The role of the ESCB in banking supervision

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LEGAL ASPECTS OF THE EUROPEAN SYSTEM OF CENTRAL BANKS

LIBER AMICORUM
PAOLO ZAMBONI GARAVELLI
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Disclaimer

This book contains a collection of articles written by friends and colleagues of Paolo Zamboni Garavelli. These are personal contributions to a collective work aimed to honour his memory. Although the authors are or have been members of the Legal Committee of the European System of Central Banks (ESCB), and the contributions depict several legal aspects of the ESCB, the views contained in those chapters are personal to their respective authors and cannot be considered to represent the collective views of the Legal Committee. The content of the book does neither describe the opinion of the respective institution for which the authors work, nor the position of the European Central Bank as editor of the book.
Paolo Zamboni Garavelli
INTRODUCTION

Antonio Fazio

It was just over a year ago that Paolo Zamboni died.

He had a long and distinguished career in the Bank of Italy that began in 1970 when he joined the Legal Department. His cursus honorum led him first to the position of Head of the Law and Economics Office and then to that of Head of the Legal Department.

The area of the Bank that deals with legal research and advice has acquired substantially broader duties and powers in recent decades. In addition to preparing opinions and assisting in pleadings, increasingly it has worked closely with the Bank’s Directorate in the fields of banking supervision and central banking. Paolo made an important contribution to the acknowledged prestige of this role.

Paolo spread his professional expertise with great versatility in many directions: from the reorganisation of public banks to the groundwork for the Consolidated Law on Banking; from antitrust measures in the banking sector to the study of law from the viewpoint of economics, to the international aspects of the Bank’s activities. He followed the progress of the Monetary Union from its conception to its creation.

His example to us is one of conscientious professionalism, particularly for the profundity of his thought and his ability to tackle every new situation with enthusiasm, inspiring the involvement of his colleagues, especially the younger generations. He has also left us with the memory of his exemplary conduct, the equable, courteous and sympathetic manner that never left him, not even in the difficult period of his illness.

He was one of the small circle of legal experts assisting the Committee of Governors to draw up the Statute of the European System of Central Banks.

His skill as a jurist and legal practitioner earned him an assignment of great responsibility and complexity when it became necessary to draft the national measures that would adapt Italian law to European legislation on monetary policy and the European System of Central Banks and thus govern the Bank of Italy’s entry into the System.

It is therefore a highly commendable idea to honour the memory of Paolo Zamboni with a collection of writings on the subjects that were closest to his heart.

These issues have gained enormous importance in recent years with the creation of the European System of Central Banks and its subsequent entry into operation – steps which have called for great effort and commitment, particularly in the legal field.
The establishment of uniform rules, allowing the new system to operate efficiently in a framework founded on a plurality of jurisdictions and acknowledged rights, was an arduous challenge.

It was won by achieving a balanced solution between a common monetary law and different national rules, whose diversity is an inexhaustible source of wealth for European legal culture.

From the outset, the decision-making bodies of the European Monetary Institute and then of the European Central Bank continuously received meticulous and valuable advice and assistance from the groups of legal experts of which Paolo was a member (initially the Working Group of Legal Experts and subsequently the Legal Committee).

Fundamental issues for the establishment and working of the System, such as the convergence of national laws and regulations and the concept of central bank independence, were analysed in those groups. The independence criteria were developed considering the tradition of autonomy of central banks, deeply rooted in their history and national legal framework.

Analysing and solving the many legal questions brought to light by the operation of the system was a crucial part of ensuring that it would function with increasing efficiency. The groups of legal experts made an invaluable contribution to the drafting of the rules that govern monetary policy operations and the various tasks entrusted to the System by the Treaty and the Statute.

Paolo Zamboni maintained an attitude of open and incisive collaboration at all times, including in various international fora, where he stands as an example to all of those who work and participate there.
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Antonio Fazio is Governor of Banca d’Italia. He is a member of the Governing Council of the European Central Bank and a member of its General Council. He was previously a member of the Committee of Governors of the Central Banks of the European Community. He was Deputy Director-General of Banca d’Italia from 1982 to 1993 and appointed its Governor for life in May 1993.
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Bernd Krauskopf is General Counsel of the Deutsche Bundesbank and a member of the Legal Committee (LEGCO) of the ESCB. After studying law, economics and politics at Gießen and Marburg University, he started his professional career as a lawyer for the German Consulate General in Malaga, Spain, before he was admitted to the Bar in Frankfurt, working as a lawyer in private industry. He joined the Bundesbank’s Legal Department in 1979. In 1990 he contributed to the preparatory work of the Federal Government and the Bundesbank for the Monetary Union between the Federal Republic of Germany and the former German Democratic Republic in his capacity as legal adviser to the Bundesbank’s Vice-President in East Berlin. He has participated in various international working groups of, among others, the G10 (Lamfalussy report), the EU Commission, the EU Council and the European Monetary Institute (in preparation for Economic and Monetary Union). He is the author of several publications in the field of central bank legislation, central bank immunity and monetary law.

Patrice de Lapasse

Patrice de Lapasse, born in 1939, studied law at the University of Toulouse. He entered the Banque de France in 1965 and was appointed head of the Legal Department of the Bank in 1992. He retired on September 2002 and resumed his studies in canon law. He was a member of the group of central bank lawyers who, under the authority of the Committee of EU Governors, prepared the first draft of the statutes of the ESCB. He is the spiritual father of the regulatory power of the ECB now enshrined in Article 34 of its Statute, and largely inspired the foundation of the European Monetary Institute. Patrice de Lapasse died on 27 May 2005.

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Niall Lenihan is Assistant General Counsel at the European Central Bank (ECB). A graduate in Law of Trinity College Dublin, a Master of Law of Sidney Sussex College Cambridge and a licensed Attorney/Solicitor in Ireland, England and New York, he began his professional career as a lawyer in 1991 with the New York law firm of Davis Polk & Wardwell. In 1996 he established the Wall Street Committee on Economic and Monetary Union (EMU), and in 1997 was engaged by the European Commission to prepare its study on the impact of EMU under US and New York law. In 1998, he joined the Legal Division of the European Monetary Institute, and thereafter the Legal Department of the ECB, where he was appointed to his current position. He represented the ECB in the G10 Working Group on Collective Action Clauses in sovereign debt instruments. He is the author of various publications in the field of monetary and constitutional law.
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PAOLO ZAMBONI GARAVELLI
A PORTRAIT

Marino Perassi

ABSTRACT

La professionalità di Paolo Zamboni Garavelli e la sua ineffabile personalità nell’ambiente professionale ed in ogni contesto nel quale si sia trovato a svolgere i propri incarichi era fortemente e direttamente influenzata dalle sue qualità umane. La ragguardevole predisposizione amichevole di Paolo e la sua gentilezza d’animo nella vita privata e nelle relazioni familiari gli avevano guadagnato il sincero attaccamento di tutte le persone che lo hanno conosciuto. Viveva i suoi rapporti personali con un gusto per la discrezione e il buon senso che non gli vennero meno neppure nei momenti più cupi della sua infermità. Con una miscela unica di gentilezza, capacità professionali e preparazione giuridica, conquistò l’apprezzamento e la stima di tutti i partecipanti al Gruppo degli Esperti Legali costituito dal Comitato dei Governatori per la preparazione della bozza dello Statuto del SEBC e della BCE, del Gruppo di lavoro di Esperti Legali e infine del Comitato Legale, in cui egli fu un maestro per più d’una generazione di legali della Banca d’Italia coinvolti in questioni internazionali. Nonostante il segno profondo lasciato nella sua carriera dalla lunga esperienza internazionale, il ricco novero di incarichi professionali assegnati a lui all’interno della Banca d’Italia dimostra l’intensità del suo coinvolgimento nell’attività della banca centrale.

Affrontò esperienze impegnative come la privatizzazione del sistema bancario italiano e la predisposizione della bozza del nuovo Testo Unico Bancario, offrendo un significativo contributo grazie alla sua ampia preparazione giuridica di base. Compito rimarchevole e difficile fu l’avvio dell’Ufficio Diritto dell’Economia, che, nei primi tempi dalla sua istituzione, egli venne anche chiamato a dirigere. Dopo la nomina a Capo del Servizio Consulenza Legale, si era riproposto con la consueta positività nella tradizionale attività giuridica. Egli ha segnato il cammino per l’attività della Consulenza Legale negli anni a venire, in cui l’interazione tra la dimensione internazionale e quella nazionale delle questioni giuridiche è destinata a crescere.
Reviewing the many occasions on which Paolo and I worked together, I found it difficult to choose one that could capture, like a flashback, the kind of person he really was and how he approached his work.

These two aspects were closely connected, for in all his work Paolo brought to bear his truly unique personal qualities: courtesy and moderation, and the ability to listen and to empathise. He was also always capable of being enthusiastic, and in a contagious way, about a new undertaking. His manner, urbane and politely authoritative, owed much to his upbringing in a family with a strong naval tradition, which counted many admirals among his ancestors.

And I still remember clearly the day when Paolo telephoned me to ask me, with his usual tact and courtesy, to take part in drawing up the rules for Monetary Union and the single European currency project; both were in their early stages at that time and would later evolve into the Treaty of Maastricht. To give you some idea of the context, at the beginning of the 1990s, when economic and political conditions in Italy were not good and there was little prospect of the country’s becoming involved in the project, such efforts seemed aimed at a very distant future and unlikely to prove successful. As I hesitated, Paolo observed that “when the lawyers are called in it means things are taking a serious turn”, adding that the decision of the Committee of Governors to pass the project on to the legal experts was a sign of confidence in its success. The upshot was that I agreed, and I did so with feelings of youthful enthusiasm, looking forward to working with someone so reliable and so remarkably talented.

After graduating in law from the University of Bologna Paolo completed his military service and then worked for a short time in the legal department of a multinational corporation in Milan before joining the Banca d’Italia’s staff of lawyers.

