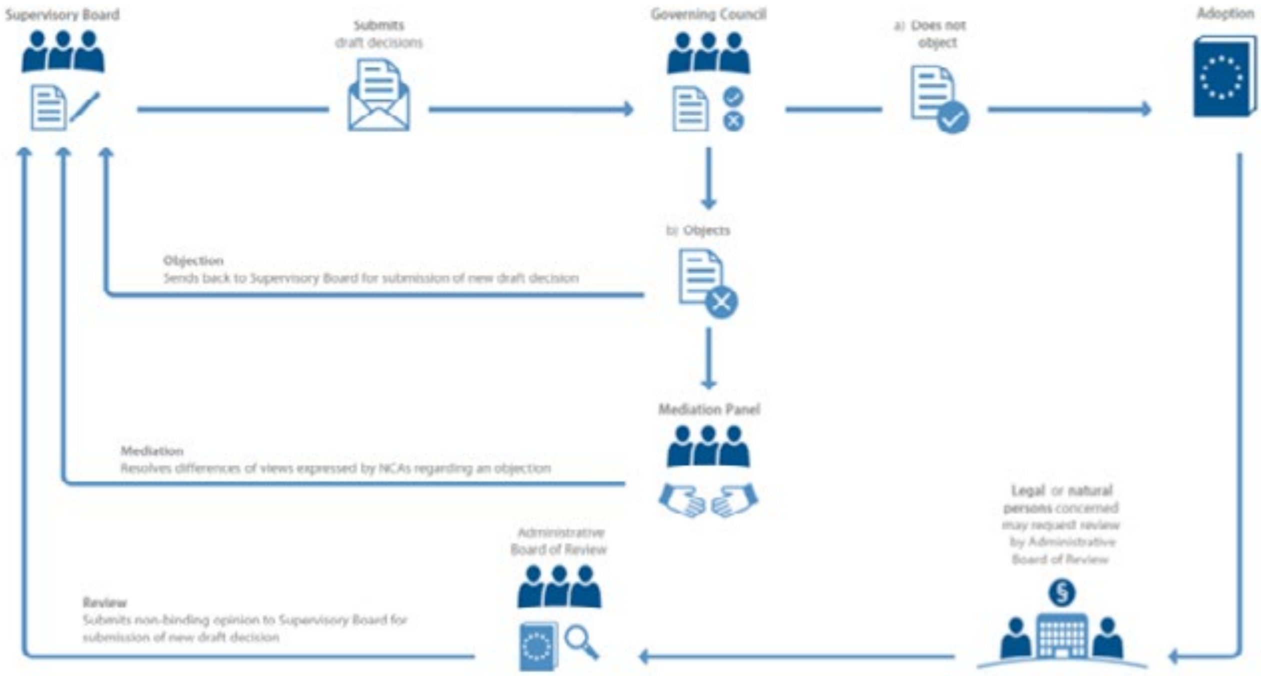
The second difference lies in the two final words of the above quote, "private body". Although the more general formulation of Art. 130 TFEU ("from any other body") arguably includes independence from private sector influence, the heightened risk for conflicts of interest to occur in the area of banking supervision spurred lawmakers' to make explicit reference to private sector actors as a potential threat to independence. This reading is strengthened by Recital 75 of the SSM-R, which stipulates that the ECB "should exercise its supervisory tasks … free … from industry interference".

Third, Art. 19(3) SSM-R adds further emphasis on conflicts of interest with the requirement for the Governing Council to establish and publish a Code of Conduct for ECB staff and management involved in banking supervision. The ECB met this requirement by publishing a revised Ethics Framework for all ECB staff, as well as a Code of Conduct for members of the Supervisory Board, both of which came into force on 1 January 2015 (see Integrity in law).

Finally, building the SSM into the ECB came with an additional complication – the need for monetary policy and banking supervision to be separated within the ECB. Here, the SSM-R is clear that its provisions for the banking supervision tasks of the ECB "shall neither interfere with, nor be determined by, its tasks relating to monetary policy".[59] Notably, this includes a requirement that supervisory staff be "organisationally separated from, and subject to, separate reporting lines from the staff involved in carrying out other tasks conferred on the ECB".[60] The specifics are addressed in an ECB decision, which imposes restrictions on the exchange of information between monetary policymakers and banking supervisors, with the special exception of emergency situations as defined by the Capital Requirements Directive.[61]

The one general exception to the separation principle is at the highest level, where ultimate decision-making power over both monetary policy and banking supervision rests with the Governing Council (see Figure 4). In order to keep the Governing Council's dual tasks "completely differentiated", meetings and agendas must be strictly separated for monetary policy and for banking supervision.[62] For cases in which the Governing Council objects to a draft decision by the Supervisory Board, the ECB has, following its obligations under the SSM-R, issued a regulation to create a Mediation Panel.[63] The regulation spells out the procedure by which the competent authorities of the concerned Member States can make a request for mediation.

**Figure 4**: Decision-making process at ECB Banking Supervision




**Source**: ECB Banking Supervision

The independence of ECB Banking Supervision also includes personal independence of the Chair of the Supervisory Board, who is appointed by the Council and European Parliament upon suggestion by the ECB's Governing Council. The appointment is for a five-year term that is non-renewable (see also Accountability in law). The Chair of the Supervisory Board is selected "from among individuals of recognised standing and experience in banking and financial matters".[64]

ECB Banking Supervision also enjoys budgetary independence. Its budget is financed independently from that of the ECB via the "supervisory fees" it levies on the credit institutions it supervises. The fees shall cover, but not exceed, the expenditures incurred by the ECB in pursuit of the tasks conferred on it by the SSM-R.[65] As a general rule, the significant banks supervised directly by ECB Banking Supervision pay a higher fee than the less significant banks supervised by their respective NCAs.

Finally, the ECB is bound by the Single Rulebook for the internal market in financial services of the European Banking Authority (EBA).[66] The Board of Supervisors of the EBA includes a representative of the Single Supervisory Board of the ECB, who does not have a vote.[67]

# INDEPENDENCE IN PRACTICE

**In practice, the ECB has continuous interactions with EU and national authorities, even more so during the crisis years. Its independence was repeatedly challenged in 'games of chicken', and the ECB had to strike a balance between intervention and overreach, including sovereign bond-buying programmes and its participation in the surveillance of reforms in 'bailout' countries. The ECB's unconventional monetary policy is discussed in this chapter, as are instances of clear overreach, such as ECB letters with explicit policy demands to the governments of Ireland, Spain and Italy.**

As recently noted by Otmar Issing, "the purpose of central-bank independence has always been to enable monetary policy to focus on maintaining price stability, without being subject to political pressure."[68] The paradigm of central bank independence, which has been formed on the basis of the 'Great Inflation' of the 1970s and early 1980s, seemed to have been vindicated by the 'Great Moderation' of the 1990s and early 2000s. The experience of the most recent decade, by contrast, has shaken this paradigm to the core. The Treaty explicitly connects and limits the ECB's independence to its price stability objective. This objective is symmetrical – inflation can be too high but also too low. The ECB's mandate therefore certainly covers fighting deflation.

Nevertheless, the question of the legitimacy and the limits of central bank independence becomes vastly more complicated in a deflationary macroeconomic environment, in which reaching the price stability objective involves central bank activities that go far beyond steering interest rates in the short-term interbank money market – the concept of monetary policy that underpinned the paradigm of central bank independence as we know it. One important aspect of this that is not covered in this report has been the increasing involvement of the ECB – in advisory roles and as an active driver of policy changes – in the European policy-making process in matters such as the financial transactions tax or the reform of the securitisation market.[69] Instead, in order to assess if the ECB's recent activities are compatible with its independence as defined by law, this section focuses on the two fundamental challenges the ECB has had to grapple with – the political challenge of lacking a fiscal counterpart and the economic challenge of reflating the economy by means of unconventional balance sheet policy. Recent episodes of potential domestic infringements on the independence of NCBs are briefly discussed at the end of this section.

## INFRINGEMENT VS. OVERREACHING: THE EXPANSION OF ECB/GOVERNMENT INTERACTIONS

The ECB continues to face the crucial political challenge of being the only notable monetary authority that lacks a fiscal counterpart. Due to this void at the heart of the institutional architecture of the euro area, the ECB is both the most powerful and the most overburdened central bank in the world – powerful, because there is no fiscal authority to encroach on its jurisdiction; overburdened, because there is no fiscal authority with which to share the burden of reflating the euro area economy. As one founding father of the euro pointed out in 2004, independence is not the same as "loneliness".[70]

Regardless of when or where it occurs, the institutional separation of the central bank from the finance ministry gives rise to a coordination problem between monetary and fiscal authorities. Independent determination of the path of fiscal policy by the finance ministry implies fiscal dominance; independent determination of the path of monetary policy by the central bank implies monetary dominance.[71] Central bank independence is designed to empower the central bank to resist fiscal dominance in the interest of price stability, forcing the finance ministry to adjust fiscal policy to the monetary policy stance of the central bank.

In the euro area, two institutional features add complexity to this coordination problem. The first is the absence of a centralised fiscal authority, and the existence of 19 different national fiscal authorities. The second reason is that since 2008, the coordination problem was not about inflation, but about moral hazard and structural reforms in specific Member States. These complicating factors turned the coordination problem between the monetary and the fiscal authority into what game theorists call a "game of chicken". The term refers to a scenario in which two drivers head towards each other on a collision course and where the first to swerve loses the game but saves both lives. During the various phases of the financial and economic crisis, the ECB and national fiscal authorities repeatedly played this game.[72]

The following summary of critical episodes acknowledges that under such conditions, there can be both too much and too little central bank independence. Political infringements by governments on monetary policy, or overreach by the ECB into political matters outside its mandate – are both problematic with regard to central bank independence.[73]

The first high-stakes game was played between the ECB and the European Council over the creation of what became the European Financial Stability Facility (EFSF). The country in question was Greece, which in the spring of 2010 needed foreign financing to avoid default. The European Council wanted the ECB to support the process of setting up a stabilisation fund by purchasing Greek government debt in secondary markets. The ECB's resistance was based, according to a former Executive Board member, on a moral hazard argument – the ECB was concerned that bond purchases would reduce "the pressure on governments to establish the bailout fund."[74] In order to dispel the European Council's expectation that the ECB would intervene prior to the establishment of the fund, Jean-Claude Trichet, on 6 May 2010, said publicly that the Governing Council "did not discuss this option".[75] On the following day, the European Council decided to establish the European Financial Stability Facility.[76] On 10 May, the ECB announced its first ever bond purchase programme, the Securities Markets Programme (SMP), which included Greek government bonds.[77] The ECB had won the first round in the game of chicken, successfully defending its political independence.

The episode of the first Greek bailout is characteristic of the interaction between monetary and fiscal authorities during the sovereign debt crisis, when the ECB not only resisted pressure from governments but also exerted pressure on governments itself. While in this instance it exerted pressure on the European Council, and thus on a collective of governments, subsequent episodes saw the targeting of individual governments.

Three cases in point are the letters President Trichet sent to the Finance Minister of Ireland in 2010 and to the Prime Ministers of Spain and Italy in 2011 (the Italian letter was immediately leaked by the government, the Irish and Spanish letters were released by the ECB in 2014).[78] In all three cases, the ECB made its support conditional on the respective governments' commitment to take specific actions and implement specific reforms. In the case of Ireland, the second letter made the continuation of Emergence Liquidity Assistance (for details on ELA see Case Study I) to the Irish banking sector conditional on an Irish "request for financial support to the eurogroup." The government filed the request two days later and Ireland became the second programme country.[79] In the cases of Spain and Italy, the letters made the extension of the SMP to Spanish and Italian government bonds conditional on commitments to specific economic reforms and budget cuts. In Italy, the failure of the government to comply purportedly caused the ECB to temporarily suspend its purchases of Italian bonds. The resulting spike in the spread on Italian sovereign debt facilitated the ousting of Silvio Berlusconi, whose government was succeeded by a technocratic caretaker administration led by Mario Monti.[80]

Unlike the 'symmetrical' conflict between the ECB and the European Council over the first Greek bailout, the Irish, Spanish and Italian letters occurred within a constellation in which the ECB wielded considerable power over individual Member States. Whether the instrument in question was ELA or the SMP – in each case the ECB held the key to keeping Member States within the euro that may otherwise have faced a disorderly exit. The authors of the Treaty did not intend the role of enforcer for the ECB. And while there is no indication that the Governing Council actively sought that role, it has repeatedly used its power over monetary policy to put pressure on Member States to deliver structural reforms, such as lower levels of worker protection or pension reforms.[81] The conflict over the third Greek bailout in the summer of 2015 (see Case Study II) has shown again that this type of ECB overreach is firmly built into the institutional architecture of EMU. While we view such overreach as incompatible with democratic principles, we acknowledge that the ECB is left with little choice within the current institutional architecture of EMU, which allows elected politicians to shirk their responsibilities, thus forcing unelected technocrats to do the 'dirty work' for them. Outside of acute crisis situations, the ECB should channel such recommendations into the annual EU exercise of economic and fiscal policy coordination, the European Semester.

√ *The institutional architecture of EMU means that the ECB will face situations in which it may use its power over monetary policy to make demands on Member State governments. More often than not, such overreach is partly the result of elected politicians shirking their responsibilities and relying on unelected technocrats to do the 'dirty work' for them. Here, the ECB should assert itself and not let its political counterparts off the accountability hook. Any ECB communications to national governments that state conditions in exchange for supportive monetary measures should be co-signed by the President of the Eurogroup and the European Parliament. In addition, such communication should be public.*

### BOX 1: DOMESTIC POLITICAL INFRINGEMENTS ON THE INDEPENDENCE OF NATIONAL CENTRAL BANKS – HUNGARY AND GREECE

While this section has focused on the structural issue of fiscal-monetary interactions in the euro area, there have also been two cases of domestic political infringement on the independence of NCBs. The first case unfolded in Hungary, a non-euro EU Member State. Following established legal rules and procedures82, the Hungarian government repeatedly consulted the ECB on legislative acts affecting the Central Bank of Hungary (Magyar Nemzeti Bank, or MNB). The Governing Council responded to these requests in a series of opinions, consistently voicing its concerns over potential infringements of the independence of the MNB and the members of its decision-making bodies.83 In March 2016, the President of Hungary rejected a law, previously adopted by the National Assembly, which aimed to shield the finances of the MNB from public scrutiny. The Constitutional Court of Hungary also rejected the law as unconstitutional. The court proceedings have revealed considerable damage to the independence and integrity of the MNB. 84 Under Gyorgy Matolcsy, a close ally of Prime Minister Viktor Orbán who had appointed him governor in 2013, the MNB endowed six newly established foundations with the equivalent of €1 billion.85 The foundations did award educational scholarships but also bought luxury properties and art, strongly suggesting embezzlement of large sums of public money for political and very likely corrupt purposes. The ECB reviewed and critically assessed these MNB programmes in its Annual Reports for 2014 and 2015, focusing on a potential conflict with the monetary financing prohibition of Art. 123(1) TFEU. In its latest statement on the issue, a written response to a question from the European Parliament, the ECB reiterated that "in view of their number, scope and size, the programmes could be perceived as potentially in conflict with the monetary financing prohibition, to the extent that they could be viewed as the MNB taking on government responsibilities and/or otherwise conferring financial benefits on the state."86 Transparency International Hungary, too, has closely tracked the developments surrounding the MNB. The MNB case shows the fragility of central bank independence, and the ease with which a determined government can appropriate and/or misdirect the considerable capacities and resources of a central bank.

The second case has occurred within the euro area, in Greece. The case revolved around the appointment of a new CEO at the country's fifth-largest bank, Attica, and an attempt by the government to prevent Attica's board of directors from confirming Theodoros Pantalakis as the new CEO. While noting "that Government sources denied any intervention in the process to select Attica's CEO", the Financial Times (FT) has reported the opposite: "According to sources, government figures arranged with the Engineers and Public Contractors Pension Fund (TSMEDE), Attica's largest shareholder, to hand the job instead to Constantine Makedos, a civil engineer with little banking knowledge. Attica has close ties to Syriza, Greece's ruling party, through links with the trade union that controls TSMEDE."87 Reacting to Mr. Makedos' nomination, Yannis Stournaras, the Governor of the central bank of Greece, responded by "setting in motion the central bank's screening process for new bank executives, intended to weed out anyone not deemed 'fit and proper' for the job. He also slapped a lending ban on Attica."88 On 15 September, shortly before the central bank announced that Mr Makedos had failed the test, anti-corruption police raided the offices of Mindworks Business Solutions, a company owned by Mr Stournaras's wife, Lina Nicolopoulou. The same FT report points to a potential link between the raid and an auction of TV licences: "Critics who see a political motive behind the raid on Ms Nicolopoulou's offices point to the lending ban imposed by Mr Stournaras [on Attica]. The ban came in the middle of a sensitive, and controversial, tendering process for digital TV licences being overseen by the government. Its effect was to scupper a loan that Attica was arranging for Christos Kalogritsas, one of the government's preferred bidders for the four licences on offer, forcing him to pull out of the contest." Although Attica is supervised by the Bank of Greece, the ECB conducted its own review of Attica's activities. The FT cites the resulting confidential report as noting "'severe findings' of poor governance and inadequate controls on lending". Overall, the Attica episode illustrates that infringements on central bank independence can happen within the euro area, too. It is notable that both episodes (Hungary and Greece) had to do more with (alleged) political patronage – abetted by the MNB, thwarted by the Bank of Greece – than with monetary policy.

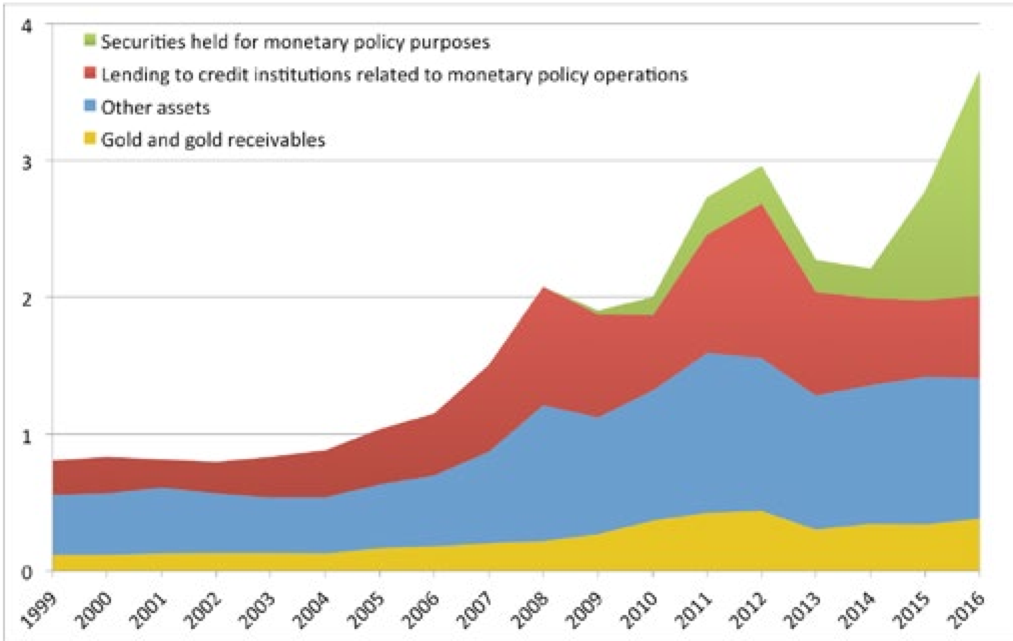
## THE EXPANSION OF UNCONVENTIONAL MONETARY POLICY OPERATIONS

Struggling to provide sufficient monetary easing to stave off deflationary pressures, all leading central banks faced an economic challenge when they exhausted their traditional instrument, the short-term interbank interest rate. Notwithstanding the debate about the precise location of the effective lower bound for traditional interest rate policy, the central banks of the world's leading financial centres have added balance sheet policy to their toolkits since 2008. Unlike traditional interest rate policy, balance sheet policy aims "to affect directly market prices and conditions beyond a short-term, typically overnight, interest rate."[89] The prime example is "quantitative easing" – large-scale purchases of financial assets financed by the issuance of new reserves by the central bank. Pioneered by the Bank of Japan in the early 2000s, quantitative easing became a key weapon in the crisis-fighting arsenal of the United States Federal Reserve (Fed), the Bank of England, and, lastly the ECB.