During the early part of his career he spent some years in one of the banking supervision departments, working side by side with colleagues engaged in the daily reality of monitoring the commercial banks. There he built up a fund of knowledge and experience of the banking sector and the broad spectrum of its operations which was later to play a crucial role in his professional life.

In the same period, he was often involved in the Bank’s international activity owing to his good command of English and the knowledge he had acquired during his university studies. It was a time when this type of work often seemed pioneering, given the closed nature of Italy’s banking and financial markets in the 1970s.

After transferring back to the Bank’s Legal Department, Paolo worked in the usual areas of the legal profession, qualifying for the rolls of attorneys authorised to appear before the higher courts. His professional development and career advancement continued, and toward the end of the 1980s he became one of the Bank’s leading senior counsels.
I have another very clear recollection, that of Rome in the hot summer of 1989 when a scandal broke involving the US branch of a well-known Italian bank that had granted excessively large and risky loans to a Middle Eastern country. The senior management of the Bank felt it was only natural that Paolo should be the one to set off at a moment’s notice, with a member of the banking supervision department, to handle the matter.

Paolo had just arrived at the seaside resort between Rome and Naples where he usually spent his holidays, and had not even had time to unpack, when he was urgently recalled to Rome to take the first possible flight to the US. Without turning a hair, Paolo came back to Rome to prepare for the journey. As he took his leave of us he remarked, with the ironic air he often adopted, that it was no great problem having to depart in such a hurry as at least he did not have to pack.

On that occasion we glimpsed an important aspect of Paolo’s character: his ability to cope with situations others would find irksome and disagreeable with a great sense of responsibility and professional commitment, but also with just the degree of detachment that allowed him to adopt a thorough but well-balanced approach to his work, without allowing it to overrun his life.

That summer was not the only difficult one for Italy’s financial sector and for the Banca d’Italia. The 1990s marked the beginning of an era of extraordinary change for Italy’s banking and financial system. At home, the publicly-owned banks were progressively being privatised as a series of major laws were passed. The restructuring of public banking was an extremely ambitious project that went hand in hand with the introduction of the group structure for companies in the banking sector. Paolo contributed significantly on these issues, writing one of the most important papers on the subject.¹

Abroad, the project for the single currency was forging ahead, and by February 1992 the regulatory structure of the Treaty of Maastricht was already in place. Paolo was able to participate in both events, taking it upon himself to monitor developments in the field of national legislation and of the implementing regulations issued by the Supervision Department. He drafted in several lawyers from the Legal Department and organised their work.

These were extraordinary years, years when Paolo was given important assignments that were to have a crucial influence on his later career. Thus, he was appointed, almost contemporaneously, a member of the Treasury Committee set up to draft the new banking law, which was passed in September 1993 as the Consolidated Law on Credit and Finance, as well as the Banca d’Italia’s representative in the Working Group of legal experts assisting the Committee of Governors to draw up the Statute of the European System of Central Banks (ESCB) and the European Central Bank (ECB).

Those fortunate enough to work with Paolo on these projects realised what a crucial role his personal qualities once again played. His positive and constructive attitude, together with his acceptance of new ideas, naturally led him to be of great assistance to the Supervision Department’s experts in drawing up the rules of the new Consolidated Law. His liberal ideas were fundamental in understanding that for banks to evolve from public law credit institutions to public limited companies, operating with all the structures and instruments permitted by private law, the old ways would have to be left firmly behind and the laws of the market adopted in their place.

One should always consider the effects that regulation can have on market forces and the behaviour and decisions of market players. This is one of the greatest lessons Paolo passed on during those years to the people working with him on the reform of the banking sector, especially the first implementation of the antitrust law passed in the autumn of 1990, which also regulated competition in the banking sector. Paolo’s ability to assess the economic repercussions and concrete consequences of regulatory options was to become a deciding factor in his further advancement.

The area in which Paolo made the greatest contribution, however, was surely that of monetary union. As a member of the small elite that helped to draw up the Statute, working alongside the Directorate of the Bank, its senior management and the staff of the Economic Research Department, Paolo never wavered in his optimistic belief that it would become a reality.

During another unsettled summer for Italy’s financial sector in 1992, when the storm triggered by the unfavourable outcome of the Danish referendum on the Treaty of Maastricht struck many European currencies, including the Italian currency (lira), the project for a single currency, or the ECU (European Currency Unit) as it was known then, seemed a very distant goal. In the autumn of that year, with a heavily devalued lira and little prospect of monetary unification, plans for work at the European level floundered.

This scepticism did not lift immediately, but instead persisted for quite a long time, that is until, with the creation of the European Monetary Institute (EMI) and the commencement of convergence by the countries involved, progress towards the introduction of the single currency resumed, at an even faster rate.

In 1995 the EMI set up the Working Group of Legal Experts (WGLE). Paolo was involved from the outset, contributing all the experience he had acquired during the preparatory work carried out on behalf of the Committee of Governors. The years leading up to the adoption of the single currency were unforgettable. At the EMI in Frankfurt and at the Commission in Brussels, the lawyers played a crucial role in designing the regulatory and legislative framework needed for the introduction of the single currency.

Paolo took part himself in the work of the WGLE and coordinated all the efforts of the Banca d’Italia’s lawyers engaged in drawing up the legal framework for
the adoption of the euro, during what was certainly one of the most significant phases of his career.

The rules governing the introduction of the euro in Italy and the amendments to the legislation concerning the Banca d’Italia during the delicate stage of implementing the principle of legal convergence represent the high point of his work. It is understandable that the legislative decree adapting Italian law to the principles of the Treaty of Maastricht is regarded in the Banca d’Italia as the fruit of his personal efforts.²

He instantly became a conspicuous participant in the WGLE, contributing well-balanced and constructive proposals. His affable and helpful manner once again proved highly valuable, and contributed greatly to the working of such a large committee, which brought together widely differing cultures and attitudes.

The greatest challenge at the time was to reconcile the different positions based on different legal systems rooted in very diverse traditions. It was not just a question of the old conflict between common law and continental law, but something more. A point of encounter had to be found between the various legal systems regarding money, and this meant using the instruments of private and public law contemporaneously. It was in this field that the experience Paolo had built up over the years, working on typical issues not only of commercial law but also of banking supervision and hence public and administrative law, proved to be particularly useful.

With the creation of the ECB and the introduction of the single currency, the WGLE was replaced by the Legal Committee (LEGCO). Once the Eurosystem was established, the Committee’s task became less demanding in one respect but possibly more arduous in another, since the role of assisting and advising the ECB’s Governing Council in its decision-making required even greater mediating skills. It was in this area that Paolo’s easygoing personality and openness to other people’s ideas proved invaluable. As a consequence his contribution was always greatly appreciated and he became a clear point of reference within the Committee. It was a real privilege for me to take part in the work of the LEGCO alongside Paolo.

In 1999, however, a new task awaited him. In that year the Law and Economics Office was set up at the Banca d’Italia, with the mandate to carry out research in the fields of economics and finance, based on a multidisciplinary approach that combined law and economics. As a result of the high regard and esteem in which the Directorate of the Bank held Paolo, he was appointed head of the Office.

Launching a new project is always an onerous task, and being at the helm of such a unit, in a unique sector, dealing with extremely new topics, was in many ways

a great challenge. Paolo took it on with equanimity and succeeded. Today, the Office is very busy carrying out research on the sectors of the economy that are of greatest interest to the Bank. Paolo’s frequent and close experience of the concrete requirements of banks and financial intermediaries certainly played a fundamental role in his new field of work.

Despite his new commitments Paolo retained a deep interest in Community matters, participating as constructively as ever in the work of the LEGCO, although on a less frequent basis. He continued to do so even in 2002, when he left the Law and Economics Office to rejoin the Legal Department as Head of Department.

Although this period was one of the high points of Paolo’s career, he was simultaneously contemplating retirement. The ability to maintain a degree of detachment from work – which had always been part of his personality – seemed to be taking over, as he began to want to spend more time with his family. It was almost a presentiment that the time left would not be very long. It goes without saying that when his closest colleagues heard of his intention to take early retirement, they found a thousand reasons why he should not do so.

This evokes another important memory. In May 2003, at the meeting of the LEGCO hosted in Dublin by the Central Bank and Financial Services Authority of Ireland (CBFSAI), we found a further reason to persuade him to stay on: the next meeting of the LEGCO had to be organised in Rome, at the Banca d’Italia. It was the last project on which Paolo worked. Even during his illness, at the time when a recovery did not seem impossible, he continued to follow the organisational aspects and drew up a programme for the event, although he did not come into the office. As fate would have it, he was unable to take part.

There is no denying that we all miss Paolo greatly. At the same time, he leaves behind some important lessons for all those who knew and worked with him.

Paolo was very good at delegating, and allowed those who worked with him plenty of scope, although he was always available to discuss problems and offer advice. The door of his office was permanently open to anyone eager to engage in discussion.

More than one generation of lawyers now following the subject dearest to him, the goal of the single currency, have learnt considerably from his guidance, his style, his method of tackling matters. Such a precious gift will help them cope in the coming years as more and more areas become ever more closely regulated by Community law, making it increasingly necessary to consider European issues.

The people who knew and respected Paolo from meetings in European fora were greatly affected by his death, and his family received many expressions of sympathy. One of the most moving tributes was contained in a letter to his family from friends and colleagues at the CBFSAI: in Gaelic it reads “Ar dheis láimh Dé go raibh a anam dílis” (May his soul sit at the right hand of God).
THE EUROPEAN UNION
AND THE EUROPEAN SYSTEM
OF CENTRAL BANKS
ABSTRACT

La costituzione non introduce cambiamenti rivoluzionari per quanto riguarda la politica monetaria e la BCE. Come la BCE ha osservato con l’opinione resa il 19 settembre 2003 dopo la conclusione dei lavori della Convenzione, “funzioni, compiti, status e regime legale della BCE e del SEBC rimangono sostanzialmente inalterati”. Nondimeno, la Costituzione introduce alcune interessanti novità, le cui implicazioni non sono agevoli da predire. La Costituzione indica la politica monetaria tra le competenze esclusive dell’Unione Europea. La rilevanza di siffatta qualificazione dipenderà dall’interpretazione delle disposizioni contenute nel capitolo relativo alla politica monetaria, contenuto nella Parte III della Costituzione. La BCE diviene un’istituzione sui generis dell’Unione, un cambiamento in linea con la decisione della Corte di Giustizia sul caso OLAF, che conferma l’appartenenza della BCE al sistema giuridico della Comunità Europea. La Costituzione, che inserisce fra le sue disposizioni la nozione di “Eurosistema”, non offre indicazioni nuove sui ruoli del SEBC, dell’Eurosistema e della BCE. Come in passato, l’individuazione caso per caso delle funzioni rispettivamente delle Banche Centrali Nazionali e della BCE resterà affidata all’applicazione e all’interpretazione delle disposizioni dello Statuto, rimasto inalterato. Neppure è agevole precisare quale impatto avrà la nuova classificazione e gerarchia delle fonti sugli strumenti legali adottati dalla BCE. I Regolamenti della BCE diventano regolamenti europei. La legge europea avrà pertanto automaticamente prevalenza sui regolamenti della BCE? O si potrebbe essere autorizzati ad invocare il principio di specialità? Queste sono alcune delle questioni sollevate dalla Costituzione con riferimento alla politica monetaria e alle banche centrali. Lo studio vuole soltanto richiamare l’attenzione su esse e su altri aspetti di un certo interesse.
1 THE EURO AND MONETARY POLICY

1.1 THE EURO

Article I-8 states that “the currency of the Union shall be the euro”. This makes the euro one of the key symbols of the Union, along with the flag, the anthem, the motto and Europe day. It is interesting to observe that the clear-cut formula relative to the currency is not to be found in the text of the Regulation that constitutes the pillar of the legal framework of the euro.1 There, the euro is presented as the currency of participating Member States and as the unit of account of the ECB and the national central banks.2 The word “euro” has also been substituted for the word “ecu” in all the provisions of the Constitution containing the name of the currency. So the primary law of the Union will at last be made to conform with secondary law and practice.

This mention among the first of the articles of Part I of the Constitution is in contrast to the lack of any reference to EMU among the objectives of the Union in Article I-3 and the formulation of Article I-15, which have lead one author to write that “the Constitution [at least in its first part – author’s observation] […] avoids regarding the achievement of the EMU as the normal situation to which the provisions of the Chapter on economic and monetary policy should be addressed and the non-achievement thereof as an exceptional situation for which a specific regime should be needed.”3

The Convention introduced a provision on the symbols in the text of the Constitution during the last stage of its work with the purpose of promoting a single European identity. The euro can indeed be a “vector of identity”.4 However, the appropriation of the euro by the citizens of the euro area depends on a number of factors. There is a kind of dialectic relationship between identity shaping and the achievements of the euro. European identity is inseparable from the success of the single currency, and this success itself appears to be a consequence of the emergence of a European identity.5

The adoption of the euro is irreversible. Protocol 10 annexed to the EC Treaty by the Maastricht Treaty expressed this feature of Economic and Monetary Union. The Constitution does not include a similar provision or protocol, although this does not mean that the principle does not remain. What the Constitution does do is provide for the right of withdrawal from the Union by any Member State in Article I-60. René Smits has pointed to the element of insecurity for the euro involved in this possibility.6 So-called disaster clauses, taking on board changes in the membership of the euro area, will flourish. On

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2 Ibid., Articles 2 and 4.
the other hand, the agreement arrived at by the Union and the Member State wanting to withdraw can include maintaining the euro as the country’s legal tender. Without this agreement, the outgoing Member State cannot keep the single currency. It is also important to remark that Article I-60 may contribute towards making the dissolution of the euro area an unrealistic hypothesis. Among other eventualities, it ensures that the withdrawal of a Member State does not affect the continuation of the integration process among the others.

1.2 MONETARY POLICY

The Constitution maintains the present asymmetry between the two pillars of EMU. It provides for a transfer of powers in the monetary field and the competence of the Member States as far as economic policy is concerned.

Article I-13, paragraph 1 (c) of the Constitution defines monetary policy as an exclusive competence of the Union for the Member States whose currency is the euro. Article I-12, paragraph 1, states that “When the Constitution confers on the Union exclusive competence in a specific area, only the Union may legislate and adopt legally binding acts, the Member States being able to do so themselves only if so empowered by the Union or for the implementation of Union acts”.

1.2.1 THE CONCEPT OF MONETARY POLICY

The main question raised by the qualification of monetary policy as an exclusive competence resides in how the concept of monetary policy is interpreted. Is it monetary policy in the narrow sense of the expression, i.e. internal monetary policy, including the determination of interest rates, the supply of liquidity to the economy and the recourse to such instruments as the imposition of compulsory reserves, or should we adopt a broader concept and consider that under monetary policy one should include the competences provided in Section 2 on “Monetary policy” of Chapter II “Economic and Monetary Policy” in Title III “Internal Policies and Action” of Part III of the Constitution? René Smits lists four additional areas to monetary policy in its strictest sense that should be held as exclusive competences: exchange rate policy, the task of the European System of Central Banks (ESCB) in holding transferred reserves and conducting exchange rate operations, the oversight of payment systems, and the issuance of banknotes. The ECB took a position in its opinion of 19 September 2003 against a narrow and technical interpretation of monetary policy. It understood “monetary policy” as reflecting the title of Section 2 and “therefore consider[ed] that it encompasses all exclusive competences related to the euro ‘as described in the relevant provisions of the […] Constitution’, in particular Articles III-[185] and [186].” As the wording of the draft of the Convention was not modified on this point by the IGC, it can be presumed that the ECB’s interpretation has been
validated by the IGC. In order to determine the allocation of competences between the EU and the Member States in a specific field, the meaning of the particular provision in Part III has to be interpreted. Indeed, under Article I-12, paragraph 6, the “scope of and arrangements for exercising the Union’s competences shall be determined by the provisions relating to each area in Part III”. This rule reflects the principle of conferred competences, included in the definition of the Union (Article I-1, paragraph 1), and reaffirmed by Article I-11, paragraph 1 of the Constitution. For example, Article III-186 provides for the possibility of both the ECB and the national central banks to issue banknotes. However, to make use of this possibility, the national central banks have to have authorisation from the ECB. Member States may issue coins10, but the ECB states the volume of the issue, while the Council harmonises the face values of these coins and adopts technical specifications for them. These provisions clarify the extent of the respective competences of the Union and the Member States. These are of course straightforward examples; a less obvious one is the delimitation of competences in the field of payment systems under Article III-185, paragraph 2, d). Moreover, it is not easy to define the precise role of the ECB and of the national authorities in the field of prudential supervision after reading Article III-185, paragraphs 5 and 6. From this last paragraph, to which we will return, this appears to be in effect a moving target.

1.2.2 EXCLUSIVE COMPETENCE AND EXTERNAL RELATIONS

Some authors have questioned the exclusive character of the external monetary competences of the Union. Doubts have been expressed in the field of external relations, in particular based on the wording of Article 111, paragraph 5 of the Treaty establishing the European Community (EC Treaty, reproduced in Article III-326, paragraph 4 of the Constitution, which states: “Without prejudice to Union competence and Union agreements as regards economic and monetary union, Member States may negotiate in international bodies and conclude agreements.”11 Chiara Zilioli and Martin Selmayr list a series of fields in which the Member States have a residual competence to conclude agreements with third countries (agreements on foreign exchange working balances, on banking supervision, on coins and old agreements under Article 307 of the EC Treaty, and agreements with countries and territories with a special status).12 We believe that most of the examples quoted are not pertinent. Either the Union (the Council or the ECB) has been given the competence to orientate, limit or effectively suppress by their action the so-called residual competence of the Member States whose currency is the euro, or it has enabled the states concerned to conclude an agreement, as was the case for the agreements on the introduction of the euro in European micro-states. Article 307 does not allow in principle new agreements to be concluded. The true exception is prudential supervision, as long as the

10 When Article I-30, paragraph 3 provides that the ECB “alone may authorise the issue of the euro”, it should more accurately have limited this sentence to the issue of banknotes. The Constitution, in Part III, directly authorises Member States to issue coins.

11 See F. Tuytschaever, Differentiation in European Union Law (Oxford: Hart, 1999), p. 171; C. Zilioli and M. Selmayr, The Law of the European Central Bank (Oxford: Hart, 2001), p. 213: “The insertion of such a paragraph in the last provision of the chapter on monetary policy can be interpreted only in the sense that there is still a certain competence of the Member States left in the field of monetary policy.”

Union and the Bank have not used their competences in this field, and these competences have become exclusive under the doctrine of pre-emption that the Constitution confirms (Article I-13, paragraph 2).

Does the Constitution sufficiently take into account the exclusive character of monetary policy in the provisions on external relations specific to the euro area? Article III-196 provides for the adoption of common positions and unified representation in international financial institutions and conferences. However, although the wording implies that there is an obligation to adopt common positions, it is somewhat looser as far as “unified representation” is concerned, which is no more than an enabling clause. Of course, the provision refers to the whole of Economic and Monetary Union, and the competences of the institutions and conferences referred to are mixed from the viewpoint of Union law. These provisions are without prejudice to the exclusive nature of the monetary policy competence of the Union, but it would be difficult to quote one of any of these institutions and conferences that bears exclusively on monetary affairs stricto or lato sensu. Moreover, Member States are not very keen to admit their substitution by the Union, although they should be in favour of the euro area speaking with one voice and achieving a single representation for the whole field of EMU, as the question of the allocation of competencies between the Union and Member States is an internal question for the euro area.  