With regard to independence, balance sheet policies raise two additional questions. First, they have distributional effects that – regardless of their direction – vastly exceed those of interest rate policies.[90] If it is distributional neutrality that justifies the exemption of interest rate policy from full democratic accountability, should balance sheet policy be covered by the same exemption? Second, unlike in the case of interest rate policy, central banks do not have a monopoly on balance sheet policy – "almost any balance sheet policy that the central bank carries out can, or could be, replicated by the government."[91] While there are limits to the fiscal capacities of governments, this observation nevertheless raises the question: If democratically legitimated governments can assume the task, should balance sheet policy fall under the exclusive jurisdiction of unelected central bankers?

Earlier, small-scale asset purchase programmes notwithstanding, the ECB embarked on full-scale quantitative easing only in March 2015, six years after the Bank of England and the Fed. The ECB had used other instruments to expand its balance sheet (most notably full-allotment and long-term refinancing operations), but compared to quantitative easing these expansions were transitory and relatively short-lived. While the ECB's hesitation to embrace quantitative easing are partly explained by the bank-based nature of the European financial system, political resistance (above all from Germany) and the drawn-out legal battle over the Outright Monetary Transactions (OMT) programme have likely caused uncertainty inside the ECB over the robustness of its independence.

**Figure 5**: Annual consolidated balance sheet of the Eurosystem (end of year, EUR trillions) **Source**: ECB



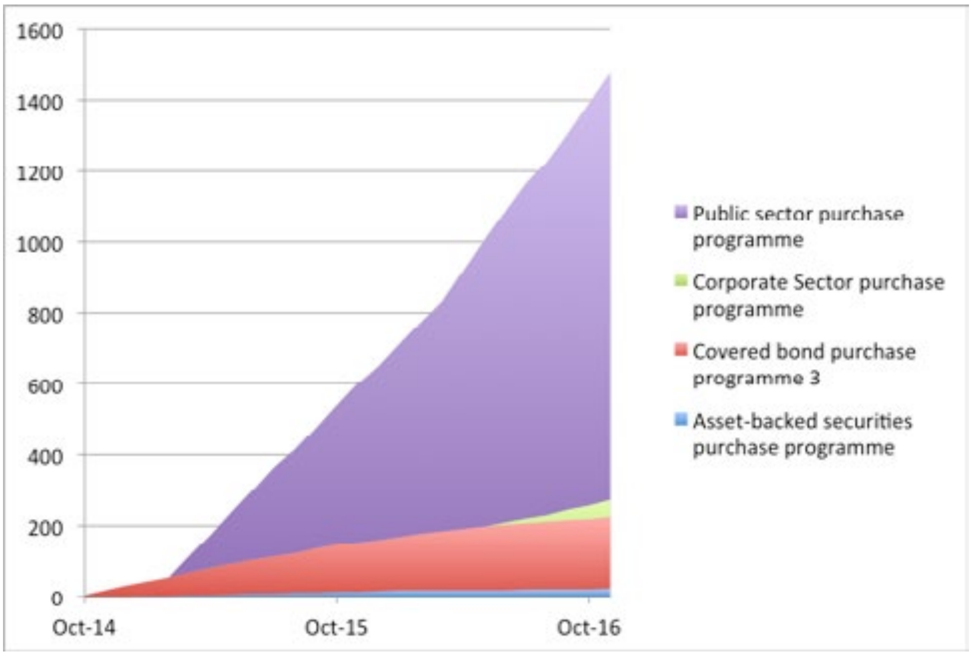

The expansion of the ECB's balance sheet was not linear, but came in the form of three peaks of increasing size (see Figure 5). The open market operations that created these peaks became increasingly unconventional.

The first peak was reached in the wake of the banking crisis of 2008 and resulted in the ECB acting as lender of last resort to the banking system. Technically, the ECB achieved this increase in central bank liquidity through 'full-allotment' (i.e., unlimited) refinancing operations.[92]

The second peak was the result of two Longer-Term Refinancing Operations (LTROs) with a maturity of 36 months and the option of early repayment after one year, which were decided upon at the second Governing Council meeting of Mario Draghi's presidency.[93] Banks' participation in the three-year LTROs, held in December 2011 and February 2012, amounted to just over €1 trillion in gross terms, or just over €500 billion in net terms (taking into account reductions in other refinancing operations).[94] These LTROs were carried out as fixed-rate, full-allotment tender procedures, which technically made them fall under the category of traditional interest rate policy. On the other hand, a very long maturity of three years combined with a very low interest rate (the ECB's main refinancing rate) made the LTROs an unconventional policy measure with substantial fiscal implications. As noted by one member of the Governing Council at the time, "bailout operations aiming to restore the health of the financial sector are effectively fiscal operations."[95] Evidence suggests that this was true for the ECB's three-year LTROs. In a classic "carry trade", banks used liquidity borrowed at a low rate (the main refinancing rate stood at 1 per cent at the time of the LTROs were conducted) to buy higher-yielding, risky assets, including lower-rated government bonds.[96] This carry trade benefitted all actors involved. The profits from the trade allowed weak banks to recapitalise; distressed governments found buyers for their sovereign debt issues; and the ECB had effectively outsourced the bond buying that central banks elsewhere, unburdened by Art. 123(1) TFEU, were doing on their own account. Although this was not how the ECB advertised the three-year LTRO programme, it was transparent, ex post, about the effects of the programme. At a 2014 hearing at the European Parliament, President Draghi justified a new lending programme, Targeted LTROs, by assuring the members of the ECON committee that "these carry trades are going to be much less profitable than they were in the early months of 2012" since due to lower interest rates on government debt "the convenience of using ECB cheap money to buy government bonds is much less."[97]

One key difference between the LTRO programme and outright quantitative easing was the built-in expiry date of the former. In fact, with banks repaying their LTRO loans early, the ECB's balance sheet began to contract again in the second half of 2012. Some observers have criticised the ECB for letting this contraction happen, arguing that it was "evident at real time" that monetary policy was "inappropriately tight" during a period when both current and expected inflation remained significantly below the target rate of 2 per cent.[98] Why did the ECB not provide more monetary easing in 2013/14? Again, the answer probably lies in the political economy of fiscal-monetary coordination – the ECB was playing another game of chicken with fiscal authorities.[99] According to this explanation, the ECB held back, lest monetary stimulus alleviates the pressure on governments to implement structural reforms, consolidate their budgets, and to build the regulatory infrastructure for a Banking Union at the European level.

**Figure 6**: Expanded asset purchase programme, cumulative purchases (€ billions)




**Source**: ECB

The ECB reversed two years of balance sheet contraction in December 2014 and, more decisively, in March 2015, when it launched its Public Sector Purchase Programme (PSPP). Since then, the ECB has purchased securities worth €60 billion each month (€80 billion from April 2016 through March 2017). At the projected completion date of the expanded asset purchase programme (APP), the ECB's balance sheet will have reached a third peak.

The securities bought under the APP fall into two categories, private and public. Covered bonds, which are issued by banks, account for the largest share in the private category, but have been outpaced, since June 2016, by purchases of bonds issued by major corporations. The corporate sector purchase programme provides another example for a quasi-fiscal subsidy to a particular sector of the economy, namely corporations large enough to be able to sell bonds in the capital market.[100] The lion's share of the APP, however, targets public debt. 10 per cent of purchases are directed at bonds issued by euro area international and supranational institutions, the remainder are directed at sovereign bonds issued by Member State central and regional governments and agencies (from March 2015 to March 2016 the number was 12 per cent).[101] This is not the place to enter into a debate about the effectiveness, inter-sectoral distributional effects, and potential unintended consequences of quantitative easing (QE) in general, and of the APP in particular. To highlight the challenges that QE has brought for the independence of the ECB, the present discussion will focus on one specific aspect – the question of risk sharing in the context of the public sector purchase programme.

The ECB's own buying of bonds from the 19 jurisdictions accounts for only 10 per cent of total purchases under the PSPP (8 per cent before April 2016). The remainder is coordinated centrally by the ECB but implemented in a decentralised fashion by the NCBs. Crucially, the risks associated with these purchases are not subject to loss sharing within the Eurosystem. Does this modality of the PSPP follow from the ECB's legal obligations under the Treaties or did it result from a discretionary decision?

Defendants and critics have proposed different interpretations. The day after the ECB began to purchase sovereign bonds, in a speech about the PSPP, Benoit Cœuré presented the absence of risk sharing as the default policy setting, mentioning in passing that the ECB had "no mandate to engage in large-scale pooling of fiscal risks."[102] Critics, by contrast, have pointed out that the Governing Council took a discretionary decision against loss sharing, which is legally mandated for net losses resulting from monetary policy operations.[103] That the decision over the modalities of risk sharing lay within the discretion of the Governing Council can be seen from the accounts of the meeting in January 2015:

> On the one hand, arguments were made in favour of full risk sharing so as to counter perceptions of a lack of unity. Full risk sharing would also underline the singleness of monetary policy. On the other hand, in view of concerns about moral hazard it was argued that a regime of partial loss sharing would be more commensurate with the current architecture of Economic and Monetary Union and the Treaties under which the ECB operates.[104]

There can thus be little doubt that the modalities of loss sharing under the PSPP are the result of a discretionary decision of the Governing Council. Why does this matter? Together with sovereign default, the main loss-generating scenario for the ECB would be the exit of one or several countries from the euro area. By isolating the risk of such a scenario on the balance sheets of the NCBs, the ECB "signaled that it wished to account for the possibility of states leaving the euro area."[105] Critics of this signalling point out that the spread between Italian, Portuguese, and Spanish 10-year government bond yields and the German equivalent, which should have declined under a PSPP with loss sharing, has persisted since the beginning of the PSPP.[106] The former Governor of the Central Bank of Cyprus has described this outcome as "an implicit tax on Member States perceived as weak and a subsidy on Member States perceived as strong", effectively imposed by the ECB.[107]

The jurisprudence of the Court of Justice of the EU (see Accountability in practice) has established the legal compatibility of the ECB's unconventional policies with the Treaties. The question remains, however, whether "[t]he power to engage in distributional policies" on such a large scale can be squared with the "intended purpose of central banks' independence", namely price stability.[108] Indeed, there is little in the Maastricht Treaty that would suggest that its authors had envisioned the possibility of a lengthy deflationary period at the zero lower bound, let alone the implications for the political economy of monetary policy. And yet, from a democratic legitimacy perspective, "the costs of political independence at the zero lower bound may be high".[109]

Safeguarding the legitimacy of the ECB, which is the bedrock of its independence, will require fundamental institutional reforms to reduce its economic overburdening and institutional loneliness. Our proposal draws on the "Principles of Delegation" developed by Paul Tucker, former Deputy Governor of the Bank of England.[110] Acknowledging that the ECB has done more than any other institution to stabilise the financial system and the broader economy of the euro area, but concerned that it had to stretch its mandate – and thus the boundaries of its independence – to breaking point, this report recommends

√ *an agreement between the European Parliament, the Eurogroup, and the ECB that establishes ex ante how the ECB may seek the political buy-in for measures to be taken in a situation in which the Executive Board or the Governing Council determine that the limits of the ECB's independence are reached, but in which the ECB could do more to avert or contain a crisis. The procedures thus agreed should involve heightened transparency requirements with regard to ECB actions.*[111]

## ECB BANKING SUPERVISION

The ECB's reporting on keeping monetary policy and banking supervision separate in practice is covered in the section Accountability in practice. The question of independence in the context of banking supervision is discussed in Case Study I. One important issue is the possibility for ECB Banking Supervision to exercise the options and discretions available under the Capital Requirements Regulation and Capital Requirement Directive (CRD IV).[112] A recommendation regarding accountability is formulated in Accountability in practice.

# CASE STUDY 1. New Supervisor, Same Old Banks: Monte dei Paschi di Siena

**As lender-of-last-resort for banks, the ECB already had a key role to play for illiquid or insolvent banks. As part of the EU's Banking Union, it also became the banking supervisor, and plays a role in the resolution of failing banks as part of the Single Resolution Mechanism. A number of other European legal innovations are meant to stop tax-payer funded bailouts of failing banks, leading to a complex tangle of untested laws and procedures. The case study discusses how the framework of the world's youngest bank regulator is playing out in the re-capitalisation of the world's oldest bank, and shows that in critical situations, technocratic policy issues invariably become political.**

## BACKGROUND: BANKING UNION, THE ITALIAN BANKING SECTOR, AND MONTE DEI PASCHI DI SIENA

The function of the supervisory pillar, which has been incorporated into the ECB, is to ensure the safety and soundness of the European banking system, to increase financial integration and stability, and to ensure consistent supervision.[114] In light of the absence of major financial turmoil, the focus of this report is necessarily on the routine practices of ECB Banking Supervision. There are rules and procedures, however, which, to be activated, require something to "go wrong" – among them, most notably, the state aid rules of the European Commission and the Bank Recovery and Resolution Directive. When the SSM became operational in November 2014, it inherited legacy problems at a number of banks. Of those cases, Monte dei Paschi di Siena (MPS), Italy's third-biggest bank by assets, has been the most important. MPS therefore provides a crucial test case for the performance of the new Banking Union institutions outside of day-to-day supervisory routines.

Economists and regulators have long regarded the European banking sector as the least healthy part of the European economy, attributing the problem at least in part to "government support and inadequate prudential supervision."[115] Two and a half years into the era of Banking Union, this structural weakness still persists, acting as a drag on credit growth and thus holding back the economic recovery of the euro area. In Italy, these problems have been particularly deep-seated, compounded by a vicious circle of weakly capitalised banks, economic stagnation and non-performing loans (NPLs). The ECB identified the NPL problem of the Italian banking sector in its 2014 Comprehensive Assessment of banks' assets, which nine Italian banks failed, including MPS.[116] According to the ECB's latest Financial Stability Review, the NPL ratio (share of total gross loans) stood at 17.7 per cent for the Italian banking system as a whole.[117]

The world's oldest bank, MPS looks back on a long history. In recent years, however, the bank "has been living on the edge."[118] Over the past ten years, MPS had to raise €16 billion in new capital. Its market value has shrivelled. It has failed, or done poorly, in all EU-wide stress tests since 2010. Perhaps most importantly, one third of MPS's loans are non-performing.

## THE LONG AND WINDING ROAD TO RECAPITALISATION

Although the ECB had identified the Italian NPL problem as early as 2014, several developments got in the way of a decisive and timely solution. In its first two years of operation, the capacity of the newly established ECB Banking Supervision to take on a problem as large as the Italian banking system was limited. Another important factor was the Bank Recovery and Resolution Directive (BRRD), which came into effect in January 2016 and made the "bail-in" of creditors a necessary condition for the recapitalisation of banks with public funds. This rule is particularly problematic in Italy, where retail investors (i.e., private households) own roughly half of all subordinated bank bonds, which means that they would be the first to suffer losses under a bail-in solution.[119] A plan to free up Italian lenders' balance sheets by securitising NPLs and selling them off to foreign investors was also thwarted by the BRRD. This is because the European Commission's state aid rules, specified in the 2013 Banking Communication, strictly limit governments' ability to use public funds to support banks.[120] As a result, state-backed guarantees for bad loan portfolios can now only be granted at market prices. Finally, both the European agencies and the Italian government were hesitant to tackle an issue as politically delicate as the recapitalisation of one of the country's largest bank in the run-up to Italy's constitutional referendum, held in December 2016.

The acute phase of the crisis of MPS began in the first two months of 2016, when its share price fell by 61 per cent. In January it was reported that ECB Banking Supervision had asked several Italian banks, including

MPS, to provide detailed information on their NPL exposure.[121] In early July, the European Commission entered into negotiations with the Italian government over the recapitalisation of MPS in line with the BRRD.[122] In the meantime, MPS attempted to raise €5 billion in new capital from investors in cooperation with Atlante, the private rescue fund newly established with contributions from the Italian banks and investors.[123] The decisive turning point occurred in early December 2016, days after Italians had rejected Prime Minister Renzi's referendum on constitutional reform. MPS had just asked the ECB for an additional 20 days to pursue a private-sector solution to recapitalisation. The board of MPS, which held a meeting that day, was reportedly wrong-footed when the ECB rejected the request on 9 December. Two weeks later, MPS abandoned the private-sector solution due to a lack of investor demand.[124] At that point, a state rescue under the new BRRD "bail-in" rules became inevitable.

Upon request by the Italian treasury, the ECB informed the Ministry on 23 December that the capital shortfall amounted to €8.8 billion.[125] Its announcement took some Italian bankers and politicians by surprise and prompted a strongly worded response from Finance Minister Pier Carlo Padoan. The Minister questioned the ECB's "very rigid approach both in terms of timing and risk valuation" and criticised a lack of transparency: "An explanation of how we got to €8.8bn would clarify the approach of the authority, helping other private banks make the right decisions when they ask for the ECB to approve any deal under its supervision."[126] Although the ECB did not publicly explain the increase in the capital shortfall, it was reported to have offered explanations to Italian officials and to MPS.[127]

The main issue at stake between Italian and European authorities, however, was not the size of the capital shortfall but the conditions under which the government would be allowed to conduct the recapitalisation. At the time of writing (late February), these negotiations are ongoing. The following aspects give an overview of the extraordinary complexity of this negotiating process:

- The BRRD harmonises the rules for the recovery and resolution of banks throughout the EU. Its key goal is to establish resolution rules that shift the burden from taxpayers to banks' shareholders and creditors – "bail-in" instead of "bail-out". Before a bank can be recapitalised, it must now be put into resolution under the auspices of the Single Resolution Board (SRB). Only once losses of at least 8 per cent of the bank's liabilities have been imposed on shareholders and creditors can the public recapitalisation proceed.

- A loophole, however, remains: If a bank is solvent, the Directive allows for a "precautionary recapitalisation". The solvency criterion is determined on the basis of stress test results. MPS's capital was negative under the hypothetical adverse scenario of the EBA's 2016 stress test but positive under the baseline scenario. On that basis, the ECB confirmed that it considered MPS solvent, thus giving its blessing, in principle, to the "precautionary recapitalisation" option.

- This option, however, comes with its own conditions. Most notably, capital must be injected on market terms, meaning that the government must pay the market price for the equity stake it acquires (as opposed to overpaying for it, thus subsidising the bank). Rather than a full-blown bail-in, this option requires burden sharing between creditors and shareholders – namely the conversion of subordinated debt into equity.

- As mentioned above, it is a quirk of the Italian banking system that much of banks' subordinated debt is held by those banks' own customers. This raises the question if – and how – depositors should be protected from the recapitalisation wiping out parts of their savings. Here, negotiations revolve around the possibility of a compensation scheme for retail investors who, unaware of their risk, had been mis-sold subordinated MPS bonds.[128]

- While the precautionary recapitalisation solution keeps the SRB out, it brings the European Commission in. Its Directorate-General for Competition is responsible for ensuring that the recapitalisation is conducted on market terms and thus in accordance with European state aid rules.

- The various stakeholders also negotiate over the commitments MPS must make in order to vindicate the ECB's solvency assessment. What could be called "recapitalisation conditionality" involves a detailed business plan for MPS, including asset sales, staff reductions, and branch closures.

- Finally, governments and authorities from other Member States are also watching closely. Germany in particular is adamant that the eventual deal will not undermine the rule, newly established under the BRRD, that creditors must take losses when a bank fails. (It should be noted that this position has drawn understandable criticism from Italy. In 2008/09 Germany had bailed out several of its largest banks on terms that would have been incompatible with the BRRD.)

In short, the process that has unfolded since the ECB's December decision to put MPS on the path for a state-funded recapitalisation reveals the extraordinary complexity of the emerging European resolution regime. While conflicts of interest can occur at many levels in this process, two potential conflicts that concern the ECB are of particular interest in the present context. The first concerns the path toward resolution.

A resolution procedure is triggered by the assessment that a bank is "failing or likely to fail" (FOLTF) and has no prospect of preventing failure via a private sector. This assessment is done by the ECB in consultation with the SRB in accordance with the criteria laid down in Article 18(4) of the SRM Regulation, which has transposed the BRRD in the euro area, and in line with the EBA's guidelines on how to interpret the FOLTF rules.[129] While the final decision on the resolution of a bank is taken by the SRB, the Council retains a veto right that, if exercised, triggers the winding down of the credit institution in question.[130] This complex array of supervisory actors, rules, and guidelines, combined with the fact the FOLTF criteria are "not linked to objective, quantitative thresholds but largely subject to regulators' discretionary judgment" suggests that the resolution procedure will continue to be a source of uncertainty.[131]

Second, the MPS episode casts a spotlight on the difficulties of keeping the tasks delegated to independent technocrats separate from politics. As the supervisory authority, the ECB has an interest in finding a solution for MPS and similarly afflicted banks that will allow the Italian banking sector to get rid of NPLs, return to profitability, increase lending, and thus support economic growth. Meanwhile, at a time of unprecedented political uncertainty, an electoral outcome in Italy that would bring an anti-euro government to power is possible. European agencies therefore have an interest in avoiding imposing terms on MPS that could be exploited electorally by political forces that aim to exit the euro area, the integrity of which the ECB has vowed to protect "whatever it takes".

None of this is to say that the presence of monetary and supervisory functions under the same institutional roof is necessarily a bad thing. Indeed, such arrangements existed in several Member States before the SSM was established. However, the situation in Italy clearly shows how financial, monetary, and political stability cannot, in practice, be separated from each other. This case study thus echoes a broader finding of this report: In critical situations, technocratic policy issues invariably become political and draw the ECB into political negotiations that are inconsistent with the textbook notion of central bank or supervisory independence. Short of undoing Banking Union and re-nationalising bank resolution, there are only two remedies – greater democratic control (and thus less independence) or, since that may not be desirable, more transparent decision-making and communication.

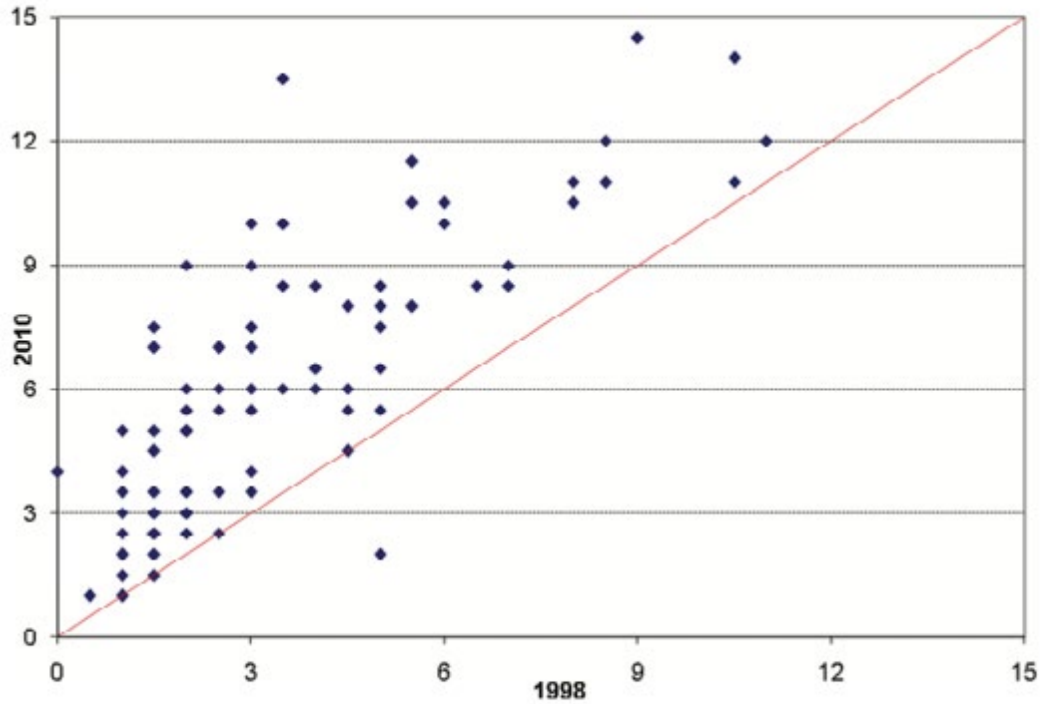
This case study suggests that the sheer complexity of the nascent European resolution framework will continue to limit the degree of transparency that can be achieved in this area. In the future, policymakers should shift the focus from establishing procedures and mechanism to consolidating and simplifying them.

# TRANSPARENCY IN LAW

**The ECB was created after transparency became a central tenet of monetary policy, but is mostly down to ECB discretion and discussed in the next section. We distinguish policy transparency, i.e. the influencing of market outcomes by communicating interest rate decisions and other ECB policies, and procedural transparency, i.e. the transparency of decision-making that is required to counterbalance the lack of democratic control. EU law mandates some transparency on banking supervision to increase accountability, including on supervisory methodology and the disclosure of prudential supervisory data.**

In order to understand the special place transparency occupies in the theory and practice of central banking, it is important to understand that, up until the early 1990s, central banks were non-transparent by design. Alan Greenspan's famous quip during a congressional hearing encapsulated the Fed's culture of strategic secrecy at the time: "Since I've become a central banker, I've learned to mumble with great incoherence. If I seem unduly clear to you, you must have misunderstood what I said."[132] Greenspan was only half joking – central banks were "shrouded in mystery" because they "believed they should be."[133]

**Figure 7**: Changes in central bank transparency on the Eijffinger/Geraats transparency index, 2010 vs 1998, 120 central banks. **Note**: Each dot represents the central bank of one country or currency area. Dots above the diagonal line indicate an increase on that central bank's transparency score. 0 = no transparency; 15 = maximum transparency.




**Source**: Dincer and Eichengreen (2014). Index first developed by (Eijffinger and Geraats 2006).[134]

Starting from the late 1990s, however, the notion of transparency took the world of central banking by storm (see Figure 7).[135] The sudden turn to transparency was linked to the discovery of central bank independence, both theoretically and politically. In economic theory, the rational-expectations paradigm in macroeconomics – which also provided the rationale for central bank independence – gave rise to the view that economic governance by surprise was doomed to fail.[136] Central banks would have to communicate their goals transparently if they were to influence market outcomes in the desired direction. In political terms, too, central bank independence called for more transparency. In order to compensate for their lack of democratic legitimacy, independent central banks would have to abide by a higher standard of transparency to be held accountable for their actions. That required central banks to communicate openly about their goals and the means by which they intended to achieve them.

These two perspectives lead to different concepts – policy transparency and procedural transparency.[137] Economists are primarily interested in policy transparency, which they define as "the absence of asymmetric information between monetary policy makers and other economic agents".[138] Here, information and communication serve as instruments of monetary policy rather than as accountability mechanisms.

By contrast, the primary purpose of procedural transparency is to enable external democratic stakeholders to hold the central bank accountable.[139] To be procedurally transparent, an independent central bank must provide all the information that is needed for the general public and its elected representatives to monitor the central bank and to hold it accountable. In line with this broader, political understanding of the nature and purpose of transparency, the ECB defines it as "an environment in which the central bank provides in an open, clear and timely manner all relevant information on its mandate, strategy, assessments and policy decisions as well as its procedures to the general public and the markets".[140]

## GENERAL LEGAL FRAMEWORK FOR TRANSPARENCY

Policy transparency lies largely within the discretion of the Governing Council. One important exception is the statutory requirement to publish the conditions under which the ECB and the NCBs stand ready to enter into open market and credit operations.[141] Beyond that, the Treaty framework has little to say about policy transparency, which is therefore discussed below in the section Transparency in practice.

Procedural transparency, on the other hand, is addressed in the Treaty framework. In particular, the Treaties mandate general information disclosure – the ECB is obligated to publish a quarterly activity report, a weekly consolidated financial statement of the ESCB, annual accounts, and an annual report on its activities, which must be presented to the Council, the Commission, the Parliament, and the European Council (for details on the Annual Report, see the Accountability section).[142]

Notwithstanding these information and disclosure obligations, a countervailing rule subjects ECB staff to strict confidentiality and professional secrecy requirements. These continue to apply after the duties of ECB staff and members of governing bodies have ceased.[143] A number of Treaty provisions are designed to safeguard confidentiality and professional secrecy.

**1.** The proceedings of the meetings of the Governing Council are confidential.[144] The decision of the Governing Council to publish accounts of its monetary policy meetings, starting in 2015, is discussed in the Transparency in practice section.

**2.** The ECB has discretion over whether to publish its decisions, recommendations, and opinions.[145] One episode that tested this provision is described below in the case study on Emergency Liquidity Assistance (ELA) in Greece.

√ *The ECB should make it a rule to publish its decisions, recommendations, and opinions. Any exceptions should be explained proactively to the European Parliament.*

**3.** The Treaties establish transparency and openness as principles of the EU and its institutions.[146] They do, however, grant the ECB a partial exemption from these principles. According to Art. 15(3) TFEU, the ECB is bound by the EU's transparency principles "only when exercising [its] administrative tasks" (the exemption – which leaves the term "administrative tasks" undefined – equally applies to the Court of Justice of the European Union and to the European Investment Bank).[147] We recommend that next Treaty amendment should remove this partial derogation for the ECB in 15(3) TFEU.

**4.** Within these Treaty-based limitations, public access to ECB information and documents is regulated by an ECB decision and its subsequent amendments.[148] This decision builds on Regulation 1049/2001 of the European Parliament and of the Council of 30 May 2001 regarding public access to European Parliament, Council and Commission documents. Under this framework, the ECB is obligated to either grant or refuse access to the requested documents within 20 working days.[149] The ECB shall reject a request if it determines that granting access would be harmful to the public interest. The definition of the "public interest" is broader than the definition in Art. 15(3) and protects, among other things, the confidentiality of the proceedings of the ECB's decision-making bodies; the financial, monetary or economic policy of the Union or of a Member State; and the internal finances of the ECB and the NCBs.[150] Judicial review of ECB decisions on access-to-document requests is limited to verifying compliance with procedural rules, the accuracy of the facts stated, and to checking for manifest errors of assessment or misuses of powers. We recommend that the ECB adopt an ambitious transposition of Regulation No. 1049/2001 on access to documents and should clarify that "administrative tasks" also include decision-making procedures relating to supervision, in line with full procedural transparency. We also note that the ECB decision transposing Regulation 1049/2001 contains additional exceptions in its Art. 4, as compared to the exceptions contained in Art. 4 of the Regulation. An updated ECB decision should bring the exceptions into line with those stated in the regulation.

**5.** The obligation for EU bodies to make documents freely accessible after a 30-year embargo applies to the ECB. However, under the ECB's Rules of Procedure the Governing Council may decide to keep individual documents classified beyond the 30-year period.[151]

## ECB BANKING SUPERVISION

The SSM Regulation contains an explicit acknowledgement that "any shift of supervisory powers from the Member State to the Union level should be balanced by appropriate transparency and accountability requirements."[152] While banking supervision is substantially different from monetary policy, the distinction, drawn above, between policy transparency and procedural transparency still applies. While the literature on supervisory transparency is smaller, it suggests "a positive correlation between the transparency of the supervisor and the effectiveness of banking supervision."[153] The argument evoked by advocates of openness is that disclosure supports market discipline, which increases financial stability. In the context of supervision, policy transparency concerns primarily the publication of supervisory methodologies and the disclosure of prudential supervisory data. Since disclosure practices lie within the discretion of the Supervisory Board, they will be discussed in the Transparency in practice section.

Procedural transparency at ECB Banking Supervision is, by and large, governed by the rules that also apply to the ECB as whole. Public access to documents remains governed by the overall ECB access framework. The ECB must present an annual report on its supervisory tasks to the European Parliament, the Council, the Commission and to the Eurogroup.[154] The annual report, which is also sent to national parliaments, must include detailed information and statistical data on conflict-of-interest and revolving-door cases.[155] Compliance with this requirement will be discussed in the Accountability in practice section.

Besides external transparency, numerous provisions govern the internal exchange of information, in particular between the supervisory and the monetary policy functions[156] and between the ECB and national or Union authorities.[157] The latter type of information exchange follows the rules of CRD IV for the release of confidential supervisory information.[158]

The preamble of the SSM-R calls for openness and transparency towards non-participating Member States.[159] Specific arrangements are to be established through memoranda of understanding between ECB Banking Supervision and authorities of non-participating Member States.[160]

# TRANSPARENCY IN PRACTICE

**The ECB has seen a steady increase in transparency over time, including in its regular press conferences, media presence and economic forecasting. It agreed in 2015 to begin publishing Governing Council accounts (non-attributable, shortened minutes), but should improve on proactively publishing ECB opinions, decisions, recommendations; can improve transparency on its balance sheet as regards the contentious issue of corporate bond purchases; and should overhaul its access to documents policy to limit the number of exceptions, which go beyond the EU law. Banking supervision presents particular challenges, as greater transparency is required to ensure accountability and increase trust in the financial system.**

Over time, the ECB has steadily increased its score on the Eijffinger/Geraats index for central bank transparency, which ranges from 0 (no transparency) to 15 points (full transparency). The original study assigned the ECB transparency values of 8.5 for 1999 and 10.5 for 2002 – on a par with the ECB's peers in Canada and the US, but behind transparency leaders in the UK, Sweden, and New Zealand.[161] According to Dincer and Eichengreen, the ECB reached a score of 11 in 2010 on the same index.[162] Another increase to 13 points came with the most recent update of the Eijffinger/Geraats index for the ECB, putting it among the group of the most transparent central banks.[163] What has driven this improved score?

This section follows the distinction – although it is not always clear-cut in practice – between policy transparency (information as an instrument of monetary policy) and procedural transparency (information as an accountability mechanism). As mentioned before, procedural transparency is largely defined by the Treaty framework, and has consequently seen only modest changes. Policy transparency, by contrast, has changed significantly over time.

## POLICY TRANSPARENCY

The most important events in the ECB's calendar are the press conferences that follow the monetary policy meetings of the Governing Council. During the press conference, the President gives an introductory statement before answering questions from journalists in real time. Transcripts of both parts are available on the ECB website. In addition to this communication channel, the ECB also communicates through public speeches and via its Economic Bulletin, both of which are available online. Published eight times per year, the Economic Bulletin (until 2014: Monthly Bulletin) aims to disseminate "the economic and monetary information which forms the basis for the Governing Council's policy decisions."[164]

The first increase in policy transparency came with the two adjustment to the monetary policy strategy in 2003: (1) a more specific (and symmetrical) definition of price stability[165]; (2) a re-ordering of the two "pillars" of the ECB's monetary policy analysis. This re-ordering relegated the "monetary analysis" to a secondary position, as a "cross-checking" tool, for the "economic analysis".[166]

Another element of the communication strategy that has become more transparent is the ECB's economic forecasting.[167] Initially, the ECB did not publish the results from its bi-annual staff macroeconomic projection exercise, which contained conditional forecasts of euro area GDP growth and inflation rates for the current and the following year. Observers criticised the non-publication of these projections, which they argued constituted the "decisive input in policy decisions."[168] Reacting to such criticism, the ECB began to publish these projections on a bi-annual basis in December 2000, before moving to a quarterly publication schedule in 2004.[169]

The most recent increase in the ECB's score on the Eijffinger/Geraats transparency index is explained by the publication, starting in 2015, of the accounts of the Governing Council meetings, usually with a delay of one month. While the ECB Statute explicitly protects the confidentiality of the meetings[170], critics have long demanded greater transparency.[171] Besides an overview of financial market, economic and monetary developments, the accounts contain, in an unattributed form, a summary of the discussion on the monetary policy stance. The ECB's aim in publishing the accounts is to "provide the rationale behind monetary policy decisions and enable members of the public to improve their understanding of the Governing Council's assessment of the economy and its policy responses in the light of evolving conditions."[172] The accounts further add to the information the ECB provides during press conferences and via the Economic Bulletin.

In practice, their added value lies not primarily in policy transparency, but in the area of procedural transparency. This is illustrated by the example, cited above, of the Governing Council's decision to conduct the public sector purchase programme without loss sharing between NCBs. In its public communication, the ECB has presented this as a non-decision that followed directly from the ECB's Treaty obligations.[173] But the accounts show that the Governing Council did have a controversial debate about the question of loss sharing.[174] This matters from an accountability perspective because it shows that the absence of loss sharing under the PSPP is the result of a discretionary decision by the Governing Council. In summary, the accounts improve the ECB's procedural transparency, and thus its accountability. The publication of "non-attributable minutes" has been a long-standing Transparency International recommendation, and we compliment the ECB for taking this step.

Finally, the ECB's unconventional policies, notably its asset purchases, have made the transparency of the ECB's balance sheet a more salient issue. In a speech, Executive Board member Benoît Cœuré acknowledged the "crucial role" transparency plays in the implementation of the ECB's expanded asset purchase programme.[175] From the beginning, the ECB has therefore reported, on a weekly basis, the aggregate amount of securities purchased under the different components of the APP. Along with data on cumulative purchases and residual maturity, this data is available for download on the website.[176]

While the ECB's weekly financial statements have always included data on the aggregate balance sheet of the Eurosystem, the ECB did not publish disaggregated balance sheet data. This changed in August 2016, when the ECB began to publish two new types of data.[177] First, following the publication of the Agreement on Net Financial Assets (ANFA), which until February 2016 had been a confidential document, the ECB decided to publish data on the annual average net financial assets of the ECB and the NCBs. Second, the ECB now publishes monthly breakdowns showing how ECB and NCB balance sheets contribute to the aggregate balance sheet of the Eurosystem. This data is easily accessible online and has been complemented by two new interactive visualisation tools, which have made it considerably easier for members of the public to understand and follow the ECB's balance sheet and its monetary policy operations,[178] and are an example of a commendable drive to innovate. Overall, these changes have increased transparency and accountability, especially of the NCBs.