### 1.2.3 PRUDENTIAL SUPERVISION

Article 105, paragraph 6 of the EC Treaty provides for the attribution to the ECB of specific tasks concerning policies relating to prudential supervision of credit institutions and other financial institutions, with the exception of insurance undertakings. The decision should be taken by the Council, which must unanimously decide on a proposal of the Commission and obtain the assent of the European Parliament. The Convention introduced the legislative procedure in this field and thus substituted qualified majority voting for unanimity within the Council in Article III-185, paragraph 6. Unexpectedly, the Italian presidency of the IGC proposed to amend the procedure by requiring once more unanimity within the Council and a simple opinion of the European Parliament. This proposal was accepted by the IGC. Neither the Convention nor the IGC changed the content of the provision and, in particular, the rather odd exclusion of insurance companies from the field of application of the tasks to be conferred to the ECB.

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14 CIG 52/1/03 REV 1 (en), Annex 8 to Addendum 1, 25 November 2003.
2 THE ECB IN THE INSTITUTIONAL SYSTEM OF THE EU

2.1 THE ECB, THE ESCB AND THE EUROSYSTEM

It is not purely by chance that the ECB and the ESCB are mentioned in an article (Article 8 EC, ex 4A) that is separate from the one (Article 7 EC, ex 4) on the (classic) institutions. Neither the ECB nor the ESCB are comparable to the main organs of the Community, which are endowed with decision-making power in all aspects of Community law. On the other hand, the choice of a specific article demonstrates the desire of the authors of the Treaty to underline the independence of the monetary authorities of the Community. Nevertheless, they are part of the Community’s overall legal order. EMU should not be considered as a specific pillar like the ones on a Common Foreign and Security Policy or Justice in Home Affairs. The provisions on EMU are inserted into the EC Treaty. The institutions play their role in both pillars of EMU, notwithstanding some peculiarities owing to the specificity of the subject. The Court of Justice is competent for reviewing the acts of the ECB, under the provisions on the appeals to the Court and Article 35 of the Statute of the ESCB and the ECB.

The precise nature of the ECB has prompted much controversy in the literature. Zilioli and Selmayr have advanced the view, first in a series of articles, and then in a book, that the ECB is “an independent specialised organisation of Community law” within the central Community pillar of the EU, on an equal footing with the other Communities. They argue that there is no hierarchy between secondary Community law and ECB law, and that the two legislations subsist at the same normative level. General Community legislation thus does not apply to the ECB, or in fields that do not lie within the spectrum of the ECB’s competences. This doctrine has unsurprisingly been strongly contested.

Although the Bank has not adopted Zilioli and Selmayr’s thesis as such, the position of the ECB was at the centre of a litigation case that placed the ECB in opposition to the Commission on the application to the Bank of Regulation (EC) No 1073/1999 of the European Parliament and of the Council of 25 May 1999 concerning investigations conducted by the European Anti-Fraud Office. The ECB had adopted a Decision 1999/726/EC of 7 October 1999 on fraud prevention. This Decision established an anti-fraud committee within the Bank.

16 See C. Zilioli and M. Selmayr, op. cit. in footnote 18.
17 Ibid., p. 31.
18 Ibid., pp. 29-30.
19 Ibid., p. 43.
22 OJ L 291, 13.11.1999, p. 36. This Decision has been replaced by the Decision of the ECB of 3 June 2004 concerning the terms and conditions for the European Anti-Fraud Office investigations of the ECB, in relation to the prevention of fraud, corruption and any other illegal activities detrimental to the European Communities’ financial interests and amending the Conditions of Employment for Staff of the ECB (ECB/2004/11), OJ L 230, 30.6.2004, p. 56, adopted in answer to the Court’s judgment.
in charge of relations with the surveillance committee of OLAF, which excluded any power of investigation of this body within the Bank. The Commission, considering this Decision contrary to Regulation No 1073/1999, appealed to the Court of Justice to annul the Decision. For its part, the Bank invoked, among other arguments, its independence as well as the independence of national central banks and the fact that it had its own finances that were separate from the Community’s budget.

Following the conclusions of Advocate General Jacobs, the Court declared the Decision null and void in its sentence of 10 July 2003.\(^23\)

The Court states that “the ECB, pursuant to the EC Treaty, falls squarely within the Community framework” (point 92). It specifies the independence recognised to the ECB by observing: “As is clear from the wording of Article 108 EC, the outside influences from which that provision seeks to shield the ECB and its decision-making bodies are those likely to interfere with the performance of the tasks which the EC Treaty and the ESCB Statute assign to the ECB. As the Advocate General has pointed out at paragraphs 150 and 155 of his Opinion, Article 108 EC seeks, in essence, to shield the ECB from all political pressure in order to enable it effectively to pursue the objectives attributed to its tasks, through the independent exercise of the specific powers conferred on it for that purpose by the EC Treaty and the ESCB Statute” (point 134). It adds that: “recognition that the ECB has such independence does not have the consequence of separating it entirely from the European Community and exempting it from every rule of Community law. First, it is evident from Article 105(1) EC that the ECB is to contribute to the achievement of the objectives of the European Community, whilst Article 8 EC states that the ECB is to act within the limits of the powers conferred upon it by the EC Treaty and the ESCB Statute. Second, as the Commission has observed, the ECB is, on the conditions laid down by the EC Treaty and the ESCB Statute, subject to various kinds of Community controls, notably review by the Court of Justice and control by the Court of Auditors. Finally, it is evident that it was not the intention of the Treaty draftsmen to shield the ECB from any kind of legislative action taken by the Community legislature, as is clear from, inter alia, Article 105(6) EC, Article 107(5) and (6) EC and Article 110(1), first indent, and (3) EC [...]” (point 135).

The Court does not qualify the ECB as an “institution” in the relatively technical sense of Article 7 EC; this is impossible under the EC Treaty. The Constitution takes the step of making a sui generis institution out of the ECB. Under Article I-30, paragraph 3, the ECB is defined as an institution with legal personality. This Article appears with the Court of Auditors\(^24\) in Chapter II on “The other Union institutions and advisory bodies”. This can be contrasted to Chapter I on the institutional framework, which includes the traditional institutions, plus the

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\(^24\) The Court of Auditors became an institution and was included in Article 7 (ex 4) EC by the Maastricht Treaty. The Constitution re-establishes some coherence in making a distinction between institutions with general competences and specialised institutions.
European Council. This distinction between the two chapters underlines the special features of the two “other institutions”.\(^{25}\)

Article I-30 also mentions the ESCB and the Eurosystem. On the ESCB, the Constitution maintains the same ambiguous situation as in the present wording of the Treaty. The ESCB is mentioned in the first and second paragraphs of the Article, while the four last paragraphs only refer to the ECB. Paragraph 1, which also alludes to the Eurosystem\(^{26}\), states that the ESCB includes the ECB and (all) the national central banks. Paragraph 2 indicates that the ESCB shall be governed by the organs of the ECB, a provision that is already contained in the present treaty. It recalls the objectives of the ESCB (price stability and, without prejudice to this objective, to support the general objectives of the Community) and states that the ESCB “shall conduct other Central Bank tasks in accordance with Part III and the Statute of the European System of Central Banks and of the European Central Bank”.

Two remarks need to be made regarding these provisions. On the one hand, paragraph 1 attributes to the Eurosystem, i.e. the ECB and the national central banks whose currency is the euro, the task to “conduct the monetary policy of the Union”. On the other hand, paragraph 4 seems to confer the same powers to the ECB, although some of the Articles of Part III that it refers to mention that the ESCB is the bearer of these competences. These provisions accurately reflect the general perplexity about the nature of the ESCB. In this regard, we would like to quote René Smits, who wrote in 2003 that “the ECB is truly ‘the central bank of the European Community’. This is my preferred view of the ECB: as an organ of the Community [...] an independent agency for the performance of monetary policy attributed to the Community level of government and for the execution of several other tasks within the overall price-stability objective.”\(^{27}\)

He continues: “This view of the ECB extends to the larger ESCB [...] it is not itself endowed with legal personality. Yet, because of the combination of legal entities entrusted with Community policy and Community tasks, the ESCB can also be seen as a Community organ.” In a similar vein he concludes: “Thus, the ECB and the NCBs – in their ESCB functions – are organs of the Community.” This does not however prevent the author from observing that “the ESCB structure, although difficult to explain, does not require urgent adaptation in the context of the European Convention for reasons of transparency.”

Perhaps the above suggestion is correct: obviously the nature and the respective roles of the ESCB (Eurosystem) and the ECB are moving targets, depending on the tension between centralisation and decentralisation within the system. However, we would at this point like to make four additional observations. First, the phrase “conduct the monetary policy” used in Article I-30, paragraph 1, in

\(^{25}\) It should be noted that in its Opinion to the IGC as quoted already in this paper, the ECB expressly requested to be included in the “institutional framework”, but without being listed among the first category of institutions. See OJ C 229, 25.9.2003, p. 8, point 11.

\(^{26}\) It is also pursuant to a request of the ECB expressed in its Opinion quoted in the note supra that the IGC inserted the concept of the “Eurosystem” in the Constitution. This expression was used by the ECB in its legal and other texts in order to make a distinction between the ESCB, in which all national central banks participate, and the kind of collaboration uniting the national central banks whose currency is the euro, and the ECB.