## PROCEDURAL TRANSPARENCY

One key requirement for procedural transparency is the possibility for the public to gain access to documents. While detailed statistics on access to documents are not publicly available, the ECB has provided data for the purpose of this report. Up until 2012, the ECB received 10 to 15 access-to-documents requests per year. Since 2013, this number has increased to 30 to 40 requests, roughly half of which concerned the role of the ECB in the Troika (see the ECB's role in the Troika under the Accountability in practice section). Table 1 provides a breakdown of the numbers for 2014 and 2015, including the number of disclosed, partially disclosed, and undisclosed documents. Since mid-2016, roughly a quarter of requests have been related to supervisory issues. Mostly submitted by private citizens concerned about individual banks, few of these requests lead to documents being disclosed.

**Table 1**: Access to document requests and outcomes

| | Number of requests | Fully disclosed documents | Partially disclosed documents | Documents not disclosed |
|---|---|---|---|---|
| **2014** | 42 | 228 | 77 | 2 |
| **2015** | 29 | 19 | 56 | 31 |

**Source**: ECB (provided for this report)

The ECB usually responds to a public access request within the prescribed 20 working days. In 2016, the ECB extended the deadline by another 20 working days in one third of the cases, generally due to the volume of identified documents or the complexity of the requests. As mentioned above, the Treaties establish that the ECB is bound by the EU's general principle of openness only when exercising its administrative tasks. In light of the CJEU case law that has built around Regulation No. 1049/2001 on access-to-documents, the exemption of the ECB from the purview of that Regulation can be questioned. If an overriding public interest in disclosure exists, case law calls for information to be released even if it undermines the protection of commercial interests of a natural or legal person. There is no doubt that monetary policy and banking supervision are often particularly sensitive and therefore come with what one recent study on the right of access to EU documents calls the ECB's "justifiable need for secrecy."[179] But this secrecy can arguably be "guaranteed on the basis of the existing exceptions to the general rules on public access."[180] At the same time, public interest in access

to ECB documents has increased as a result of the expansion of the ECB's activities since 2008, both de facto (unconventional monetary policy) and de jure (banking supervision). One on-going case involves a petition launched by prominent members of the Democracy in Europe Movement 2025 (DiEM25). The petition follows MEP Fabio De Masi's request for access to a legal opinion the ECB had solicited from external lawyers in the context of its interactions with Greece over Emergency Liquidity Assistance in the summer of 2015 (see Case Study II).[181] In its response to De Masi, the ECB declined the request citing the 'attorney-client privilege'.[182] There is, however, a problem with this argument. If accepted, it would open the door to simply outsourcing legal advice on any delicate matter for the sole purpose of circumventing the ECB's legal obligations on access to documents under EU law.

√ *The ECB should replace Decision ECB/2004/3 with a new and ambitious transposition of Regulation No. 1049/2001 on access to documents, which should clarify that "administrative tasks" also include decision-making procedures relating to supervision, in line with full procedural transparency. The exceptions to disclosure contained in Art. 4 should urgently be brought into line with the 2001 Regulation. Finally, the next Treaty amendment should remove the partial derogation granted to the ECB in article 15(3) TFEU.*

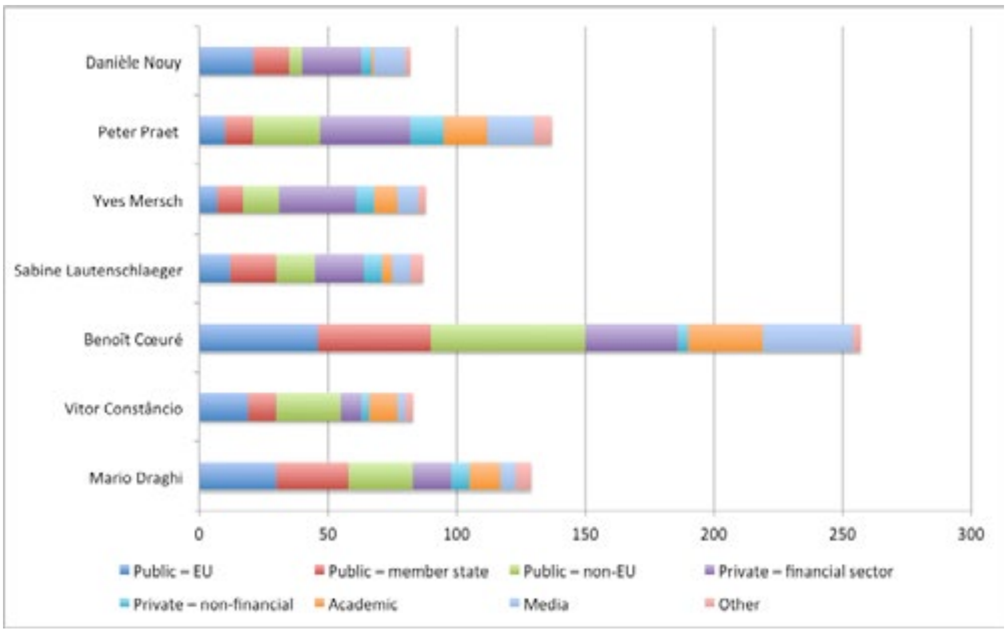
One innovation that has increased the ECB's procedural transparency is the publication of the diaries of the members of the Executive Board, as well as of the Chair and the Vice-Chair of the Supervisory Board. This follows the example of the European Commission's November 2014 transparency initiative, but is not as far-reaching as the Commission practice, which includes Commissioner's cabinet members (advisers in the case of ECB leadership) and Directors-General at staff level. Since November 2015, the ECB publishes these diaries with a three-month delay on its website, whereas the Commission publishes meetings within a two-week delay and additionally publishes, at least in part, agendas for the upcoming week.[183] We also note that the ECB retains the right to not to publish ex-post diary data in cases in which "releasing the information could undermine the protection of public interests recognised at EU level."[184]

The decision to publish the diaries coincided with an episode in May 2015, in which a speech given by one Executive Board member at an academic event in London, which contained market-moving information, was published on the ECB website only the following morning.[185] Since the event was attended by private investors, the episode increased the interest of the public and of the European Ombudsman – who subsequently welcomed the ECB's decision to publish the diaries[186] – concerning the informal contacts central bankers maintain with financial sector professionals. Members of the Executive Board must walk a fine line, communicating to and gathering information and feedback from financial market participants, while avoiding being influenced or captured by the interests of a sector that represents only one part of the economy – not least because they have only few meetings with representatives of the 'real economy'. Based on an analysis of all monthly diaries available at the time of writing, Figure 8 presents an overview of the meetings and speaking engagements between November 2015 and September 2016. The data show that the majority of meetings and events attended by Executive Board members are hosted by public bodies at the EU, Member State, or international level. While financial sector events are rarely attended by the President and the Vice-President, such events constitute the largest category for Peter Praet, the ECB's Chief Economist, and for Yves Mersch, who has been particularly involved in ECB activities related to market infrastructure and payments. All members regularly meet with media representatives and speak at academic conferences.

**Figure 8**: Meetings & speeches of Executive Board members and of Danièle Nouy, Chair of the Supervisory Board, November 2015 – Sept. 2016

The decision to publish the diaries was supplemented by the publication, in October 2015, of the Guiding principles for external communication by members of the Executive Board.[187] The first principle stipulates several guidelines to avoid a scenario in which "potentially financial market sensitive information may not be available to the widest possible public audience at the same time." The second principle prohibits the divulging of financial market-sensitive information at private or bi-lateral meetings; the third re-affirms that during the seven-day "quiet period" ahead of monetary policy meetings of the Governing Council, public speeches or remarks "should not be such as to influence expectations about forthcoming monetary policy decisions."

Together, these principles and the publication of the diaries provide a highly welcome strengthening of the procedural transparency of the ECB. However, we see no reason why the ECB should not publish diary items sooner. Time is of the essence when it comes to enabling accountability, both towards the media and towards the EP. While the accessibility of the ECB's diary data is conveniently published on single website, unlike the information provided by the European Commission which is spread over 98 different webpages, the ECB should emulate the bi-weekly publication schedule. Moreover, unlike the Commission, the ECB did not link this practice to the Joint Transparency Register, which, as the EU's 'transparency hub', is open to all EU bodies,




Source: Data compiled from monthly diaries available at https://www.ecb.europa.eu/ecb/orga/transparency/calendars-of-the-EB-members/html/index.en.html and would require any interest representatives seeking to influence the ECB to register their interest with the Transparency Register. This would have a significant impact, given that of the 129 entities supervised directly by the ECB, a majority has not yet registered on the so-called lobby register according to our research, even while it is difficult to believe that the Eurozone's largest banking conglomerates would not lobby EU policy-makers directly and indirectly, via sector associations. The ECB's Ethics Framework equally makes it clear that the ECB is a target of lobbying,[188] and umbrella organisations such as the European Banking Federation have recently set up dedicated lobbying offices in Frankfurt in order to facilitate contacts for its member banks with ECB Banking Supervision,[189] as have national banking associations.

√ *The ECB should join the EU's Joint Transparency Register and require that interest representatives falling under its scope must register their interests before being eligible to meet ECB decision-makers, unless required for banking supervision or exceptionally in the interest of financial stability. It should furthermore publish meetings within two weeks.*

### TRANSPARENCY TO THE GENERAL PUBLIC

As shown in the introduction to this report, there has also been marked loss of trust in the ECB among European citizens. In some countries – most notably Germany – media coverage has been largely hostile. Countering scepticism among the general public has been an uphill battle for the ECB. The technical complexities of monetary policy and banking supervision put formidable obstacles in the way of public understanding of the ECB's mandate, instruments, and policies.[190] The task is further complicated by the need to conduct a single monetary policy for the euro area as a whole, even while citizens in different countries grapple with different economic outlooks.

The ECB has therefore taken first steps to improve its capacity to reach the general public via different communication channels. The first communication channel is the ECB's website. Under the tab "Explainers", the website offers explanations of key concepts in simple words ("Tell me"), multimedia illustrations ("Show me"), and longer explanations for readers looking for more details on selected topics ("Tell me more"). Beyond the website, the outreach division of DG Communication also runs public information campaigns, welcomes visitor groups, organises conferences and responds to citizens' enquiries according to the European Code of Good Administrative Behaviour.

The media provide a second communication channel to reach the general public. President Draghi and the other members of the Executive Board speak regularly to journalists, often for on-the-record interviews. Moreover, DG Communication maintains a Global Media Relations division that facilitates access for and provides information to journalists.

Finally, President Draghi has pioneered a new way of engaging with domestic audiences at the Member State level. Since 2013, he has accepted invitations to speak to and respond to questions from national parliaments in France, Spain, Germany, Finland, Italy, and the Netherlands.

√ *We commend the ECB for these efforts and encourage it to continue to make its voice heard not only among experts and financial market professional but also among the general public.*

√ *The ECB should not shy away from countering politically motivated statements that are factually wrong or misleading. Exaggerating the extent to which its work is 'purely technical' may stand in the ECB's way when it comes to engaging in public debates about the euro.*

## ECB BANKING SUPERVISION

Regarding procedural transparency, ECB Banking Supervision is bound by the same rules as the ECB as a whole. One area in which procedural transparency falls short is with regard to the ECB's participation in the meetings of the Group of Central Bank Governors and Heads of Supervision (GHOS), the oversight body of the Basel Committee on Banking Supervision. Both Mario Draghi, as President of the central bank, and Danièle Nouy, as Chair of the Supervisory Board, attend these meetings, which take place every six weeks. President Draghi also currently serves his second three-year term as the Chairman of the GHOS. While members of the Executive Board participate regularly in a number of international financial fora and institutions,[191] the GHOS is of particular importance due to the pivotal role of the Basel Committee on Banking Supervision (BCBS). While the BCBS is not a formal supranational authority, and while the prudential rules it proposes are not legally binding for European financial institutions without further legislative action at the EU level, it nevertheless wields considerable power as the de facto global standard setter in the fields of banking regulation and supervision.[192] Moreover, once agreed at global level, diverging from these standards at European level carries costs, leading to a de facto 'lock-in' of rules at supranational level. Membership in the BCBS is restricted to central banks and banking supervisors from currently 28 jurisdictions.

Most recently, the fraught negotiations over reforms to the Basel 3 framework have cast a spotlight on the lack of transparency of the GHOS and the Basel Committee. While the Annual Report for 2015 does list the various subject areas in which ECB Banking Supervision was involved, the ECB provides no substantive information – in the annual report or elsewhere – about the nature of this involvement.

Regarding the general public, de facto transparency is inevitably limited by the sheer complexity of this policy area. However, the website of ECB Banking Supervision, the handling of enquiries from the general public and dedicated public conferences provide comprehensive information on its tasks and governance structure, including a section dedicated to non-technical explanations on different aspects of banking supervision.[193]

Policy transparency, in the area of banking supervision, is primarily a matter of public disclosure of supervisory methodologies and of micro-prudential supervisory data. In both areas, the transparency of ECB Banking Supervision is currently relatively low.

Regarding the publication of supervisory methodologies, the European Court of Auditors has deemed the information disclosed to supervised entities "not sufficient in all respects for a proper understanding of SSM methodology."[194] This is because the ECB currently publishes only short sections of the SSM Supervisory Manual, which defines the methodology behind the Supervisory Review and Evaluation Process (SREP), as well as the procedures for cooperation within the SSM and with other authorities. In terms of transparency, this practice puts the ECB in between the US, where supervisory manuals are published, and the UK, where they are not.[195] In a survey conducted by the Court of Auditors, just over half of the 69 responding banks (out of 129 that received the questionnaire) reported a perceived lack of transparency regarding the SREP methodology.[196] Expressing a similar concern, the European Parliament has also called for more transparency in this area.[197] As detailed by the ECB in its response to the report by the Court of Auditors, it has since published the SSM SREP Methodology Booklet, which addresses the legal basis and the methodology of the SREP process in a way that is "of more relevance for credit institutions than the internal Supervisory Manual."[198]

Regarding the disclosure of supervisory data, a recent survey notes that only "four of the 19 banking union countries make any individual bank data easily available online", and mostly only data on balance sheet size and capital.[199] Several countries have actually regressed on supervisory transparency over the past two years. In our interviews, ECB banking supervisors said that while their goal was to catch up with the US Federal Reserve and the Bank of England on the disclosure of supervisory data on individual banks, the need to get all NCAs on board is making this process a slow one.

In November 2016, the ECB began to publish more detailed banking supervision statistics on a quarterly basis. The data include information on banks' profitability, capital adequacy and the quality of their assets. While some of the statistics are broken down by country and by categories of banks, data on individual banks remain protected under Article 27 SSM-R and Articles 53 and 54 CRD IV.

Supervisory information on individual banks is disclosed, however, by the EBA as part of the transparency exercises and the stress tests, which over the past two years it has conducted on an annual basis (for 131 and 51 banks, respectively). The ECB, which conducts a parallel stress test, using the same methodology, on an additional 56 banks, has not disclosed the results for individual banks.

√ *We endorse recent calls for ECB Banking Supervision and national competent authorities to improve the disclosure of bank-level supervisory data, thereby following international best practice.*[200]

Another aspect of the stress test procedure that has attracted criticism concerns the lack of clarity on "how and when undercapitalised banks will be strong-armed into raising fresh equity."[201] Indeed, this lack of clarity created considerable confusion and friction in the context of the re-capitalisation of Monte dei Paschi di Siena, see Case Study II.

# ACCOUNTABILITY IN LAW

**The ECB's accountability is limited by the high degree of independence. Accountability is therefore limited to answerability, i.e. explaining its policies, vis-à-vis the European Parliament and the general public, as well as the European Ombudsman and Court of Auditors. Only the Court of Justice of the EU has enforceability, in cases of clear violations. In light of the risks involved in banking supervision, especially in the event of a bank failure, greater accountability is needed for banking supervision in particular.**

The ability of citizens to hold those in power accountable is the hallmark of democracy. Broadly speaking, three levels of accountability can be distinguished. The first and most direct mechanism is for politicians, whom citizens can hold accountable through elections. At the second level, officials in administrative bodies are unelected but directly accountable to democratically elected politicians who appoint, direct, and dismiss them. At the third level, however, a select few officials enjoy political and operational independence. Central bankers are prime examples – within the democratic mandate conferred upon them by the Treaty, they enjoy considerable independence. In the case of the ECB, members of the Executive Board are appointed by a democratically legitimated body (the Council) but subsequently act independently while being protected from dismissal. Crucially, however, the ECB's exemption from direct democratic accountability does not exempt it from indirect democratic accountability. On the contrary, a high degree of independence implies particularly exacting standards for ex post accountability. In the ECB's own words, "[i]ndependence and accountability are two sides of the same coin."[202]

**ACCOUNTABILITY: The concept that individuals, agencies and organisations (public, private and civil society) are held responsible for reporting their activities and executing their powers properly. It also includes the responsibility for money or other entrusted property.**

Accountability is a notoriously slippery concept. One widely cited definition distinguishes two dimensions – answerability and enforcement.[203] While the former is purely discursive – explaining and justifying one's actions – the latter involves being rewarded for good or punished for bad behaviour. The ECB's strong independence allows for enforcement only by the judicial authority, the CJEU. Its political accountability is limited to the dimension of answerability. This is reflected in the ECB's own definition of accountability as "being held responsible for one's decisions and being required to justify and explain them."[204] In short, while the democratic principle implies that independence and accountability must go together, a trade-off clearly exists between the two.

As explained above, a consensus formed during the 1980s that the monetary policy function should be shielded from political interference. Explicitly or implicitly, this consensus rests on the argument that gains in economic efficiency outweigh the lower degree of democratic accountability associated with independence (namely, the enforcement-dimension of accountability).

The establishment of ECB Banking Supervision raises the question whether the same argument can be made with regard to the banking supervisor, whose financial stability mandate is invariably broader and "fuzzier". In light of the potential fiscal implications of supervisory decisions – let alone the failure of individual banks – the arguments used in favour of separating monetary and fiscal policy do not necessarily work in support of the separation of the supervisory function from political oversight (which partly is reflected in the accountability framework for ECB Banking Supervision).

## GENERAL LEGAL FRAMEWORK FOR ACCOUNTABILITY

This section presents the legal accountability framework by asking four questions – who is accountable, to whom, what for, and through which process?[205]
Who is accountable? The Governing Council of the ECB, which acts as a single and collegial body, is jointly accountable. In practice, it is primarily the President and the members of the Executive Board who justify and explain the actions of the Governing Council.
The accountability framework does not provide for a mechanism to dismiss the President or the Executive Board, which can only happen through disciplinary action instituted by the Governing Council or by the Executive Board before the CJEU in cases in which the person in question "no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct."[206]

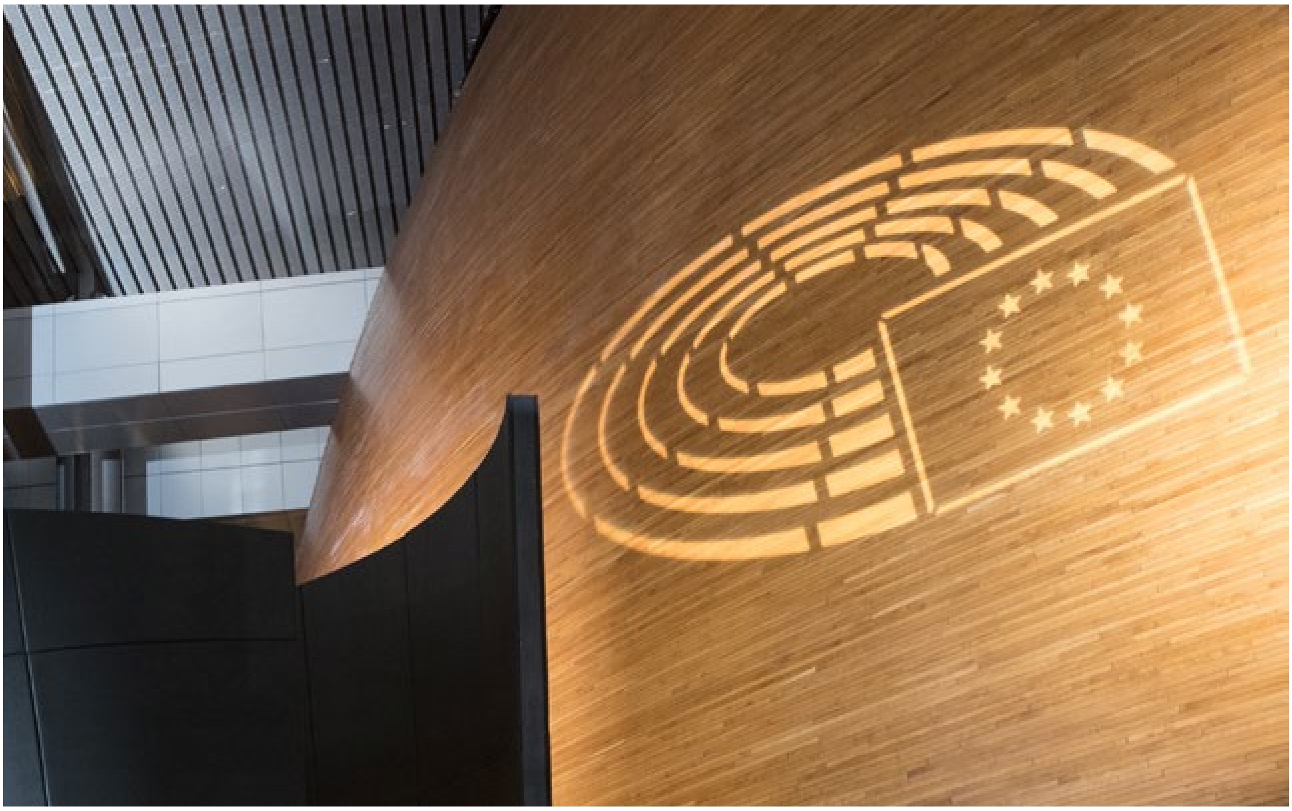
To whom is the ECB accountable? The democratically elected body mandated to hold the ECB to account is the European Parliament (EP). Importantly, while the accountability mechanism makes the ECB answerable to the EP, it does not grant the Members of the European Parliament any powers of enforcement. Other actors empowered by the law to hold the ECB accountable are the European Court of Auditors, the European Ombudsman and, more importantly, the Court of Justice of the EU (CJEU). These are discussed at the end of this section.

What is the Governing Council accountable for? As noted above, the ECB's independence is limited to those functions that are related to its mandate. The mandate consists of two hierarchically ordered objectives. The primary objective of the ECB is to maintain price stability. While the Treaty does not contain a quantitative definition, the Governing Council has specified the definition of price stability as "a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2 %."[207] This formulation is meant to be symmetrical, meaning both inflation above 2 per cent and deflation (i.e. an inflation rate below zero) are deemed inconsistent with price stability. In 2003, the Governing Council further specified its monetary policy strategy, announcing that it aimed "to maintain the inflation rate below, but close to, 2 % over the medium term".[208] This increased the symmetry of the inflation target, while allowing more flexibility regarding short-term fluctuations. To the extent that doing so does not interfere with its primary objective, the ECB is also mandated to "support the general economic policies in the Union".[209] Finally, another provision (which served as the basis for the SSM Regulation) mandates the ESCB to "contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system."[210]

This hierarchical formulation means that the ECB is accountable, above all, for its performance in maintaining price stability, and distinguishes the ECB from the US Fed, which has a dual mandate to promote both maximum employment and price stability.[211] What are the implications of the relative narrowness of the ECB's mandate for accountability? The ECB itself has pointed out that "the more clearly and precisely the objective is defined, the easier it is to monitor whether the ECB complies with it."[212] This was arguably true as long as conventional interest-rate setting was all there was to monetary policy. However, since the onset of the financial crisis the ECB has used unconventional monetary policy instruments in ways that have likely contributed towards the goal of price stability, but whose primary (intended) effects were to preserve the integrity of the euro area or to shore up the banking system. This seems to challenge the argument that it becomes easier to monitor the ECB's compliance with its mandate "the more clearly and precisely the objective is defined" – in other words, that the narrowness of its mandate strengthens the ECB's accountability.[213]

This latter point gains relevance in view of the consistent undershooting of the price stability objective in recent years. We would argue that a failure to publicly acknowledge that the ECB undershot its objective over a period of time that arguably exceeds the 'medium-term' indicates an accountability deficit. If the ECB fails to reach its objective, this should be addressed in an open and self-critical manner. In this case in particular, an ex post assessment could question what aspects of the ECB's policy framework and decision-making process contributed towards the ECB becoming the last major central bank to embrace quantitative easing.

Through what processes is the ECB accountable? Parts of the interaction between the ECB and the EP are based on informal rules, or soft law. They are sufficiently institutionalised, however, to be discussed in the Law section rather than in the Practice section. The ECB's formal Treaty obligations vis-à-vis the EP are limited to (a) the President presenting the ECB's annual report and (b) the President or Executive Board members appearing before the EP when called upon to do so.[214] The report is presented each year to the EP by the Vice-President of the ECB in a dedicated session of the Committee on Economic and Monetary Affairs (ECON Committee). The ECB President presents the report and attends the plenary debate on the European Parliament's resolution that evaluates the ECB's performance and responds to its Annual Report. This resolution is usually adopted over nine months after the year in question has ended. In addition, and beyond what is codified in the Treaty, the EP and the ECB have established three informal, soft-law mechanisms. First, the President of the ECB appears before the ECON Committee four times a year for what has been dubbed the Monetary Dialogue. During these meetings the President delivers an introductory speech on the ECB's monetary policy, taking into account the topics chosen by the Committee, which is followed by an open discussion during which the President answers the committee members' questions. The transcripts of these hearings are published on the website of the EP.[215] Second, other members of the Executive Board meet with the ECON Committee (sometimes in joint sessions with other committees) on specific topics. Third, MEPs have the option to submit mandate-related questions to the ECB (up to six per month), which the ECB answers in writing and within six weeks upon receipts.[216] Its answers, along with the questions, are also published online.[217] In practice, both the questions and the answers often leave key concepts unexplained



or unaddressed, often because questions go beyond the remit of the ECB's mandate.

Other accountability channels. In addition to these direct interactions with the EP, the ECB must comply with a number of reporting obligations, briefly mentioned above in the section on Transparency in law. Notably, the ECB must publish quarterly activity reports, weekly consolidated financial statements of the ESCB, and annual accounts.[218] In addition, the ECB's various transparency-oriented activities (see above) also support the accountability framework.

An external, private-sector auditor recommended by the Governing Council and approved by the Council of the EU audits the annual accounts to certify that they represent a true and fair view of the financial position of the ECB.[219] The accounts for 2015 were audited by Ernst & Young.

The mandate of the European Court of Auditors, an EU body, is limited by the ECB Statute to the "examination of the operational efficiency of the management of the ECB".[220] In recent years, however, the ECA has conducted audits that were somewhat broader in scope – a development that we welcome.[221]

The European Ombudsman acts as the complaints mechanism for citizens, receiving complaints regarding alleged instances of maladministration by the ECB.[222] Most cases involve citizens who file a complaint with the Ombudsman after their access-to-documents requests have been rejected by the ECB or who are not satisfied with the handling of their enquiries (see Transparency in practice section). However, the Ombudsman may also open inquiries into the ECB at its own initiative, as it has recently done in the case of the membership of Presidents Trichet and Draghi and involvement of other senior ECB staff in the Group of 30, a transnational private non-profit body comprising current and former central bankers and representatives of the private financial sector.[223]

Finally, the acts or omissions of the ECB are subject to judicial review by the EU courts.[224] Moreover, the CJEU has jurisdiction in cases in which national central banks' compliance with their Treaty obligations is in question.[225] The CJEU adopts a broad understanding of the scope of its judicial control that even includes – if they produce legal effects – policy statements on the ECB website.[226] The most important instance of judicial review concerned the ECB's Outright Monetary Transactions (OMT) programme, which is briefly discussed in the Practice section below.

## ECB BANKING SUPERVISION

The accountability framework of ECB Banking Supervision is set out in the SSM-R, which includes additional accountability obligations that go beyond the rules governing the ECB's accountability in its central bank functions. This more demanding framework reflects that the financial stability mandate of the ECB's supervisory arm is less specific than the price stability mandate of its monetary policy arm.

Who is accountable? The Chair of the Supervisory Board is appointed by the European Council and the EP. While she reports to these institutions in person, she cannot, in line with the principle of personal independence, be discharged by them.

Who is ECB Banking Supervision accountable to? The SSM-R states that "the ECB shall be accountable to the European Parliament and to the Council for the implementation of this Regulation".[227] In practice, when reporting to the Council, the Chair of the Supervisory Board reports to the Eurogroup in a setting that includes representatives from Member States participating in the Banking Union whose currency is not the euro (the so-called Banking Union composition).

What is ECB Banking Supervision accountable for? One of the main differences between the accountability frameworks of the two arms of the ECB lies in the specificity of their respective mandates. The mandate of ECB Banking Supervision is to contribute "to the safety and soundness of credit institutions and the stability of the financial system within the Union and each Member State". These tasks are to be fulfilled in a non-discriminatory manner and "with a view to preventing regulatory arbitrage."[228] It is clear that these objectives – and a recent report by the Basel Committee features a more comprehensive list of banking supervision objectives[229] – are less well-defined policy objectives than a numerical inflation target. Thus, given the nature of the task, supervisory objectives will inevitably "be broader and vaguer than monetary objectives."[230] Combined with the immediate impact supervisory decisions can have on individual credit institutions – and therefore on Member States – this places additional weight on the procedural aspects of the accountability mechanism.

Through what process is ECB Banking Supervision accountable? Mirroring the procedure for the ECB, ECB Banking Supervision discharges its accountability obligations through the reporting of the Chair of the Supervisory Board. However, whereas the President of the ECB reports in person only to the EP, the Chair of the Supervisory Board presents the annual report both to the EP (in a public session) and to the Eurogroup.[231] In addition, both the EP and the Eurogroup can request to hear the Chair on the execution of supervisory tasks, while the ECB is also required to provide oral or written answers to questions posed by these bodies.[232] Moreover, in cases where confidentiality is particularly important, the Chair's reporting obligations towards the EP may be discharged via closed-door discussions between the Chair of the Supervisory Board and the Chair and Vice-Chairs of the Economic and Monetary Affairs (ECON) Committee of the EP.[233]

An Interinstitutional Agreement spells out the details of the accountability mechanisms between the ECB and the EP. Relating to the protection of confidential supervisory information, for instance, it prescribes that no minutes shall be taken and no information divulged from confidential meetings.[234] It also specifies that the ECB shall provide records of the proceedings of the Supervisory Board that make the content of its discussions transparent to the members of the ECON Committee.[235]

Furthermore, both the Interinstitutional Agreement with the EP and a Memorandum of Understanding with the Council contain specific (and identical) requirements for the content of the annual report of ECB Banking Supervision. Most importantly, the annual report must explain the measures taken by the ECB to ensure the separation, mandated by the SSM-R, between monetary policy and supervisory tasks.[236]

Finally, and unlike the President of the ECB, the Chair of the Supervisory Board reports, within limits, to national parliaments. This provision partly takes into account the potential fiscal implications of supervisory failure at the national level, while also being in line with the more active role accorded to national parliaments under the Treaty of Lisbon.[237] Specifically, the SSM-R enables national parliaments to address "their reasoned observations" regarding the annual report to the ECB, to obtain written answers from the ECB to their questions, and to hear the Chair of the Supervisory Board for an "exchange of views in relation to the supervision of credit institutions in that Member State".[238]

Beyond reporting obligations, the requirement for the appointment of the Chair of the Supervisory Board to be confirmed by the EP provides another channel of accountability.[239] The ECB must inform the EP of the composition of the pool of applicants, its screening method and its shortlist. The chosen candidate appears for a hearing before the EP and must be approved both by the ECON Committee and by a plenary vote.[240]
Other accountability channels. The SSM-R extends the powers of the Court of Auditors to the supervisory activities of ECB, which the Court audits with regard to the operational efficiency of its management structures.[241] As part of the ECB, ECB Banking Supervision falls under the same rules regarding judicial review by the CJEU.[242] In addition, the SSM-R requires the European Commission to publish a comprehensive review, every three years, of "the application, appropriateness and effectiveness of the SSM's governance, accountability and financial arrangements, the effectiveness of the ECB's supervisory and sanctioning powers and the potential impact of the SSM on the functioning of the internal market."[243]

# ACCOUNTABILITY IN PRACTICE

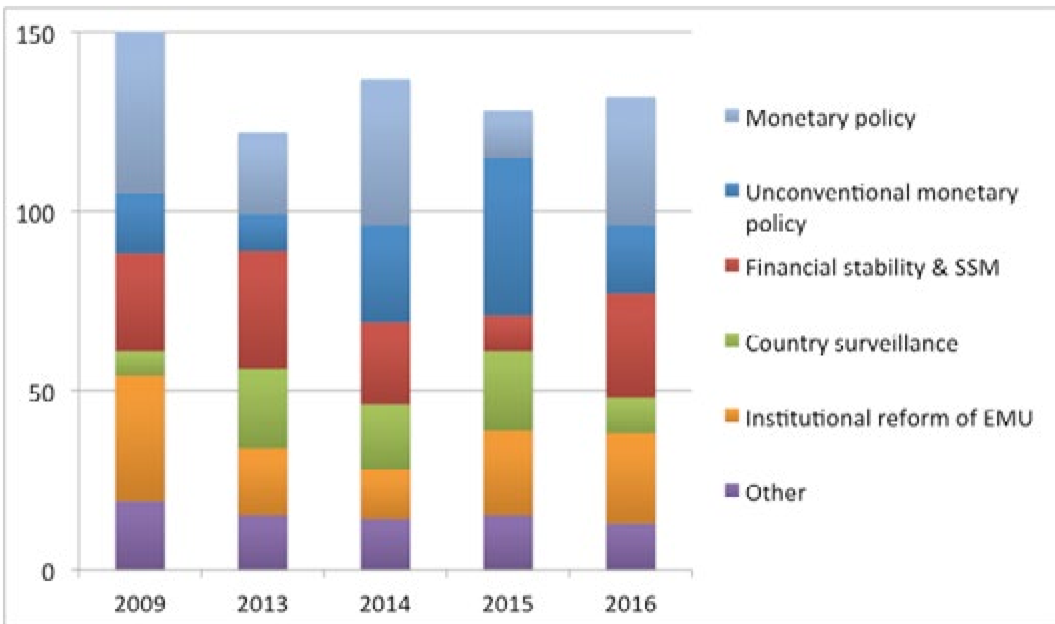
**In practice, the 'Monetary Dialogue' with the European Parliament is not exactly a 'grilling' of the ECB's leadership, with questions often focusing on areas outside of the ECB's direct control. The Courts have adopted a broad interpretation of monetary policy, meaning judges are unlikely to second-guess ECB decisions on the economy. In particular, the ECB needs to be held accountable over its contributions to global regulatory bodies such as the Basel Committee on Banking Supervision, and its participation in the 'Troika' of international creditors: the ECB should stop playing a formal role in the reform conditionality for 'bailout' countries.**

The central pillar of the ECB's accountability framework is the Monetary Dialogue with the European Parliament (EP). A team at the ECB's EU Institutions & Fora division is dedicated to the relations between the ECB and the EP. The Court of Auditors, the Office of the Ombudsman, and judicial review by the CJEU provide further accountability mechanisms.

## THE MONETARY DIALOGUE WITH THE EP

In the past, the Monetary Dialogue sometimes resembled a "dialogue des sourds" (dialogue of the deaf) in the sense that both sides would talk past each other. Based on different understandings of the ECB's mandate, Members of the European Parliament (MEPs) would mostly ask questions about growth and employment, while ECB would only talk about price stability.[244] This has since changed – MEP questions are now covering a "much broader area" than in the past.[245] This broadening of the Monetary Dialogue is evident from data we gathered from the transcripts from 2009 and 2013-16, shown in Figure 9. Without claiming 100 per cent accuracy for our classification, the number of observations is sufficiently large for individual classification errors not to invalidate the overall picture (n = 670 individual questions). Most notably, the data show that monetary policy, conventional and unconventional, accounted for less than half of MEPs' questions. By contrast, financial stability and supervision, country surveillance, and the agenda for institutional reform of EMU together account for roughly 50 per cent of MEPs' questions. In this context, we note that fully translated transcripts are only sporadically available for the eventful years of 2010-2012. The ECON Committee of the European Parliament should complete the archival record by publishing fully translated transcripts for these years.

**Figure 9**: Topics addressed by MEP questions in the Monetary Dialogue, 2009 & 2013-16




**Source**: European Parliament, transcripts of Monetary Dialogue meetings.[246]

The growing diversity of topics covered by the EP is visible also in the significantly increased number of written questions MEPs have sent to the ECB. While the 179 questions the ECB received in 2015 "exceeded the number of letters received during the entire previous parliamentary term", the majority concerned "non-standard monetary policy measures, the economic outlook and macroeconomic adjustment programmes."[247] The ECB responds in writing to all letters and (unlike the European Commission) publishes all of its responses.[248] In addition, ECB representatives participate in ad hoc meetings with EP rapporteurs on specific topics, often to explain the views of the ECB on pending financial legislation.

The remainder of this section selects three issues that have already been identified as relevant to the independence and transparency of the ECB, respectively – the ECB's role in transnational regulatory institutions; its role in the Troika (and thus its interaction with Member States and the Eurogroup); and the question of the scope and limits of its mandate in the context of the Outright Monetary Transactions case before the CJEU.