\(^{27}\) R. Smits, op. cit. in footnote 13, pp. 24-25.
relation to the Eurosystem does not correspond to the legal situation if we give the verb “conduct” its ordinary meaning. It is the ECB, and not the (Euro)system or the national central banks and the ECB, which is in the driving seat with regard to deciding monetary policy. Second, the national central banks have a role in the implementation of monetary policy, but they are submitted in a clear hierarchy to the authority of the ECB. Third, all the legal acts adopted on the basis of Treaty (Constitution) provisions are acts of the ECB and not of the system. Fourth, the insertion of the concept of the “Eurosystem” in a single provision of the Treaty cannot clarify the legal situation. It is to be regretted that the opportunity was not taken to review systematically the provisions of the Statute of the ESCB and of the ECB, in order to replace, where convenient, the expression “ESCB” with “Eurosystem”. Obvious examples here are Article 14, paragraph 3 on guidelines and instructions that cannot be addressed to central banks other than the ones whose currency is the euro; or Article 15, paragraph 2, which imposes the establishment of a weekly consolidated financial statement of the ESCB, something that has never been done. In practice, the statements reflect only the situation of the Eurosystem, and rightly so. However, the “cleaning” exercise was perhaps politically difficult because of the different views held on what belongs to the competence of the System and what to the competence of the ECB, as became clear during the negotiation of the Maastricht Treaty.

2.2 THE APPLICATION OF COMMUNITY LAW TO THE ECB

The Court has ruled in its judgment of 10 July 2003, already quoted, “that there are no grounds which prima facie preclude the Community legislature from adopting, by virtue of the powers conferred on it by the EC Treaty and under the conditions laid down therein, legislative measures capable of applying to the ECB” (point 136). Elderson and Weenink observe that “the quotation is important as it recognises that the legislator can only adopt legislation of relevance to the ECB in so far as the Treaty allows for this.”

There is a case where the Treaty (Article 285) and the Constitution (Article III-429) expressly reserve the right of the ECB to adopt rules on its own for the establishment of statistics for which Article 5 of the ESCB Statute confers a competence to the ECB. But this explicit “non-prejudice clause” is the exception. In other hypotheses, it is a question of how to interpret the (general) provisions of the Treaty and the (specific) provisions on the ECB and monetary policy.

The question has been raised about the application of general Community law to the ECB, for example in the field of public procurement, competition, other rules of the internal market, civil servants, accounting and auditing. We cannot enter into an in-depth discussion on this subject, which is a complex one; nevertheless, some aspects appear clear. For example, EU institutions are not directly bound by the directives that apply to public procurement and which bind the Member States. However, they “have adopted their own set of procurement

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28 On this topic, see the sometimes contrasting views expressed by R. Smits, op. cit. in footnote 13, pp. 25-33, and F. Elderson and H. Weenink, op. cit., pp. 287-91.
29 Op. cit., p. 287. The italics are the authors’.
rules in line with the principles of the Directive.”

If we examine Competition law, there is an agreement that the ECB and the national central banks are not “undertakings” in the meaning of Articles 81 and 82 EC. However, René Smits seems to be posing the right questions when he asks: “are the ESCB activities undertaken within its public authority or ancillary to its tasks? Or, does the Eurosystem also undertake activities which are normally engaged in by private companies for gain?” On the other hand, it is well-known how delicate and controversial the subject of the “anticompetitive State action in Community law” is as treated by the case law of the Court of Justice, which may be transposed to the action of public authority in general. One has to take into account the fact that both the Treaty (the Constitution) and the ESCB Statute refer to “the principle of an open market economy with free competition” (Article 105, paragraph 1 EC and Article III-185, paragraph 1 of the Constitution; Article 2 of the Statute).

2.3 THE OBJECTIVES OF THE ECB AND ESCB (EUROSYSTEM)

Nothing has changed as far as the objectives of the ESCB/ECB are concerned (Articles III-185 and Statute, Article 2). The suggestion made by some participants in the Working Group on Economic Governance to add a reference to growth and employment was not accepted by the Group. So the primary objective remains price stability and, without prejudice to that objective, the support of economic policies in the Union that support the general objectives as laid down in Article I-3 and which include among other aims, a social market economy and sustainable development. This topic is covered by the contribution of Servais and Ruggeri in this volume. We will observe that the application of the objectives of monetary policy to the Member States whose currency is not the euro is not treated the same way in the Constitution as it is in the Statutes, which are an integral part of it. Under Article III-197, a transitory provision, which lists in paragraph 2 the provisions of the Constitution which do not apply to non-participating Member States, paragraph 1 of Article III-185, on the objectives, is declared to be inapplicable. In the ESCB Statute, under Article 43, paragraph 1, Article 2 on the objectives is not quoted in the list of inapplicable provisions. Which of these provisions should then prevail? It has to be observed that the situation is no different now, as the same inconsistency exists. Is the question only a theoretical one? Partly yes, because “stable prices”

30 Ibid., p. 288. There is an explicit exclusion of transactions carried out in pursuit of monetary, exchange rate or public debt management policy by “a Member State, by the ESCB, by a national central bank or by any other officially designated body, or by any person acting on their behalf” in Article 7 of the Directive 2000/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), OJ L 96, 12.4.2003, p. 16. As far as the obligations of persons working at the ECB are concerned, see point 3.7 of the Code of Conduct of the ECB adopted in accordance with Article 11.3 of the Rules of Procedure of the ECB, OJ C 76, 8.3.2001, p. 12.

31 R. Smits, op. cit. in footnote 13, p. 27; F. Elderson and H. Weenink, op. cit., p. 288.

32 R. Smits, op. cit. in footnote 13, p. 27. The production of banknotes appears to be a case in point. The ECB has decided that a common Eurosystem competitive approach with tendering will be fully implemented by 2012 at the latest. The national central banks with in-house/public printing works will be allowed to opt out of this common approach, see ECB Annual Report 2003, p. 95. In 2004 the Euro Private Banknote Printers Association (EUPBA), created in 2002, submitted a complaint to the Commission against alleged anti-competitive behaviour by national central banks and other public printers, apparently on third markets, see Het Financieele Dagblad, 23 April 2004.

is a requirement for all Member States under Article III-177, sub-paragraph 3 (ex Article 4, paragraph 3 EC). On the other hand, under Article I-30, “Member States whose currency is not the euro, and their central banks, shall retain their powers in monetary matters”. They are able in the transition period to state their own priorities compatible with the Treaty in order to promote their economic recovery and to decide the path (or at least the rhythm) that they will follow in order to adopt the euro. “Price stability” as such has been promoted by the Constitution, but as one objective among others. There are reasons to admit some flexibility for the “Outs”. At any rate, there is no other sanction provided for them apart from critical convergence reports and delayed entry into Economic and Monetary Union.

2.4 INDEPENDENCE AND ACCOUNTABILITY

2.4.1 INDEPENDENCE OF THE ECB AND OF THE NATIONAL CENTRAL BANKS

Article I-30 confirms the independence of the ECB in the following terms: “it shall be independent in the exercise of its powers and in the management of its finances.” This provision is developed by Article III-188, which takes over the content of Article 108 EC. In a letter of 5 June 2003 and in its Opinion to the IGC of 19 September 2003, the ECB requested recognition of the independence of the national central banks in Article I-30. It wanted this provision to be in line with Article III-188. Obviously, the ECB feared the possible modification of Article III-188 under the simplified procedure. Nevertheless, the wording of Article I-30, paragraph 3, remains unchanged. It does not appear to be a threat to the independence of the national central banks, because, as observed in 1991 by Governor de la Rosière, one cannot conceive of an institution in charge of a single monetary policy which would include delegations with instructions that are possibly contradictory.34

2.4.2 FINANCIAL INDEPENDENCE

The specific mention of financial independence is new and a welcome innovation because, although the budgetary independence of the ECB was recognised in practice, and by the Court in its already quoted judgment of 10 July 200335, it did not have special recognition either in the Treaty or in the Statute.36 Article 26 of the Statute relates only to accounting and reporting. The word “budget” does not appear in the Statute. Budgetary independence was, and still is, held to be inherent in the nature of an independent central bank.

2.4.3 DEMOCRATIC ACCOUNTABILITY

No progress has been made with regard to the degree of accountability of the ECB, a natural complement of its independence.37 The Constitution, by including

35 Point 132.
36 One of the principles applicable to the (general) budget of the EC is the principle of unity, from which there are a certain number of exceptions, see “Les Finances de l’Union européenne”, Commentaire J. Mégret, Vol. 11, 2nd ed. (Brussels: Editions de l’Université de Bruxelles, 1999), p. 265, No 497.
Article III-383, paragraph 3 (cf. Article 113 EC), creates the conditions for the continuation of what has been called the “monetary dialogue” between the ECB and the European Parliament.38

The Italian presidency of the IGC has proposed to enlarge the scope of provisions covered by the existing enabling clause (the so-called simplified revision under Article 107, paragraph 5, which is under the present treaty limited to technical or financial provisions) for amending the ECSB/ECB statute.39 The Articles which would have been added to the list were Articles 10 to 12, concerning the Governing Council and the Executive Board, as well as Article 43, which states the provisions of the Statute to be applied and those that do not apply to central banks of countries whose currency is not the euro. The ECB vigorously protested against this suggestion in a letter by its President of 26 November 2003. It argued that the simplified procedure would encompass any change to the basic provisions governing the decision-making bodies of the ECB. It would also do away with the need for each Member State to ratify, as currently foreseen in Article 10.6 of the Statute regarding the voting power within the Board of Governors. “This would imply a far-reaching change to the current constitution of the ESCB, which the Governing Council cannot support.” The IGC did not adopt the Italian suggestion. This means that most of the statutory rules governing the ESCB/ECB will remain at the level of primary (constitutional) law, which guarantees that the status quo will be preserved, but also represents a situation that is in stark contrast to the powers of the Legislature over the central bank in any state in the world.40 This may be explained by the fact that the ECB is still a young institution that needs to strengthen its position.

2.5 OTHER INSTITUTIONAL ASPECTS AND LEGAL INSTRUMENTS

2.5.1 THE APPOINTMENT OF THE MEMBERS OF THE EXECUTIVE BOARD AND VOTING IN THE GOVERNING COUNCIL

Article III-382 substitutes a Decision of the European Council by qualified majority vote to the common agreement of the governments of the Member States at the level of Heads of State or Government, regarding appointing members of the Executive Board. This change will contribute to avoiding the appearance of “horse trading”. On the other hand, it will make it easier for larger states to form coalitions designed to assure the continuity of their “representation” on the Executive Board.