## THE ECB'S ROLE IN TRANSNATIONAL REGULATORY INSTITUTIONS

Regarding the ECB's role in transnational regulatory institutions, MEP Sylvie Goulard (ALDE) used the occasion of the Monetary Dialogue of September 2015 to ask President Draghi if, in the interest of improving the ECB's transparency and accountability, the ECB would "be prepared to tell us a little more about what it does on the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (BCBS)." President Draghi currently serves as the Chairman of the Group of Central Bank Governors and Heads of Supervision, the oversight body of the BCBS. In light of the on-going conflict between many European members and the US over the post-crisis reform of the Basel 3 regulatory framework, the ECON Committee has a legitimate interest in knowing more about the policies the ECB advocates in the BCBS negotiations. In his response, President Draghi seemed to acknowledge the legitimacy of that interest, stating that transparency in that area could indeed be improved but arguing that "[t]he ECB stands ready to inform the European Parliament and the ECON Committee about its positions in these organisations and also in any others." Following up on this Commitment, MEP Sven Giegold (Greens/EFA), sent a written question asking the ECB to provide a "list of all international fora, institutions, ad hoc groups and 'all the like' to which the ECB participated during last or this year in order to have a basis for this conversation."[249] In its response to Mr. Giegold, the ECB provided such a list, which also named the BCBS and FSB working groups the ECB has been involved in.[250]

Since then, however, only modest progress has been made in this area.[251] The Annual Report (Supervision) for 2015 explained that ECB Banking Supervision had become a member of the BCBS and had been granted a seat on the Standing Committee on Supervisory and Regulatory Cooperation (SRC) of the FSB. However, beyond noting that "ECB Banking Supervision has started to contribute to the work of the SRC", the report contained no information regarding substantive positions the ECB takes or advocates in either of these transnational bodies. Similarly, the Vice-President of the ECB addressed the issue in his presentation of the ECB's Annual Report (central banking) to the ECON Committee, but without explaining the substantive positions taken or advocated by the ECB at the FSB and the BCBS.[252] The ECB's active role in the standard-setting work of the BCBS and the FSB also reinforce the need for the ECB to join the EU's Joint Transparency Register.

√ *Given the lack of transparency and accountability of the BCBS and the FSB, the ECB should commit to the EP to report, both in the Monetary Dialogue and in its Annual Reports, on the substantive positions that the ECB advocates at the BCBS, the FSB, and in other transnational regulatory bodies.*

## THE ECB'S ROLE IN THE TROIKA

The second accountability issue concerns the ECB's role in the Troika, as established by the Two-Pack Regulation (Regulation (EU) 472/2013) as well as by the Council Regulation establishing the European Financial Stabilisation Mechanism (EFSM) and, subsequently, the Treaty establishing the ESM. Rather than assessing decisions or policies of the Troika, the purpose of the following discussion is to show the ECB's accountability framework in action in the context of an issue that has been sufficiently critical to involve the three main EU bodies that contribute towards that accountability framework – the Parliament, the Court of Auditors, and the Court of Justice. The central question concerned the precise distribution of decision-making powers within the Troika, and between the Troika and the Eurogroup.

Of the various actors that have weighed in on this question, the EP's ECON Committee was the first to put the question to the ECB directly. In September 2013, MEP Sylvie Goulard (ALDE) asked President Draghi "who in fact decides what measures are taken by the Troika? Are you just an advisor or is the Troika, which incidentally has no legal basis in the Treaties, a decision-making entity?" Pressed by Ms Goulard, President Draghi ultimately gave the following important response: "It is true that the Troika does not decide.

It is the Euro Group that decides, because it is the Euro Group that decides to finance the programmes. … So it is the Euro Group as the political institution – I think we can call it that – that decides on the programmes. The Troika, at least as far as the ECB is concerned, has an advisory role." It should be noted that the Eurogroup is not a formal institution but an informal consultative body with no decision-making powers. It is possible, however, that President Draghi was referring to the European Stability Mechanism's (ESM) Board of Governors, whose composition is identical with that of the Eurogroup.[253]

Indeed, the Two-Pack Regulation, the EFSM Regulation and the ESM Treaty assigned the ECB an advisory role by requiring the European Commission to consult with the ECB on the formulation – and subsequent assessment – of economic and financial adjustment programmes and policy conditions for programme countries.[254] The three main pillars of the accountability framework are reviewed below to assess how this advisory role played out in practice.

First, the ECON Committee, following up on the exchanges with President Draghi, conducted an enquiry on the role and operations of the Troika with regard to the programme countries. In its report, the Committee found the ECB's role in the Troika to be at odds with its mandate. It requested that "in any reform of the Troika framework the ECB's role is carefully analysed, in order to align it with the ECB mandate", and that "the ECB be given the status of a silent observer with a transparent and clearly defined advisory role while, not allowing it to be a full negotiation partner and discontinuing the practice of the ECB co-signing mission statements." Moreover, the report asked the ECB "to conduct and publish ex-post evaluations of the impact of its recommendations and its participation in the Troika."[255] The ECB answered the questionnaire contained in the ECON Committee's report of the report in a written statement that is available on its website.[256] Other answers to written questions related to the Troika are also available online. In addition, President Draghi addressed the ECB's role in the negotiation and monitoring of the macroeconomic adjustment programmes at last ECON Committee hearing of 2015.[257] Then and at other hearings, President Draghi answered MEPs' questions on the issue.

Second, the European Court of Auditors, in a special report on the Commission's management of financial assistance programmes entitled "Financial assistance provided to countries in difficulties", noted critically that the advisory role with regard to programme countries was "very broad".[258] It is noteworthy that the European Commission, in its written response to the audit, criticised that "[t]he role of […] the European Central Bank (ECB) in the preparation and monitoring of the programmes is underplayed."[259]

Third, the judicial review pillar of the accountability framework also addressed the ECB's role in the Troika. In principle, the CJEU, in its Pringle judgement, has confirmed the compatibility with the Treaties of the tasks conferred to the ECB under the ESM Treaty.[260] Subsequently, the Court's preliminary opinion in the Outright Monetary Transactions (OMT) case, spelled out the limits of this compatibility. Notably, in a scenario in which OMT (further details below) was activated, "it would, for that programme to retain its function as a monetary policy measure, 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."[261] The Advocate General's opinion thus saw the ECB's role in the Troika as compatible with its mandate as long as OMT was not activated for the Member State in question. This more lenient position was, if anything, further softened by the final OMT judgement, which lacked any reference to the Advocate General's opinion on the ECB's role in the Troika.

In summary, the parliamentary accountability mechanism declared the ECB's role in the Troika to be incompatible with its mandate, and the Court of Auditors criticised it as very broad. The judicial review mechanism, by contrast, did not take issue with the arrangement, which has been enshrined in secondary legislation. The following section discusses one important reason for the comparative leniency of the judicial review pillar of the accountability framework, which became evident in the CJEU's final judgement on the OMT case.

*The ESM Treaty and secondary legislation (the so-called Two-Pack Regulation)[262] should be changed to the effect that the ECB no longer plays a substantive role in the Troika and no longer co-signs mission review documents. In the context of the eventual inclusion of the European Stability Mechanism into the EU treaty framework, the ECB should be given no formal role in the negotiation and surveillance of reform conditionality associated with macroeconomic adjustment programmes.*

## THE OMT JUDGEMENT AND THE LIMITS OF JUDICIAL REVIEW

The OMT programme is the formalised version of President Draghi's July 2012 pledge that "within our mandate, the ECB is ready to do whatever it takes to preserve the euro".[263] The programme is designed to deter speculation against individual Member States by committing the ECB to sovereign debt purchases. Unlike quantitative easing, these purchases would have had "no ex ante quantitative limits" but, as a counterweight, would be subject to conditionality under an ESM programme.[264] Its effectiveness resting primarily on deterrence, the OMT programme put an end to the acute phase of the debt crisis without actually being activated.

The OMT case was first brought before the German Constitutional Court, which, in an unprecedented decision, referred it to the superior legal authority of the CJEU as the highest court in the EU.[265] The claimants voiced two main legal concerns, namely that the OMT programme formed an "ultra vires act" that was "not covered by the mandate of the ECB", and that the programme infringed the monetary financing prohibition of Article 123 TFEU.[266]

In its judgement, the CJEU staked its assessment of the legality of the OMT programme on whether it could be classified as a monetary policy measure. Crucially, the Court concurred with the ECB's understanding of OMT as a monetary policy measure that would primarily be geared towards safeguarding the transmission mechanism of monetary policy, the disruption of which would likely "undermine the singleness of monetary policy." [267] The CJEU confirmed the compatibility of OMT with the ECB's mandate by reiterating the key argument from its Pringle judgement, namely that "a monetary policy measure cannot be treated as equivalent to an economic policy measure merely because it may have indirect effects on the stability of the euro area."[268] In short, the Court decided that OMT qualified as a monetary policy rather than an economic policy measure. This classification was crucial for the judgement to be consistent with the Court's own case law, which defines the ECB's independence as "strictly functional", that is, limited to its price stability mandate.[269]

The position the Court developed in its Pringle and OMT judgements, while consistent, demonstrates the limits of judicial review as an accountability mechanism.[270] In order for the overnight interbank interest rate in the interbank money market – which the ECB indirectly controls – to actually affect consumer prices, it must feed through the money market, the capital market, the labour market, and the market for goods and services. In other words, the transmission mechanism of monetary policy effectively encompasses the entire economy. This absence of any clearly defined boundary to the price stability mandate that would limit the topics on which the ECB can publicly state its positions was also addressed in the Monetary Dialogue on 26 September 2016.[271] To put it succinctly, and perhaps provocatively, by accepting the ECB's transmission mechanism argument, the Court effectively relinquished judicial review as a mechanism to hold the ECB accountable for potential ultra vires acts.

The CJEU has thus put the accountability ball back in the legislative court with the Council, the Commission, and the EP. Indeed, it should not be the task of one independent institution to enhance the democratic legitimacy of another independent institution. Instead, strengthening the accountability framework must involve strengthening the rights of the EP or an equivalent parliamentary chamber for the euro area. Initial improvements can be achieved within the existing Treaty framework and CJEU case law, both of which already construe the ECB's independence in functional terms, that is, as limited to the powers, tasks and duties conferred upon it by the Treaties. Neither Treaty law nor case law should therefore prevent the Council and the EP from reviewing, and potentially tightening, the rules regarding the ECB's accountability in policy areas that are crisis management-related and reasonably remote from conventional, price stability-oriented monetary policy or from supervision.

√ *The usefulness of the legal framework of monetary policy can change when the environment in which that framework is embedded changes. The ECB's principals – the Council (effectively the Eurogroup) and the European Parliament – should establish a high-level commission to re-assess the accountability framework of the ECB in light of the recent changes in the economic, political, and institutional landscape of the euro area, and to submit concrete legislative proposals. This commission could be co-chaired by the Chair of the ECON Committee and the President of the Eurogroup, representing the 19 fiscal authorities. The membership should include, but not be limited to, central bankers and financial professionals.*

As for measures that would require the Treaties to be amended, we recommend

√ *that the EP, via the ECON Committee, should be given confirmation power in the appointment process for Executive Board members. This provision should specify the purpose of parliamentary hearings to determine the competence and integrity of candidates in a non-partisan way.*

## ECB BANKING SUPERVISION

As described above, the accountability framework for ECB Banking Supervision resembles but goes beyond that of the monetary policy arm. Discharging her accountability obligations towards the EP, the Chair of the Supervisory Board appeared before the ECON Committee for the presentation of the ECB's 2014 Annual Report on supervisory activities, two ordinary public hearings, and two ad hoc exchanges of views. One of the topics discussed was the Supervisory Review and Evaluation Process (SREP). Echoing the assessment of the European Court of Auditors (see Transparency in practice), the EP called for transparency regarding the SREP and, as a first step in this direction, suggested that the ECB publish a list of Frequently Asked Questions on the SREP.[272] The ECB followed up on this suggestion.[273] Another relevant statement by the EP, published in its response to the ECB's annual report on monetary policy, concerns the division of responsibilities between the ECB and the European Banking Authority (EBA). Here, the EP stressed that "the ECB should not become the de facto standard-setter for non-SSM banks."[274]

In addition to the face-to-face interactions at the EP, the ECB published 26 replies to questions from MEPs on supervisory matters. Among the topics covered in these exchanges were the 2014 comprehensive assessment of banks' financial health, the proportionality of supervisory decisions and specific risks for supervised banks.[275] In accordance with its Interinstitutional Agreement with the EP, the ECB also transmitted the (otherwise confidential) proceedings of its Supervisory Board meetings to the ECON Committee. Following feedback from MEPs that the proceedings were too technical to process for non-experts, the ECB switched to transmitting longer and more explanatory proceedings.[276] Assessing the overall process in its annual report on Banking Union, the EP has welcomed "the efficient and open way in which the ECB has so far fulfilled its accountability obligations towards Parliament."[277]

In accordance with the ECB's Memorandum of Understanding with the Council, the Chair of the Supervisory Board also met with the Eurogroup (in Banking Union composition) twice – to present the 2014 Annual Report on supervisory activities, and for an exchange of views on topics including the implementation of the supervisory framework, the 2015 comprehensive assessment, and the harmonisation of the national options and discretions available under the Capital Requirements Regulation (CRR)[278] and the CRD IV.[279] In the context of the latter, the ECB's supervisory practice is likely to lead to de facto administrative rule making for the Banking Union. Here, further accountability mechanisms need to be developed.


In addition to the EP and the Council, the CJEU (no major cases to date), the European Commission, and the European Court of Auditors also fulfil important accountability functions. The first review report, due by 31 December 2015, has been delayed. The ECB was first approached for information in July 2015. The two institutions only concluded a Memorandum of Understanding on the provision of non-public information in November 2015, following which the ECB finalised the provision of information in response to the Commission's request on 16 December 2015. Following a more detailed request in February 2016, the ECB submitted additional information on 19 April 2016. The Commission did not receive the requested bank-specific information (dataset of banks to assess supervisory fees), as the ECB raised concerns regarding secrecy.[280]

The account in the preceding paragraph is gleaned from the SSM report by the European Court of Auditors, with additional input from the ECB. In addition to the transparency concerns mentioned in the Transparency in practice section, the ECA report points to the absence of a performance framework that would allow the general public to assess the performance of banking supervisors under the SSM. The ECB has already developed such a tool, but it is currently available only to the Supervisory Board and to senior management.[281]

√ *In order to enable outside stakeholders to assess the extent to which ECB Banking Supervision achieves its objectives, the ECB should create a public version of the SSM Supervisory Dashboard Pilot, which is currently available only to the Supervisory Board and to senior management.*

# CASE STUDY 2. Fine-tuning Greece: Emergency Liquidity Assistance (ELA)

**This case study zeroes in on questionable arrangements that the current euro area institutional architecture has given rise to. After years of austerity and structural reforms, a new Greek government attempted to renegotiate the 'bailout' in 2015, leaving Greek banks at the mercy of the Eurosystem's Emergency Liquidity Assistance. Our case study shows that this allowed the ECB's Governing Council to squeeze Greek banks as part of negotiations between the Greek government and the Troika of international creditors, potentially causing a disorderly "Grexit".**

The standard procedure by which banks in the euro area receive central bank credit is through the open market and credit operations of the Eurosystem, as specified in the ECB Statute.[282] In order to participate in these operations, banks need to post collateral with the Eurosystem. From the perspective of the Eurosystem, this serves a risk-management purpose – if a bank defaults on its debts to the central bank, the latter retains the collateral. In order for this to work, the collateral must be "adequate", that is, of a certain minimum quality.[283] In exceptional circumstances, however, particular banks or banks in a particular country may not hold enough collateral that meets these eligibility criteria of the Eurosystem. This is where emergency liquidity assistance (ELA) comes in. ELA is a separate procedure that allows solvent credit institutions that are facing temporary liquidity problems to borrow directly from their national central bank (NCB).

While ELA itself is not mentioned in the Treaties, Article 14.4 of the ECB Statute provides that NCBs can "perform functions other than those specified in this Statute." This provision contains two conditions. First, such functions "shall be performed on the responsibility and liability of national central banks" and are not part of the single monetary policy. That is to say ELA loans appear only on the balance sheet of the respective NCBs, which carry the risk on these transactions. Second, the Governing Council, with a majority of two thirds of the votes cast, can stop any NCB activities, including ELA, which it judges "interfere with the objectives and tasks of the ESCB."

It can be difficult, amid the legal arcana of ELA, to tell the forest from the trees. In public, the ECB has emphasised that ELA is a responsibility of NCBs, and that Article 14.4 assigns to the Governing Council the responsibility to restrict ELA operations if it considers that these operations interfere with the objectives and tasks of the Eurosystem. However, the peculiar architecture of the monetary and financial system of the euro area means that whoever calls the shots on ELA – under circumstances similar to those prevailing in Greece in 2015 – is calling the shots on the euro-area membership of the country in question. No other central bank in the world holds that power – no decision by the US Fed could result in the ejection of a state from the Union. Given that the alternative – letting politicians call the shots on other countries – seems even less desirable, our proposals for greater transparency and accountability will be based on the assumption that the Eurosystem will continue to act as the lender of last resort to euro area banks.

The first section recounts how the Greek ELA crisis unfolded in the summer of 2015. The second section reviews the ELA decision-making process and discusses who carries legal and political responsibility for ELA. The conclusion reviews recent developments and makes concrete suggestions for a more transparent and accountable lender-of-last-resort function for financial institutions in the euro area.

## WHAT HAPPENED IN THE SUMMER OF 2015? AND HOW DID GREECE AND THE ECB GET THERE?

ELA played an important role during the protracted financial crisis in the euro area. Between 2010 and 2014, ELA had been extended to banks in Ireland, Greece, Cyprus, and Portugal. The most dramatic episode, however, occurred in the summer 2015 in Greece. The following timeline of the lead-up to that episode puts the events of that summer in context.

- In May 2010, the ECB temporarily suspended the application of the minimum-rating threshold for "debt instruments issued or guaranteed by the Greek government".[284] In other words, it granted a waiver for Greek government bonds. This followed the agreement on an economic and financial adjustment programme, which Greece had negotiated with the European Commission, in liaison with the ECB and the International Monetary Fund. The Governing Council's decision to suspend the credit quality threshold was based on its positive assessment – also from a risk management perspective – of the adjustment programme and of the commitment of the Greek government to implement it. The decision allowed Greek banks to use Greek government bonds as collateral in ECB refinancing operations at a time when rating agencies had downgraded Greek debt to junk-bond status.

- In February 2012, after further downgrading of Greek debt by rating agencies (which occurred in anticipation of the March 2012 debt restructuring)[285], the ECB revoked the waiver for Greek sovereign bonds on the basis of Article 18.1 of the ESCB Statute, which requires that ECB lending to credit institutions be "based on adequate collateral".[286] In a statement that appears to be at odds with the narrative that ELA is, at base, a national responsibility, the ECB simultaneously announced that "the Governing Council decided that the liquidity needs of affected Eurosystem counterparties can be satisfied by the relevant national central banks, in line with relevant Eurosystem arrangements (emergency liquidity assistance)."[287]

- In March 2012 the Governing Council acknowledged the activation of the collateral enhancement scheme, agreed by the Heads of State or Government of the euro area on 21 July 2011 and confirmed on 26 October 2011. In light of this, the Governing Council reinstated the waiver for Greek sovereign bonds.[288]

- In July 2012, due to the expiration of the buy-back scheme for marketable debt instruments issued or fully guaranteed by Greece, the Governing Council revoked the waiver, again making Greek government bonds ineligible for use as collateral in Eurosystem monetary policy operations.[289]

- In December 2012, the ECB reinstated the waiver, following a "positive assessment" by the Troika institutions of "the policy package for the first review under the Second Economic Adjustment Programme for Greece", including measures implemented by the Greek government in the areas of fiscal consolidation, structural reforms, privatisation and financial sector stabilisation.[290]

- On 4 February, 2015, based on the assessment that a successful conclusion of the programme review could not be expected, the ECB revoked the waiver again. The ECB explained that banks that lacked sufficient collateral for standard monetary policy operations could obtain liquidity from their respective NCBs by means of ELA.[291] In practice, this statement applied mostly to Greek banks, which at that point held the majority of Greek government bonds that remained in private ownership.

In light of concerns over the conclusion of the on-going review in the context of Greece's second macroeconomic adjustment programme – the Syriza-led government had threatened to leave the programme – the waiver had already been due to expire on 28 February (as stated in the ECB's Annual Report 2015). Some observers therefore interpreted the decision to have the waiver expire two weeks earlier as a "warning shot to Athens, and to eurozone leaders, to agree a new deal as soon as possible".[292] The political dimension of the decision was reinforced by the fact that the Governing Council was reportedly "fairly evenly split" at a moment when, under the system of rotating votes, the non-voting central bank governors were those of Greece, Cyprus, Ireland, and France, which arguably shifted the balance against Greece. At the time of the vote, Greek banks were already borrowing under ELA to cover their liquidity needs.[293]

Over the following months, Greek banks borrowed from the Bank of Greece by means of ELA. For several months, ELA borrowing steadily increased in step with continuous capital flight. In fear of the currency depreciation that would inevitably follow a potential "Grexit", depositors withdrew cash and transferred deposits abroad in what became a slow "run" on the Greek banking system. The ECB's "ELA Procedures" state that if total volumes exceed €500 million – as was the case in Greece – NCBs must report their ELA operations in advance to the ECB.[294] Moreover, the same document specifies that the Governing Council may decide to set a ceiling, beneath which it would not object to intended ELA operations for a specified period of time. For several months, the Governing Council kept raising that ceiling. These decisions were not publicly announced by the ECB, but were regularly reported by the financial press based on information from sources at either the ECB or the Bank of Greece. [295] The lack of transparency and the resulting uncertainty for Greece, which gave the ECB and the other institutions considerable leverage, constitute the most problematic aspect of the Greek ELA episode. They are a direct consequence of the decentralised architecture of ELA.

By late June 2015, the existing macroeconomic adjustment programme was off-track. The Troika made a new programme proposal on 25 June, but the Greek government broke off negotiations the following day. The Prime Minister announced that a referendum would be held on 5 July to approve or reject the Troika's new proposal. The Greek stock market closed on 27 June. On 28 June, the Governing Council, using its veto right under Art 14.4 of the Statute, decided not to increase the ELA ceiling for Greek banks. It should be noted that this decision did not amount to a withdrawal of ELA or a request for an immediate repayment. In its annual report, published many months thereafter, the ECB explained that it had taken this decision in the context of "the decision by the Greek authorities to hold a referendum and the non-prolongation of Greece's second macroeconomic adjustment programme … [having] a negative impact on the adequacy and sufficiency of assets used by Greek banks as collateral for ELA operations with the Bank of Greece."[296] Faced with increasingly rapid capital flight and without a new EU/IMF adjustment programme, the Greek government and the banking sector holding the Greek government debt were at risk of becoming insolvent. The ECB's rules do not allow ELA to be provided to insolvent financial institutions.

The need to stop liquidity outflows from the banking system led the Greek government to impose, on the very same day of 28 June, a bank holiday. Because the "financial situation in Greece deteriorated further in the following days", the Governing Council, on 6 July, citing Article 14.4, re-affirmed that the ceiling would not be lifted. In a decision motivated by risk-management considerations – the market value of Greek government-related marketable assets had fallen – the Governing Council also instructed the Bank of Greece to raise the haircuts it applied to these assets.[297]

On 16 July, four days after a Euro Summit had agreed on a third macroeconomic adjustment programme for Greece, the Governing Council decided not to object to an increase of the ELA ceiling. The liquidity situation of the Greek banking system stabilised, but even after banks reopened on 20 July, Greek authorities only gradually reduced restrictions on cash withdrawals and capital transfers. One year later, in June 2016, the ECB reinstated the waiver of minimum credit rating requirements for Greek government debt, acknowledging "the commitment of the Greek government to implementing [the] current ESM programme."[298]

## WHEN PUSH COMES TO SHOVE, THE ECB CALLS THE SHOTS ON ELA

The semi-decentralised structure of ELA gives rise to a two-tiered lender-of-last-resort function that is unique to the euro area. Although not formally mandated to do so, the ECB has – as central banks should – acted as the lender of last resort to the banking system of the euro area, especially in the wake of the collapse of Lehman Brothers.[299] But the ECB is not the ultimate resort – under ELA, the lender of ultimate resort in the euro area are the NCBs. They act on their own risk but within the limits of Art 14.4, which allows the Governing Council to object to activities that it deems interfere with the tasks and objectives of the ESCB. This dual structure – which the Director General Legal Services and the Chief Economist of the ECB have acknowledged, albeit using different terminology[300] – creates a jurisdictional problem.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In legal terms, the jurisdictional problem with ELA follows from Art. 14.4 ECB Statute. Technically, ELA is a responsibility of the NCB in question. The Governing Council can revoke the NCB's right to provide ELA only if there is an interference with the "objectives and tasks of the ESCB". In practice, however, such interference will often be a realistic scenario. This is because the need to resort to ELA arises only once domestic banks lose access to the official refinancing operations of the Eurosystem, generally because the assets on their balance sheets do not meet the collateral eligibility criteria of the Eurosystem.

From that moment onwards, there is a risk that ELA is granted to banks that are actually insolvent. Such lending would both pose a threat to financial stability and constitute a breach of the Treaty obligation to "act in accordance with the principle of an open market economy with free competition", which applies to both ECB and NCBs.[301] The provision in the "ELA Procedures" – which the ECB had laid down already in 1999 but made public only in October 2013[302] – that ELA can only be granted to solvent credit institutions is therefore not at the discretion of the Governing Council, but follows directly from the Treaties.

Therefore, from the moment it had suspended the waiver for Greek government-related marketable assets, the ECB faced an irresolvable dilemma. In order to be able to continue raising the ELA ceiling in the context of the rapidly deteriorating Greek economic and financial situation, the Governing Council would have had to make the case that Greece's banking system and its government were solvent and that Greek banks had enough collateral of sufficient quality for increased ELA borrowing. On the other hand, maintaining the ceiling on ELA for just a few days longer (beyond 16 July 2015) would likely have forced Greece out of the euro area.[303] With neither of these alternatives acceptable to the Governing Council, the ECB ended up tiptoeing between a rock and a hard place until a new adjustment programme was agreed, which stabilised the financial situation of the Greek government and banking sector.

The key take-away is that the roots of the high-profile involvement of the ECB in the political negotiation process over the Greek adjustment programme lie not in Greece but in the legal framework of ELA. The possibility that the scenario that played out in Greece in 2015 might repeat itself is real. Not only are Greek banks still borrowing under the ELA procedure, but in February 2017 the volume of these loans has also seen its first increase since June 2016.[304] This has occurred in the context of yet another standoff between the Greek government and its creditors over the second review of the third adjustment programme.[305] Preventing a repetition of an ELA crisis – in Greece or elsewhere – will require an overhaul of the ELA framework. Any future procedure needs to acknowledge that under certain circumstances a decision to restrict or even revoke ELA may be tantamount to pulling the plug on a country's membership in the euro.

## REDUCING TECHNOCRATIC DISCRETION, INCREASING ACCOUNTABILITY

The first step towards greater transparency has already been made when, in October 2013, the ECB published the two-page document that contains its ELA Procedures (subsequently amended in February 2014).[306] The Procedures specify a list of nine items on which NCBs must provide information to the ECB within two business days after an ELA operation.[307] The Procedure also notes that if "the overall volume of the ELA operations envisaged for a given financial institution or given group of financial institutions" exceeds €2 billion, this will automatically trigger a review by the Governing Council of whether that operation interferes with the objectives or tasks of the Eurosystem.

The ECB's decision to publish its ELA Procedure was preceded by the report of the European Parliament on the role of the Troika, which also contained two ELA-specific recommendations. First, the EP called on the ECB and the NCBs "to publish comprehensive information on ELAs in a timely fashion."[308] Second, the report criticised the ECB's concept of solvency – which is at the heart of the ELA review process – for "lacking in transparency and predictability", and called on the ECB to update its guidelines in that respect.[309] The EP repeated this call in its response to the ECB's 2015 Annual Report, which explains that the lack of "a sufficient level of clarity and legal certainty" in the ECB's concept of insolvency stemmed from the fact that the ECB had "referred alternately to a static concept of solvency (based on whether a bank complies with minimum capital requirements at a certain point in time) or to a dynamic concept (based on forward-looking scenarios of stress tests) for justifying the continuation or limitation of emergency liquidity assistance (ELA) provision."[310]

Addressing the first recommendation, the ECB issued a decision that gave NCBs "the option to communicate publicly about the provision of Emergency Liquidity Assistance (ELA) to the banks in their country."[311] By contrast, the ECB has not yet heeded the EP's call to make the insolvency criterion more transparent. Indeed, the ambiguities built into the lender-of-last-resort function pose obstacles for resolving the ELA problem through greater transparency alone.

In our view, the establishment of the SSM constitutes a game changer with regard to how ELA should be organised.[312] Centralised ECB responsibility for the supervision of significant credit institutions should be accompanied by centralised last-resort lending to these institutions.

√ *Conditional on the completion of Banking Union, the co-existence of a lender of last resort and 19 lenders of "ultimate" resort should be ended for significant credit institutions under direct ECB supervision. The ECB is now the central bank of the euro area and the supervisor of significant credit institutions. As such, it should act as the designated lender of last resort. Centralising the lender-of-last-resort function would simplify the process and thereby increase both transparency and accountability.*

# INTEGRITY IN LAW

**The ECB's integrity framework is based on three lines of defence, and was recently upgraded with a new Ethics Framework and a dedicated governance and compliance unit. Regular audits and an Audit Committee complete the picture. At present, Governing Council members do not file declarations of interests and assets, cooling-off periods against 'revolving-door' appointments are patchy and shorter than they should be, the whistleblowing policy is fragmented, outdated and needs urgent updating.**

The integrity framework of the ECB is based on a three-layered functional approach that consists of "three lines of defence": (1) operational management; (2) special functions (control, compliance and oversight); (3) the Internal Audit Committee.

## GENERAL LEGAL FRAMEWORK FOR INTEGRITY

### FIRST LINE OF DEFENCE

On a day-to-day basis, each organisational unit (Section, Division, Directorate or Directorate General) has primary responsibility for managing its own risks, as well as for ensuring the effectiveness and efficiency of its operations.

Members of ECB decision-making bodies are bound by several sets of rules. The ECB Statute establishes serious misconduct as a reason to remove members of the Governing Council from office and prohibits members of the Executive Board from engaging "in any occupation, whether gainful or not."[313]The Code of Conduct for members of the Governing Council and the Supplementary Code of Ethics Criteria for the members of the Executive Board contain strict rules regarding the acceptance of gifts and prohibit the use of confidential information for personal gain, including insider trading, but do not foresee the publication of declarations of assets or financial interests.[314] This is in contrast to members of the European Commission, the European Parliament and the European Investment Bank's Management Committee, who all file such public declarations. The first Code applies also to any accompanying person who is present at the meetings of the Governing Council.[315]

√ *Members of the Governing Council and in particular the Executive Board should file public declarations of interests and assets.*

The ECB's ethics rules, which were introduced in 1998, received a major upgrade in 2010 with the introduction, and inclusion into the Staff Rules, of the Ethics Framework. Subsequently, the 2014 SSM Regulation contained a provision that required the Governing Council to "establish and publish a Code of Conduct for the ECB staff and management involved in banking supervision concerning in particular conflicts of interest". This requirement, amongst others, was reflected in an enhanced ethics framework that entered into force in January 2015.[316] It is part of the Conditions of Employment and Staff Rules that apply to all staff and management. The Ethics Framework among other things prohibits any transaction concerning securities, bonds or shares of private banks and any financial corporation established in the EU.[317]

The Ethics Framework obliges all staff to "adhere to the highest standards of professional ethics and act with loyalty to the Union and the ECB".[318] Interestingly, it was only the insistence of the Office of the European Ombudsman that led to the inclusion of "the Union" in that phrase. The Ombudsman had admonished the original phrasing, arguing that "members of staff may find themselves in a situation of having to report serious irregularities outside the ECB, for example to the Ombudsman or to OLAF."[319] The final phrase therefore requires staff to be loyal both to the ECB and to the Union. Among other provisions, the Ethics Framework prohibits staff from accepting gifts from the private sector, with an exception for situations which would cause an offence or put the professional relationship at risk. In these cases, staff must report and hand over any gift to the ECB. Advantages of any kind are prohibited. Hospitality, which under some circumstances can be accepted, cannot be accepted from suppliers or from any supervised entities. In situations in which rejecting a gift would cause an offence or put the professional relationship at risk, staff must report and hand over the gift to the ECB.[320]

The four areas that are of particular interest for the present report are cooling-off periods for "revolving-door" appointments, whistleblowing rules, lobbying, and insider trading.

## COOLING-OFF PERIODS FOR "REVOLVING-DOOR" APPOINTMENTS

The Ethics Framework sets out detailed rules for cooling-off periods for staff who, after leaving the ECB, seek employment in the private sector. It is widely recognised that banking supervision is particularly vulnerable to regulatory capture, inter alia via the "revolving door". Specifically, officials may need to take critical decisions affecting the financial health and reputation of firms that are possible future employers. By the same token, a former supervisory official may be tempted to make use of privileged information or access in the interest of the firm. Accounting for a banking supervisor's increased risk of conflicts of interest, the new Ethics Framework regulates conflicts of interest more strictly than the rules that had previously been in place, following amendments to the SSM-Regulation by the European Parliament, as well as Transparency International's recommendation from 2013.[321] The length of cooling off periods varies between functions and salary bands, for 3-12 months for non-supervisors. In the majority of business areas of the ECB, members of staff who were employed for at least six months and are at salary band I or above (Head of Section, Adviser, Deputy Head of Division, or higher), "may only start working for a financial corporation established in the Union after the expiry of three months from the date on which their work in these business areas ceased",[322] with longer cooling-off periods for payment systems (6 months), selection of suppliers (6-12 months depending on contract size, with the cooling-off period only applicable for the supplier in question). Former members of staff have to respect a 6-months cooling-off period before lobbying the ECB in subject areas they previously worked on.[323] In comparison, the EU Staff Regulation foresees cooling-off periods for "senior officials" (Directors and Director-Generals and their equivalent salary bands) of up to two years, and includes the obligation to publish at least once a year lists of revolving door cases assessed.

A cooling-off period of one year applies to the members of the Governing Council.[324] This, too, compares unfavourably to the European Commission, whose members are subject to a two-year cooling-off period, and three years for the President.[325] The ECB's Executive Board may exceptionally waive the cooling-off periods, upon a request by the member of staff to the Compliance and Governance Office (see below).

√ *Members of the ECB Governing Council and senior ECB officials should be subject to a cooling-off period of two years, as foreseen in the EU Staff Regulation and the Code of Conduct for members of the European Commission.*

√ *Post-employment rules should be governed by the Ethics Committee, rather than the Executive Board.*

The rules on cooling-off periods also apply to temporary staff who, like regular staff, may also apply for generous unemployment allowances from the ECB for up to two years if cooling-off periods prevent them from finding alternative employment in the private sector.[326]

Rules on cooling-off periods for supervisory staff are discussed in the next section.

## WHISTLEBLOWING RULES

The rules governing ECB internal administrative inquiries are set out in an Administrative Circular on Internal Administrative Inquiries issued in 2006 by the Executive Board,[327] and has not been published proactively by the ECB. The circular obliges all managers and encourages all staff members to report any potential breach of professional obligations to the competent senior manager. Staff members may request that their anonymity is maintained when reporting a breach, but will always have to disclose their identity to the manager they are approaching, typically the Director of Internal Audit. The circular provides that the purpose of an administrative inquiry is to clarify the facts, without prejudice to any disciplinary procedure.

In addition, the ECB is obliged to report to the European Anti-Fraud Office (OLAF) any information which gives rise to a suspicion of the existence of possible cases of fraud, corruption or any other illegal activity affecting the Union's financial interest.[328] A 2016 ECB decision on the terms and conditions for OLAF investigations states that if a staff member becomes aware of any information giving rise to suspicion about the existence of possible cases of fraud, corruption, etc. he or she have a "duty to report" without delay to either the Director of Internal Audit, the senior manager in charge, or the relevant member of the Executive Board.[329] The same provision also states that whistleblowers "must in no way suffer inequitable or discriminatory treatment as a result of having communicated the information referred to in this Article."

Finally, the 'Implementation practices' of the new Eurosystem Ethics Framework, adopted on 12 March 2015, also contain guidance concerning the reporting of compliance incidents, including the recommendation for NCBs to "define clearly how their staff should report cases of non-compliance" – an area in which the ECB, too, could improve.[330] The guidance goes on to note that local rules should include whistleblowing, defined as "direct reporting to the compliance function or to a third body if the regular reporting channels cannot be used". The guidance states that while a whistleblower's identity must be protected, anonymous reports should be discouraged.

While these provisions reflect some of the practices required to encourage whistleblowers to come forward, they are not sufficient. The whistleblowing procedure is not immediately recognisable as such ('Administrative Circular'), and cannot be found online. Extensive searching of ECB websites and registers yields no documents that contain a description of the procedure whistleblowers may follow, nor what to expect in terms of inquiries opened, timelines to be followed, etc. The ECB decision on modalities of cooperation with OLAF is not a substitute for a detailed whistleblowing policy. In addition, the Administrative Circular dates from 2006 and predates current best practices on whistleblowing.[331] Since hierarchical institutions tend to reward uncritical behaviour, ensuring an institutional culture that encourages whistleblowing is difficult. The ECB adopted policies on whistleblowing early on, but the real test is how the whistleblowing culture works in practice. The ECB should endeavour to make sure staff are aware of whistleblowing options, and should continually adapt these to keep pace with modern standards. Making sure the whistleblowing procedure is easily understood and well known is a first step towards ensuring that the procedures are indeed followed.

In particular, prospective whistleblowers who fear reprisals should always have at least the option to report anonymously, which means the proactive provision of an anonymous reporting form via the ECB's intranet and even public website. The burden of ensuring anonymity should not fall on the whistleblower, as is currently the case. While anonymous reporting should not be the norm, it must be an option, in particular in institutions that have not yet successfully instilled a healthy whistleblowing culture. Any whistleblowing report has to be verified and corroborated regardless of anonymity, thus reducing the risk of baseless or slanderous reports. Once a report is made, the whistleblower should receive a reasoned response as to whether an inquiry is opened. By updating the whistleblower about the outcomes of the inquiry, the whistleblower is made a part of the complaint. Lastly, whistleblowing rules should more clearly extend beyond fraud, corruption and illegal activity harming the Union's financial interests, to cover cases of insider trading, incompetence, and conflict of interests. Cases uncovered thanks to whistleblowers should furthermore be disclosed to staff, so as to encourage a culture of reporting on potential problems.