It should also be recalled that, on the basis of an enabling clause inserted in the Statute by the Treaty of Nice, the Council, at the level of Heads of State and Government, has adopted a Decision modifying Article 10.2 of the Statute from the perspective of enlargement.41 This Decision has been submitted to the
ratification of the Member States under their constitutional provisions. It establishes a system of asymmetric rotation within the Governing Council in which governors of national central banks exercise successively and at a distinct frequency their voting rights.\textsuperscript{42}

\subsection*{2.5.2 Legal Instruments}

The first part of the Constitution provides a new classification and hierarchy of legal instruments. Article I-33 lists the legal acts of the Union: European law, European framework law, European regulations, European decisions, recommendations and opinions. So the regulations and decisions of the ECB become respectively European regulations and European decisions in Article III-190 of the Constitution and in Article 34 of the Statute.

Like the present Treaty, the Constitution does not mention the guidelines and instructions that are addressed to the national central banks, and which are the main instruments used by the ECB within the System. They still are provided in Articles 12 and 14 of the Statute, as annexed to the Constitution, and there is no reason to believe that they will lose their prominent role among the instruments used by the ECB.

As far as recommendations are concerned, the Constitution innovates. Article I-35, paragraph 3, provides that the ECB adopts recommendations “in the specific cases provided for in the Constitution”. Such a condition has not been introduced in Article 34 of the Statute, but it seems obvious that the new wording of the Constitution will prevail. An example of a provision enabling the ECB to adopt a recommendation is Article III-187, paragraphs 3 and 4, which confers on the ECB the right of initiative for the adoption of legislative acts.

Another question is raised by the new classification and hierarchy of the legal acts, especially between a European law and an (autonomous) regulation, be it of the ECB or of the Council.\textsuperscript{43} It is certain, as observed in the literature, that there are other principles than purely hierarchy to resolve a possible contradiction between two norms\textsuperscript{44}, such as the principle of \textit{lex specialis}, the restrictive interpretation of an exception to a general rule, \textit{lex posterior}, etc. Indeed, under the Constitution, laws and regulations have their respective domains. However, as the same author observes, although the Constitution does not explicitly establish the primacy of the law on regulations, it is most probable that the Court will be inclined to establish such a ranking between two legal acts, considering in particular that the conditions of appeal of private persons against regulations under Article III-365, paragraph 4, have been made easier than appeals against laws.\textsuperscript{45} Of course, there is no problem when the Constitution itself includes a “no prejudice clause” that preserves the legal acts adopted by the ECB, but there is but one example (which we have already mentioned) of such a

\begin{footnotesize}
\begin{enumerate}
\item \footnotesize Ibid., p. 216, point 9.
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favourable situation, namely the regulation of the establishment of statistics (Article III-429).

2.5.3 THE PRINCIPLE OF SUBSIDIARITY
As an institution of the Union, the ECB is bound by the principle of subsidiarity in the fields that are not within the exclusive competence of the Union (Article I-11, paragraph 3). It should not be considered as an innovation if one takes note that the ECB is already part of the Community, which under Article 5 EC is bound by this principle. What is new under Article 3 of the Protocol on the application of the principles of subsidiarity and proportionality is the obligation of the ECB to comply with the procedure of transmitting to the national parliaments its recommendations aiming at the adoption of a “European legislative act”, *insofar as the proposed act does not fall within the exclusive competence of the Union*. The ECB is indeed competent under Article III-187, paragraphs 3 and 4, for initiating, via recommendations, the legislative procedure for a simplified revision of the Statute and for adopting so-called complementary legislation on statistics, compulsory reserves, sanctions, etc.

The recommendation is transmitted through the Council (Protocol, Article 4). As with the legislative initiatives of the other EU institutions, groups of Member States or the European Investment Bank (EIB), the purpose of transmission is to enable national parliaments to issue, within six weeks, a reasoned opinion on whether the draft complies with the principle of subsidiarity (“Early warning procedure”). The opinion will be transmitted to the ECB by the president of the Council (Article 6). If at least one-third of all the votes allocated to the national parliaments (two votes for each national parliament, shared among the assemblies in case of bicameralism) consider that the draft does not comply with the principle of subsidiarity, then it must be revised (Article 7). The ECB may decide “to maintain, amend or withdraw the draft. Reasons must be given for this decision”. So, in principle, the ECB remains legally free to choose whether to follow the opinions of the national parliaments. To borrow a metaphor from football, these opinions function like yellow cards, rather than red ones. However, if there is widespread agreement in the national parliaments, then the pressure on the drafter of the text will be considerable.

2.5.4 OPENNESS AND TRANSPARENCY
Article I-50 of the Constitution enshrines the principle of openness and the right of access of citizens and residents of the Union to documents of institutions, bodies and agencies of the Union, whatever their medium. The right of access to documents is also provided in the Charter of Fundamental Rights (Article II-102). The principle of openness is recognised by Article 1, sub-paragraph 2, of the Treaty on European Union (TEU), and the principle of access to documents is taken from Article 255 of the EC Treaty, where it applies only to the European Parliament, the Council and the Commission, and enlarged to all the institutions, bodies and agencies. The conditions of application of the

46 The justification of the draft legislation must also encompass the principle of proportionality. See Protocol, Article 5.
principle of access to documents are included in Article III-399. This article limits the obligation of access to documents of the Court of Justice, the ECB and the EIB to their exercise of administrative functions. The ECB has recently adopted a Decision on public access to the documents of the ECB. 47

2.5.5 THE IMPLICATION OF THE ECB IN REVISION PROCEDURES

We have already mentioned the role of initiative of the ECB in the simplified revision of its Statute. The Convention has introduced the legislative procedure in this field and modifies the rule of the existing treaty, which provides for unanimity in the Council if the act is based on a proposal from the Commission, and qualified majority if it is based on a recommendation of the ECB. In his letter of 16 April 2004, the President of the ECB requested equality of rights for the Commission and the ECB in the procedure. Article I-25, paragraphs 1 and 2, indeed makes it easier to reach a qualified majority in the Council when the act to be adopted is based on a proposal by the Commission than if it is not. This traditional rule expresses the philosophy of the initiative competence of the Commission under the treaties. However, the IGC did not agree to the request of the ECB.

In its letter of 16 April 2004 the ECB also asked the IGC to ensure that the ECB is consulted in the simplified procedure if the provisions of Title III of Part III of the Constitution on the internal policies and actions of the Union are amended, should an institutional change concerning the ECB be proposed. The ECB must indeed be consulted on such changes as part of the ordinary procedure (see Article IV-443 and Article 48 TEU). In its earlier opinion of 19 September 2003, the ECB also asked to be consulted in the negotiation of agreements with a Member State that has notified its decision to withdraw from the Union, if these arrangements include provisions that affect the institutional status of the ECB. The IGC accepted the first but not the second of these requests. It should be noted that the Constitution does not foresee the consultation of the ECB in the case of any change from unanimity to qualified majority voting or for the introduction of ordinary legislative procedure under the so-called passerelle (or cross-over) procedure, a simplified revision procedure under Article IV-444, notwithstanding the fact that the recourse to this procedure may affect the institutional balance in monetary policy.

CONCLUSION

The Constitution does not include any revolutionary changes as far as monetary policy and the ECB are concerned. As observed by the ECB in its opinion of 19 September 2003, delivered after the work of the Convention had been completed, “the tasks, mandate, status and legal regime of the ECB and of the ESCB remain substantially unchanged.” At the end of the IGC, Otmar Issing observed in an interview that “Die EU-Verfassung ist eine Bestätigung der

entscheidenden Elemente der Europäischen Währungsverfassung: der Unabhängigkeit und des Mandats der EZB". Nevertheless, as we have observed, it is not yet possible to foresee all the consequences for the ECB that will derive from recognition of its new institutional status, or the implications for its activities of the classification and hierarchy of norms introduced by the Constitution.

THE EU CONSTITUTION: ITS IMPACT ON ECONOMIC AND MONETARY UNION AND ECONOMIC GOVERNANCE

Dominique Servais and Rodolphe Ruggeri

ABSTRACT

Il contributo analizza l’impatto della Costituzione europea sul funzionamento dell’Unione economica e monetaria e sul governo dell’economia. Conformemente alla dichiarazione di Laeken, la Costituzione sancisce la separazione delle competenze tra l’Unione e gli Stati membri. Tuttavia lo studio sostiene che, a motivo della sua specificità, il coordinamento delle politiche di bilancio ed economiche è una competenza UE sui generis. La Costituzione non apporta modifiche fondamentali all’attuale governance economica della UE. Il ruolo della Commissione è in qualche modo rafforzato nel settore delle politiche di Multilateral Surveillance Procedure e Excessive Deficit Procedure; nel Consiglio sono introdotte nuove regole di votazione ma il loro impatto è limitato ed il ruolo del Parlamento rimane, nell’insieme, invariato. La situazione è piuttosto diversa per quanto concerne la governance dell’area dell’euro, la cui autonomia è notevolmente accresciuta. La Costituzione dà facoltà agli Stati membri dell’area di adottare misure specifiche per le politiche di bilancio ed economiche della stessa area. Viene anche notevolmente incrementato il numero dei casi in cui nel Consiglio votano esclusivamente gli Stati membri dell’area dell’euro, mentre il ruolo dell’Eurogruppo è ufficialmente riconosciuto nella Costituzione. Tuttavia, ciò non implica la creazione di uno specifico Consiglio Ecofin per l’area dell’euro. Infine, ulteriori modifiche vengono apportate nei campi della rappresentanza esterna della UEM, delle misure che governano l’utilizzo dell’euro e l’entrata nella UEM, delle procedure semplificate di revisione, ecc. La Costituzione non corregge l’esistente squilibrio tra i due pilastri della UEM, quello economico e quello monetario, ma apre la porta a una migliorata governance economica all’interno dell’area dell’euro. I Ministri finanziari dell’area dell’euro raccoglieranno la sfida?
INTRODUCTION

Enhancing economic policy coordination was one of the items put on the agenda of the Convention by the European Council of 14-15 December 2001. Many economic and political observers have indeed criticised the asymmetry between the economic and the monetary parts of Economic and Monetary Union (EMU). National governments remain responsible for the conduct of economic and budgetary policies, while monetary policy has been transferred to the European level. Loose and mostly non-binding coordinating mechanisms are in place in the economic field, while a centralised decision-making process has been established within the Eurosystem in charge of the monetary policy of the euro area.