√ *The ECB should overhaul its whistleblowing framework, adopting a clearly identifiable and public whistleblowing policy, which sets out in detail how reports will be inquired, includes the option to report anonymously and follows international best practices to incentivise prospective whistleblowers.*

## LOBBYING

Article 3.5 of the Code of Conduct for members of the Governing Council foresees that members only meet interest groups based on "an approach that is compatible with their independence" and the "the principle of integrity". This represents an insufficient level of protection from undue influence by interest representatives. In view of the ECB's discretion in supervisory practices, the wide-ranging impacts of its quantitative easing and corporate bond purchase schemes, and its role in global regulatory bodies such as the Basel Committee on Banking Supervision, a much higher level of transparency should be achieved as regards ECB meetings with private interests. In particular, over half of the banks supervised by the ECB are not registered on the EU's Joint Transparency Register, and of those that are registered, almost none mention the ECB as a target. While meetings of individual banks with ECB supervisors will largely pertain to regular supervisory practices, it is clear that meetings with the European Banking Federation and the national banking associations fall firmly in the scope of the transparency register. Even within regular supervisory practices, the ECB's power to impose fines of up to 10 per cent of annual turnover and to revoke banking licenses for breaches of EU law will lead to situations in which ECB decisions create winners and losers, inevitably making it a target of lobbying. This is recognised in the regulation establishing ECB Banking Supervision, which speaks of the need to protect the ECB from "industry interference".[332] The ECB's Ethics Framework equally recognises the ECB as a target of lobbying, including from former staff, when it imposes a cooling-off period of six months on lobbying former colleagues.[333] The fact that the ECB as a central actor in EU economic governance elicits more attention from interest representatives means that the ECB should increase its efforts in ensuring an adequate level of transparency. Here, the ECB can draw on the experiences and best practices of other EU institutions, and join the EU's Transparency Register which is designed to enhance transparency on these interactions, and based on an inter-institutional agreement which encourages all EU institutions to join.

√ *The ECB should join the EU Transparency Register and prohibit meetings with any private sector interests not registered, unless these meetings are required in the context of banking supervision or to safeguard financial stability.*

## INSIDER TRADING

The issue is comprehensively addressed in the ECB Staff Rules under the heading "Private financial transactions". The paragraph reads as follows: "Members of staff shall be prohibited from using or attempting to use information which pertains to the activities of the ECB, national central banks, national competent authorities or the European Systemic Risk Board, and which has not been made public or is not accessible to the public (hereinafter 'inside information'), to further their own or another's private interests. Members of staff are specifically prohibited from taking advantage of inside information in any private financial transaction or in recommending or advising against such transactions."[334] In addition to this general prohibition on the use of inside information, the Staff Rules contain further provisions on four categories of private financial transactions (exempt, prohibited, subject to prior authorisation, subject to ex post reporting).[335] The prohibition on the use of confidential information for private financial transactions is reiterated, with additional emphasis on independence and the avoidance of conflicts of interest, in the Codes of Conduct for the members of the Governing Council, the Executive Board, and the Supervisory Board.[336]

A more comprehensive whistleblowing framework would help the policing of this type of misbehaviour in particular.

## SECOND LAYER: SPECIAL FUNCTIONS (CONTROL, COMPLIANCE AND OVERSIGHT)

In January 2015, the Executive Board established a dedicated Compliance and Governance Office (CGO), thus replacing the Ethics Officer. The purpose of the CGO is to support the Executive Board – to which it reports directly via the President on compliance matters – in protecting the integrity and reputation of the ECB, to promote ethical standards of behaviour and to strengthen the ECB's accountability and transparency and thereby making the codes of conduct and rules more effective. The CGO receives and answers staff requests for advice on ethical questions, and acts as secretariat to the ECB Audit and Ethics Committees. While very recent, it is encouraging to see the ECB adapting its institutional structure to strengthen the focus on matters of governance, compliance, accountability and transparency. The CGO is also in charge of access-to-document requests, and serves as liaison point for the European Ombudsman. It is early days for the CGO, but we would welcome if it

could introduce specific reporting on its work, following the example of the EIB's Anti-Fraud Activity Report, which would be a good place to aggregate data on issues such as access to document requests received, whistleblowing reports processed, and other instances of (potential) ethics breaches investigated.[337]

In addition, the ECB set up an Ethics Committee with its members being appointed by the Governing Council (one of which must be a member of the Audit Committee).[338] The Ethics Committee provides advice on questions of ethics on the basis of individual requests from members of high-level ECB bodies.[339]

### THIRD LAYER: INTERNAL AUDIT FUNCTION

The third control layer in the integrity framework of the ECB is internal audit.

The Directorate Internal Audit, according to the ECB Audit charter, provides "independent and objective assurance and consulting services designed to improve the ECB's operations", helping the ECB "to accomplish its objectives by bringing a systematic approach to evaluating and improving the effectiveness of risk management, control and governance processes." All activities, operations and processes of the ECB may be subject to internal auditing.

The Internal Audit function also reports to the five-member ECB Audit Committee,[340] which is chaired by Erkki Liikanen (Governor of the Bank of Finland). The other members are Vítor Constâncio (Vice-President of the ECB), Ewald Nowotny (Governor of the Austrian National Bank) and two former members of the Governing Council, Josef Bonnici (Governor of the Central Bank of Malta until 2016) and Patrick Honohan (Governor of the Central Bank of Ireland until 2015)."

*The 5-member Audit Committee currently consists exclusively of former or current central bank governors and (vice) presidents. Bringing in at least one outside member would strengthen the capacity of the Committee to perform its important control function.*

Regarding corruption, one area that poses particular challenges is public procurement. A decision laying down the rules on procurement provides that a tenderer shall be excluded on the grounds of criminal conviction or conflict of interest.[341] The ECB may exclude candidates which have been convicted of fraud, corruption, money laundering and other criminal offences, guilty of grave misconduct or otherwise deficient in the delivery of their duties as specified in the guidelines, notifying excluded candidates and allowing appropriate recourse unless final judgment by a competent court was passed.[342] Generally, it is best practice to list such "debarred" entities publically, as per Transparency International's research.[343] However, we note that the ECB's procurement guidelines remain a moving target, having been updated twice in February and June 2016,[344] only to receive a recommendation from the European Ombudsman in October 2016 to once more adapt the guidelines, in the context of a complaint received in 2015.[345] The Ombudsman received a reasoned opinion from the ECB on the matter in December 2016, and expects a further update of procurement guidelines by April 2017.[346]

## ECB BANKING SUPERVISION

The SSM Regulation obligated the ECB to strengthen its integrity framework in light of the particularly close interaction between supervisors and private credit institutions.[347] The revised ECB Staff Rules, which include the Ethics Framework and are applicable to all ECB staff, were the result of this provision.

The one area in which the Staff Rules include specific provisions for supervisory staff is with regard to cooling-off periods. Here, supervisory staff at salary band I (in brackets: salary bands F/G to H) must observe cooling-off periods of one year (six months) before working for "a credit institution in the supervision of which they were directly involved", and of six months (three months) before working for "a direct competitor of such a credit institution".[348] In this respect, we endorse the European Ombudsman's view[349] that no differentiation should be made between directly supervised banks as opposed to their competitors, who will equally profit of privileged information and contacts.

While these longer periods attest to the need for stronger rules on banking supervision, this need is hardly fulfilled with three to 12-months cooling-off periods. Cooling-off periods have to be weighed against the fundamental right to work, and therefore justified by the principle of proportionality. Generally speaking, the more discretionary power an official has over individuals and institutions, the greater the corruption risk. Positions that involve direct contact and exchange with private sector institutions are also more prone to conflicts of interest. Banking supervision exhibits both of these features to a high degree, much more so than monetary policy. Indeed the ECB compares favourably to other banking supervisors – the Bank of England merely requires staff to alert Human Resources if they may seek employment with entities supervised by the staff member;[350] globally, about half of banking supervision authorities have specific cooling-off periods in place.[351] And although the ECB is currently employing rather than shedding staff. private-sector salaries will entice staff to pass through the revolving door and work for supervised entities, typically during economic upswings.[352] ECB

Banking Supervision requires teams of staff to visit and even be embedded in the supervised entity; switching sides should therefore be made more difficult.

Members of the Supervisory Board must observe a one-year cooling-off period for any credit institution directly supervised by the ECB.[353] They must make a request for the ECB Ethics Committee to issue an opinion on the cooling-off period applicable to their individual case, which can lead to a prolongation or to a shortening of that period. Until two years after the end of their term, members of the Supervisory Board shall inform the President of the ECB of their intention to engage in any occupational activity, regardless of who would be the prospective employer.[354] Moreover, they are required to submit to the President of the ECB written information about their wealth, their direct or indirect involvement in any company, and the prospective organisation for the management of their assets during their term of office.[355]

√ *We recommend that such information be gathered by the Internal Audit function rather than the President, and that cooling-off periods be extended to up to two years for supervisory staff and Supervisory Board members.*

While the internal whistleblowing rules discussed above also apply to SSM staff, additional rules for external whistleblowers exists for Banking Supervision. These flow from the requirement of the SSM-Regulation that the ECB and national competent authorities (NCAs) adopt internal procedures on whistleblowing, including the protection of the individual, the requirement to follow up on reports, and inform the Audit Committee in addition to the Supervisory Board or Governing Council.[356] To facilitate this, the SSM made a specific Breach Reporting Mechanism available to the public, on its website, which is readily found by common search engines.[357] The website encourages prospective reports, including a quote by Supervisory Board Chair Danièle Nouy on the significant contribution of whistleblowers from supervised entities. We would welcome a similar approach to internal whistleblowers.

At the same time, the Breach Reporting Mechanism has some important limitations. It is only applicable to wrongdoing by supervised banks, not for breaches by the ECB or its banking supervisors, closing off an alley for externals to report on possible misconduct. Furthermore, the legal information accompanying the Mechanism states that within its scope, "relevant Union law does not cover any matters related to supervisory tasks that are not conferred on the ECB, e.g. preventing the financial system being used for money laundering and terrorist financing", and notes that "the ECB is not allowed to collect personal data in this regard and will not forward it to any other authority".[358] This would appear to be at odds with the obligation of ECB staff to report any fraud, corruption or illegal activity harming the Union's financial interest to the Director of Internal Audit.

The documentation regarding this reporting mechanism also includes an admonition that "misusing the BRM may constitute a criminal offence" in some countries and the "ECB may seek the initiation of criminal proceedings in a Member State if a report was not submitted in good faith".

Finally, in accordance with Article 71(3) of the Capital Requirements Directive IV, banks must also provide procedures for their employees to report breaches internally through a specific, independent and autonomous channel.

# INTEGRITY IN PRACTICE

**In practice, the ECB has recently started publishing the diaries of Executive Board members. However, the ECB needs to join the EU Transparency Register if it is to preclude lobbying by unregistered private interests, including by the banks it supervises. The lack of an appropriate whistleblowing framework has made reporting of wrong-doing a rare instance. Rules on the 'revolving door' are inadequate, as witnessed by a series of ECB managers going on to lucrative private sector appointments. Finally, the Ethics Committee should be impartial and not chaired by a former ECB President.**

Since its institution in January 2015, the Compliance and Governance Office (CGO) has played a vital role in developing, implementing, and monitoring the ECB's integrity framework in practice. The more than 1,300 requests for advice it received in 2015 suggest a high level of awareness among ECB management and staff of the existence and function of the CGO, as well as of the new Ethics Framework. The requests concerned a wide range of topics, including private financial transactions, gifts and hospitality, and external activities.[359] Of those, 116 requests concerned potential conflicts of interest. Among the requests for advice it received, the CGO identified "a limited number of instances of non-compliance with the revised Ethics Framework".[360] Among those, one third came from staff and management involved in banking supervision and mainly related to (perceived) conflicts of interest, but none involved intentional misconduct.

The Ethics Committee has also been receiving increasing numbers of requests for opinions from members of the ECB's governing bodies. An increased use of internal control functions may signal a heightened awareness for the need to safeguard integrity, but the composition of the Committee is questionable. The Governing Council, which makes appointments to the Committee, in 2015 appointed Jean-Claude Trichet, a former President of the ECB to it, who was subsequently voted its Chairman. Appointing former Presidents can limit the impartiality and independence of the Committee. If former European Commission President José Manuel Barroso had chaired the Commission's Ethical Committee, he would hardly have been in a position to assess his own follow-on employment as a non-executive Chairman of Goldman Sachs International.

In order to ensure that newly recruited staff members are familiar with rules on integrity, their first-day induction training contains an obligatory session on the Ethics Framework. Moreover, as of 2017, staff members are obliged to take an Ethics e-learning course on an annual basis. The training covers all topics addressed in the ECB Staff Rules. The electronic course is complemented by a workshop that teaches case studies on concrete, real-world situations.

The remainder of this section reviews the practical implementation, monitoring, and enforcement of the rules on "revolving-door" appointments, whistleblowing, and insider trading.

## COOLING-OFF PERIODS FOR "REVOLVING-DOOR" APPOINTMENTS

The new Ethics Framework has increased cooling-off periods for both ECB Banking Supervision staff and management, but has also introduced a leaner monitoring process. Under the new process, DG Human Resources requests information on follow-up jobs from parting employees. This information is passed on to the CGO, which determines whether a cooling-off period applies. The resignation of one member of staff involved in banking supervision triggered a cooling-off period in line with the revised Ethics Framework,[361] but not much more information is available at this early stage.

Another relevant issue in this context is top decision-makers transitioning through the revolving door into lucrative private-sector positions after their tenure has ended. Prominent recent examples include the former President of the European Commission Barroso at Goldman Sachs International, Mervyn King, the former Governor of the Bank of England, who became a senior advisor to Citigroup, and Axel Weber, the former Governor of the Bundesbank, who became the Chairman of the Swiss bank UBS. While none of President Draghi's two predecessors at the helm of the ECB took up significant positions in the financial sector, several alumni of the Executive Board have gone through the revolving door, listed here according to the chronological order of their times in office.

- Tommaso Padoa-Schioppa (member of the Executive Board 1998-2005) subsequently became Chairman of Europe at Promontory Financial Group
- Otmar Issing (1998-2006) became international advisor to Goldman Sachs less than six months after leaving his post with the ECB[362]
- Jose Manuel Gonzalez Paramo (2004-12)

joined the executive board at BBVA as Chief Officer for Global Economics, Regulation & Public Affairs and Chairman of the International Advisory Board[363]

- Lorenzo Bini Smaghi (2005-11) became Chairman at Société Générale[364]

- Jörg Asmussen (2012-13) took up positions as a non-executive director of the board at Funding Circle,[365] as an independent member of the Board of Directors at Generali Investments Europe,[366] and as Managing Director in Financial Advisory at Lazard[367]

None of these highly accomplished civil servants had significant professional experience in the private financial sector prior to their Executive Board tenure. A follow-up Transparency International study forthcoming in 2017 will provide a more in-depth analysis of revolving-door appointments.

√ *A comprehensive, transparent and formal assessment procedure should be instituted to assess if post-office employment is compatible with the responsibilities of senior ECB executives.*

## WHISTLEBLOWING RULES

The following summary of the procedure by which whistleblowing rules are monitored is based on our interviews at the ECB. Apart from their own senior managers, the central point of contact for whistleblowers is the Directorate Internal Audit. When reporting a potential breach of rules, informers can ask for anonymity, but their identity will always be known to the Director Internal Audit. This reflects a deliberate policy on the part of the ECB to not solicit anonymous information in order to prevent the instrument from being abused for covert bullying or retaliation. Three informants came forward in 2015, two in 2016. The majority of the cases concerned breaches at the non-managerial level. Among the breaches reported were the suspected misuse (i.e. leaking) of information and the misappropriation of assets. Following the internal investigation, the Director Internal Audit issues its report to the Executive Board. Civil service law disputes which can result from inquiries and subsequent disciplinary measures can be escalated to the ECJ; suspicions of criminal staff misconduct need to be escalated to OLAF or the national judiciary.

√ *The ECB should clarify a timeline within which it will deal with incoming information. In the interest of making the whistleblower a part of the procedure, the ECB should provide updates on and follow-up of the outcomes of the disclosure.*

√ *This should be facilitated via a dedicated digital reporting form, which should also allow for anonymous reporting. This is intended to encourage a culture that promotes whistleblowing.*

## INSIDER TRADING

The following summary of the procedure by which insider-trading rules are monitored is based on our interviews at the ECB. Upon proposal of the CGO, the Executive Board approves that the statutory auditor conducts regular compliance checks. For this purpose, 10 per cent of the members of ECB staff are audited, selected from all hierarchical levels and with different likelihoods depending on their proximity to inside information (this includes Executive Board members, senior management, non-senior managers, and administrative staff). The findings of the auditor are reported by the CGO to the Executive Board and to DG Human Resources, the latter deciding on potential disciplinary measures. While roughly a handful of cases have findings that require further clarification, no cases of insider trading have been found.

At the same time, some personnel appointments have in the past caused irritation, as with a recent case uncovered by the Handelsblatt, leading to further accusations from staff representatives.[368] In the event, the appointment of an “advisor and close confidant” of an Executive Board member as head of the ECB’s Brussels office was revoked, leading to a regular job advert and selection procedure for the post.[369] New rules should prevent such slip-ups in the future.
In summary, by establishing the CGO, the Executive Board has given this key function an urgently needed upgrade towards better organisational compliance and governance.

# METHODOLOGY

Our methodology is based on the adaptation of Transparency International's National Integrity System (NIS) assessments, taking into account the characteristics of a central bank such as the ECB. The NIS is the methodological hallmark of TI and is based on a holistic approach to integrity. Its original main aim was to evaluate the strengths and weaknesses of the formal integrity framework of different institutions and then assess its use in practice with a view to making recommendations for improvement. Used in over 70 countries since 2001, the NIS framework looks at thirteen key functions in a state's governance structure: the legislative; executive; judiciary; public sector; electoral management body; ombudsman; law enforcement agencies; supreme audit institution; anti-corruption agencies; political parties; media; civil society; and business.

In 2015 TI-EU published the first such study applying the NIS approach to the supranational level by looking at the structure of the EU's governance. In practice this meant an assessment of individual EU institutions and actors rather than evaluating specific governance functions. This TI report on the EU integrity system provided us with a useful template to create a bespoke analytical framework to examine the ECB.[370]

Regarding independence, we examined the extent to which the ECB can act without interference from other actors and determine its own leadership and actions. We also investigated instances in which the ECB is at risk of overstepping the limits of its independence. Regarding transparency, our analysis focused on both policy transparency and procedural transparency. The former is particularly important to the economic audiences of the ECB, while the latter is crucial for the public to scrutinize the decision-making and actions of the ECB in order to hold it accountable. Accountability is indeed the third pillar of our analysis, understood as the extent to which the ECB can be held responsible by other democratic institutions and the broader public on the fulfilment of its mandate and the legality and propriety of its actions. Finally, to assess the ECB's integrity safeguards, we studied the external and internal legal frameworks meant to serve as barriers to corruption and malpractice, as well as the procedures the ECB has in place to implement, monitor, and enforce these rules. Throughout the report, we took a close look at the scope of the involvement of the ECB in supporting the overall integrity of EU governance via cooperation with other institutions such as the OLAF, the Ombudsman or the European Court of Auditors.

This report draws on a large number of secondary sources. These have been selected on the grounds of relevance as well as academic quality and reputation. Rather than citing outliers championing or condemning the ECB, this report draws on voices from the mainstream section of the debate, which is sufficiently broad to include critical voices.

The research for this report was carried out in two phases. A desk research phase from August through October 2016 was followed by on-site research in Frankfurt. We conducted interviews over five days on the premises of the ECB during the first week of November 2016. The structured interviews used questionnaires tailored to the expertise of our interlocutors and were geared towards information gathering and clarifications on issues that could not be fully researched on the basis of publicly available documents. Additional functions of the interviews were to validate the findings from the desk research phase and to gather knowledge on actual institutional practices. The cooperation with the ECB, represented by the Compliance and Governance Office, was excellent and we were able to conduct interviews with management and senior management.

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