A Working Group on Economic Governance, chaired by Klaus Hänsch, was established within the Convention to discuss this issue. Members of the Convention proved to be deeply divided, resulting in only limited progress on this issue, although some doors were nevertheless opened. The final result reached by the Intergovernmental Conference (IGC) is very similar to the conclusions of the Convention’s proposals.

The Constitution not only reorganises the provisions of the European Union (EU) Treaty: it also brings some changes. In this paper, we analyse these from different points of view: the Union’s objectives and symbols (Chapter 1); the respective competencies of the Member States and the Union in the economic field, and more particularly the specific position of the competence to coordinate economic policies among the competencies of the Union (Chapter 2); economic governance within the Union (Chapter 3); and economic governance within the euro area (Chapter 4). Finally, we will examine some other relevant changes in the field of external representation, measures governing the use of the euro, entry into EMU, withdrawal from the Union, and the revision procedures (Chapter 5).

This contribution does not cover amendments to the institutional position of the European System of Central Banks (ESCB) and the European Central Bank (ECB), which are addressed in Professor Jean-Victor Louis’ contribution to this volume.

1 THE OBJECTIVES AND SYMBOLS OF THE UNION

The objectives of the Union were reviewed first by the Convention and then by the IGC, resulting in the introduction of a specific title in the Treaty regarding the Union’s symbols.

1 See the “Laeken Declaration on the future of the European Union”, annexed to the Presidency conclusions.
1.1 THE UNION’S OBJECTIVES

The Maastricht Treaty referred to “the establishment of economic and monetary union, ultimately including a single currency”, as a means of realising the Union’s objective “to promote economic and social progress and a high level of employment and to achieve balance and sustainable development”. Since EMU is now a tangible reality, references to its establishment have disappeared from the Union’s objectives. However, Part I of the Constitution mentions some of EMU’s core elements. One of these is price stability, which should be regarded as a cornerstone of EMU.

Besides the existing reference to balanced economic growth, the Constitution mentions price stability as among the objectives of the EU. Price stability was introduced into the Constitution at a late stage in the IGC negotiations, following lengthy discussions and constant and repeated advocacy by the Eurosystem. The Eurosystem’s arguments in favour of such an explicit reference can be summarised in three main points. First, non-inflationary growth is mentioned as one of the Community’s objectives in the Treaty establishing the European Community (“the Treaty”). Second, “Price stability is not only the European System of Central Banks’ primary objective but also forms part of the heart of monetary union for all European citizens; in this sense ‘stable prices’ clearly benefit society [...]”. Third, the introduction of a simplified procedure to amend Part III of the Constitution, which includes the EMU provisions (see section 5.7), rendered this reference necessary in order to strengthen the commitment towards price stability.

Hence, Article I-3 (3), first indent, of the Constitution reads: “The Union shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance.” However, this wording is not entirely free of ambiguity. Is price stability referred to as a goal, or as a means to achieve the sustainable development of Europe alongside balanced economic growth, a competitive social market economy, etc.? This is a hard question to answer and may be the subject of considerable debate.

To maintain price stability is the primary objective of the Eurosystem. In this regard, it should be noted that mentioning price stability among the Union’s objectives does not change, widen or restrict the primary objective of the Eurosystem’s monetary policy. In fact, the question had been put forward by...
some Convention members. However, it was considered that “maintaining price stability is the best contribution monetary policy can make with regard to the achievement of other economic goals”.

As an objective of the Union, price stability should also constitute a guiding principle for all EU institutions when they act in the economic field and play a key role in the definition of Member States’ economic policies and their coordination through the Broad Economic Policy Guidelines and through budgetary discipline.

1.2 THE SYMBOLS OF THE UNION

The euro, as the currency of the Union, is one of the key symbols of the EU, together with the flag, the anthem, the motto (“united in diversity”) and Europe Day. With this provision, the Constitution corrects a peculiarity of the Treaty: the Maastricht Treaty wording referring to the ECU (European Currency Unit) as the single currency was never changed, and the legal status of the euro was instead derived from a Council regulation.

The Constitution presents the euro as the currency of the Union. However, in other instances, the Constitution refers to “the Member States whose currency is the euro”. So, whose currency is the euro? Is it the currency of the Union, or the currency of its Member States? It could be the former, given that Article I-7 of the Constitution gives legal personality to the Union. However, as not all Member States have joined the euro area yet and given the place where the euro is referred to as the currency of the Union, we regard this reference to the euro as the “currency of the Union” as being primarily symbolic. Legally, the euro remains the currency of those Member States which have adopted the euro, as stated in the substantive provisions of the Constitution. Therefore, this “new and explicit” status as the currency of the Union should not change the nature of the euro, nor have any impact on the functioning of EMU.

In the long run, however, it might have some influence on the current neutrality policy of the EU institutions with regard to the international role of the euro. Indeed, as a symbol of the Union or a token of its identity, the euro might also acquire a political dimension, as indeed was the case with the old legacy currencies (e.g. the Deutsche Mark), which were symbols of national identity to which citizens were bound and that they aimed to protect or to promote.

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6 ECB Monthly Bulletin, op. cit. in footnote 3, p. 58. For further considerations in this respect, the reader is invited to consult the contribution of Professor Jean-Victor Louis in this volume.
7 Article I-8, 4th indent, of the Constitution.
9 Articles I-13 (1) (c), I-15 (1), I-30 (1), III-194, III-195, III-196 (3), III-197 (2) and (4) and III-198 (2) and (3) of the Constitution.
2. THE COORDINATION OF ECONOMIC POLICIES: A SPECIAL CASE IN THE CATEGORIES OF THE UNION’S COMPETENCE

One of the main objectives of the Convention on the Future of Europe – as described in Declaration 23 annexed to the Treaty of Nice – was to establish “a more precise delimitation of powers between the European Union and the Member States”. The subsequent Declaration of Laeken repeated the need to “clarify, simplify and adjust the division of competence between the Union and the Member States in the light of the new challenges facing the Union”.

Given this clear mandate, the Convention and the IGC have undertaken to clarify the allocation of powers between the Union and its Member States on the basis of the principle of conferral as well as on the definition of categories of the Union’s competence. The principle of conferral belongs to the fundamental principles on which the entire European integration process rests. In accordance with this principle, the Union must act within the limits of the competences conferred upon it by the Constitution in order to achieve the objectives set out in the Constitution. Conversely, competences that are not conferred upon the Union by the Constitution thus remain with the individual Member States.

On this basis, Article I-12 of the Constitution enumerates three main categories of competences which are entrusted to the Union and further detailed in Part III of the Constitution: exclusive competence, which includes the monetary policy of the Member States whose currency is the euro; shared competence; and finally, the “competence to carry out actions to support, coordinate or supplement the actions of the Member States”. In addition to these three categories, Article I-12 (3) states that “the Member States shall coordinate their economic and employment policies within arrangements as determined by Part III, which the Union shall have competence to provide”.

What is the nature of this competence of the “coordination of economic and employment policies”? To which category of competence does it belong? This issue is a complex one, and is examined below.

11 European Council of Laeken, 14 and 15 December 2001, Declaration annexed to the conclusions of the summit.
12 Article I-11 (1) of the Constitution.
13 Article I-11 (2) of the Constitution.
14 Article I-12 (1). For an exhaustive list of the exclusive competences, see Article I-13 (1) of the Constitution.
15 As Jean-Victor Louis mentions in his paper in this volume, some authors suggest a broad interpretation of this concept. The wording of the ECB Opinion of 19 September 2003 addressed to the IGC, which has been invoked in this debate in favour of a broad interpretation, was especially carefully chosen to avoid entering into this debate on the scope of the exclusive competencies. The ECB Opinion clearly refers to the wording of the provisions of Part III related to monetary policy. This results in our view that the Eurosystem’s exclusive competence covers the conduct of monetary policy and of foreign exchange operations as well as the holding and management of the official foreign reserves of the Member States. Competences are, on the other hand, in our view shared in the field of payment systems, where the Eurosystem’s task is “to promote the smooth operation of payment systems”, as well as in the field of financial stability, where the Eurosystem’s task is “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”. See also the view expressed by the ECB in H. K. Scheller, The ECB, History, Role and Functions (Frankfurt: ECB, 2004), p. 142.
16 Article I-12 (2) of the Constitution.
17 Article I-12 (5) of the Constitution.
The provisions of Article I-12 (3) must be read in conjunction with Article I-15 (1), which further describes the type of competence that the EU can exercise in the field of economic policy. Article I-15 (1), first indent, reads as follows: “The Member States shall coordinate their economic policies within the Union. To this end, the Council of Ministers shall adopt measures, in particular broad guidelines for these policies”. The wording closely reflects Article 99 (1) of the Treaty. It can be argued that it follows from the wording of Article I-15 (1) that the coordination of economic policy does not belong to “exclusive” or “shared” competences\(^1\), but solely consists of a coordinating role on the part of the EU. Moreover, Article I-15 (1) leaves no doubt as to the economic competence of the Member States. Hence, the coordination of economic policies should pertain to the third main competence of supporting, coordinating or complementary action.

However, Article I-14 (1) of the Constitution seems to invalidate this hypothesis by clearly stating that “the Union shall share competence with the Member States where the Constitution confers on it a competence which does not relate to the areas referred to in Articles I-13 and I-17”, i.e. exclusive competence and areas of supporting, coordinating or complementary action respectively. In addition, it can be derived from the wording of the second paragraph of Article I-14 that the list of “principal areas” of shared competence it contains is not exhaustive. Since the coordination of economic policies is not mentioned as an exclusive competence or among the areas of supporting, coordinating or complementary action, one could conclude that it belongs to the category of shared competence.\(^1\)

During the work of the Convention, some members of the Working Group on Economic Governance considered that “in order to ensure economic growth, full employment and social cohesion, this should extend to bringing macro-economic policy within the shared competence of the Union and the Member States”. However, in its final Report to the Convention plenary, the Working Group recommended that “the current structure whereby exclusive competence for monetary policy within the Eurozone lies with the Community, exercised by the ECB under powers conferred upon it by the existing Treaty, and competence for economic policy with the Member States, should be maintained”.\(^2\)

We argue that the coordination of economic policies, given its specificity, forms a distinct category of the Union’s competence. This interpretation is supported by five key arguments.

First, a specific provision deals with the coordination of economic policies, not only in Article I-12, which lists the different categories of competence, but also in the following Articles that describe each of them. Indeed, Articles I-13 to I-17 repeat the same logical order as Article I-12: Article I-13 first deals with exclusive competence; Article I-14 then describes the areas of shared competence; next come the provisions of Article I-15 on the coordination of

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1. These are listed in Articles I-13 and I-14 respectively.

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economic policies; and finally Article I-17 deals with areas of supporting, coordinating or complementary action. Sources argue that this represents a deliberate choice by the Convention to underline the specific nature of the Union’s competence in the coordination of economic policies.21

Second, when the Union shares a competence with the Member States, it may legislate and adopt legally binding acts in that area.22 In the coordination of economic policies, on the other hand, the Council adopts Broad Economic Policy Guidelines. The Broad Economic Policy Guidelines are adopted under the form of a Recommendation, which is not legally binding, unlike other instruments such as European laws or framework laws. Furthermore, Article I-12 (2) specifies that “the Member States shall exercise their competence to the extent that the Union has not exercised, or has ceased to exercise, its competence”. Since the Union cannot adopt legally binding acts and the individual Member States retain their basic competence in economic policy, this cannot be a shared competence.23

Third, Article I-15 does not merely entrust the EU with a competence, but notably provides that “the Member States shall coordinate their economic policies within the Union”. Different wordings were used in the various drafts produced by the Convention. Initially, the emphasis was exclusively put on the Union’s competence; a reference was then progressively reintroduced regarding the Member States’ competence (compare Article I-11 (3) with Article I-14 (1), 2nd sentence of the “Draft Treaty establishing Constitution for Europe”, submitted to the European Council on 20 June 2003). The IGC completed the shift of emphasis in favour of the Member States’ competence.24 As pointed out by P. J. G. Kapteyn, “care is taken to avoid anything that could be explained as conferring on the Union itself a competence to co-ordinate the economic and employment policies of the Member States. Obviously Member States were prepared to go to great length to protect themselves against encroachment of their powers in these fields”.25 The Union resembles a forum where coordination takes place but without the ability to play its own role. In this sense, the concept of coordination seems to be limited to the strict application of the rules foreseen in Articles III-179 and III-184.

Fourth, the power of the Council to adopt sanctions against individual Member States in the framework of the Excessive Deficit Procedure makes the

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21 In his commentary on the Convention’s work, “Vers une Constitution européenne”, Etienne de Poncins clearly affirms that the competence remains within the realm of the Member States, which thus leaves absolutely no room for a shared competence between the Union and its Member States. He adds that the Union only coordinates the policies of the Member States, and that it is because of the importance of this coordination that the Convention deemed it necessary to mention it in a separate Article (see E. de Poncins, Vers une Constitution européenne. Texte commenté du projet de traité constitutionnel établi par la Convention européenne (Paris: Editions 10/18, 2003), p. 108).
22 Article I-12 of the Constitution.
23 Peter Norman writes that the coordination of economic policies was given its own article because of its political importance and because it did not involve legislation (see P. Norman, The Accidental Constitution: The Story of the European Convention (Brussels: EuroComment, 2003), p. 197).
coordination of economic policies a specific competence. Not even in the areas of exclusive competence may the Council exercise such power. The only other instance where the Council has similar power is the suspension of voting rights in the case of a breach by a Member State of the values of the Union.

Fifth, the coordination of economic policies does not belong to the third category of competence either. In the areas of supporting, coordinating or complementary action, the Union may adopt legally binding acts when it chooses to act, although its actions do not supersede the competence of the Member States. By contrast, in the coordination of economic policies the Union does not have the power to adopt legally binding acts, nor the choice to exercise its competence.

Therefore, we consider that the coordination of economic policies neither belongs to the area of shared competence nor to the areas of supporting, coordinating or complementary action, but is instead a specific competence. By confirming that the competence for economic policy remains national and by conferring to the Union only a very limited competence regarding the coordination of economic policies, the Constitution does clarify the allocation of power between the Union and its Member States. However, it does not touch upon the existing imbalance between the two pillars of EMU, i.e. economic union and monetary union. Except for some changes and improvements (see Chapters 3 and 4), one may argue that the structural weakness of EMU in terms of economic and budgetary policy remains fundamentally unchanged. This lack of political will towards further integration explains the difficulties encountered for instance in the implementation of the Stability and Growth Pact (SGP) or in the external representation of EMU. As we have seen, such structural weaknesses also have an impact on the instruments used (i.e. non-legally binding acts). This also considerably limits the possibility for the euro area to move towards an economic government even if Article I-15 (1), second indent, provides that “specific provisions shall apply to those Member States whose currency is the euro” (see section 4.1).

3 THE ECONOMIC GOVERNANCE OF THE EU

One basic feature of the Maastricht Treaty (and thereafter the EU Treaty) is that the provisions which relate to the coordination of economic policies apply to the whole Union. Except in very limited cases, the same rules apply to both euro area and non-euro area Member States. While maintaining this basic feature, the Convention and later the IGC discussed some changes with the aim of improving the economic governance of the EU.

26 See Triantafyllou, op. cit., pp. 47-49.
27 The German Chancellor Gerhard Schröder published a scathing open letter in this respect: “The pact will work better if intervention by European institutions in the budgetary sovereignty of national parliaments is only permitted under very limited conditions. […] In addition, more respect should be given to EU members’ primary competence over economic and fiscal policy […]”, Financial Times, 17 January 2005.
28 Kapteyn, op. cit.: “The asymmetry of the ways economic and monetary policy objectives are pursued under the EC Treaty has been retained in the Constitution” (p. 124).
3.1 THE ROLE OF THE COMMISSION

The Commission’s role is somewhat strengthened both in the multilateral surveillance procedure of Article III-179 and in the Excessive Deficit Procedure of Article III-184.

First, in both procedures, the Commission’s role as “guardian of the Treaty” or as “independent referee”\(^\text{29}\) will be strengthened, as it will be able to address an early warning directly to the Member State concerned. For the moment, this possibility is reserved to the Council and limited to the preventive arm of the SGP.\(^\text{30}\) Under Article III-179, the Commission will have the possibility to issue an early warning to a Member State when it has established that its economic policies are either not consistent with the Broad Economic Policy Guidelines, or risk jeopardising the proper functioning of Economic and Monetary Union. This will cover the case of a significant budgetary deviation, thereby avoiding the repetition of the January 2002 episode, when the Council decided not to issue an early warning to Germany and Portugal, contrary to the Commission’s recommendation. When issuing its warning, the Commission will alert a Member State at an early stage, thereby allowing that Member State to take the necessary measures with the view to avoiding an excessive deficit situation. Under Article III-184, when the Commission considers that an excessive deficit in a Member State exists or may occur, it will now have “to address an opinion” to the Member State concerned. This opinion could also be considered as a warning, providing a Member State with the opportunity to take supplementary measures and show goodwill, which would thus weigh favourably on the Council’s decision as to whether an excessive deficit actually exists. However, because this opinion will be issued just before the Council decision, it can also be regarded mainly as being merely informative (no notification procedure currently exists when the Commission considers a Member State to be in an excessive deficit situation).

Second, in the Excessive Deficit Procedure, Council decisions on the existence of an excessive deficit in a Member State will be based on a Commission proposal instead of a recommendation. Again, the right of initiative of the Commission will be reinforced, since the Council needs unanimity to deviate from a Commission proposal as opposed to qualified majority in the case of a recommendation. However, this represents the only case where the Constitution extends the use of Commission proposals as opposed to recommendations. The Commission had advocated for a more general use of proposals in the EMU chapter, particularly regarding the adoption of the Broad Economic Policy Guidelines and associated surveillance measures.

3.2 THE NEW VOTING RULES IN THE COUNCIL

To cope with an enlarged Union, the decision-making process within the Council had to be revised. Besides the new double majority rule, two other amendments


\(^{30}\) In the event that the Council identifies that the budgetary position of a Member State has significantly diverged from its medium-term objective or the adjustment path towards it (see Council Regulation (EC) No 1466/97, Articles 6.2 and 10.2).
were introduced which are specific to EMU. The first and most important of these amendments consists in increasing the number of cases where only the euro area Member States take decisions (given its importance, this issue will be dealt with in a separate chapter). The second amendment consists in extending the list of cases where the Council can act without the vote of the Member State in question.

3.2.1 THE EXCLUSION OF THE MEMBER STATE IN QUESTION FROM THE VOTE

In the exercise of multilateral surveillance, the Council may address the necessary recommendation to a Member State when it has established that the economic policies of this Member State are not consistent with the Broad Economic Policy Guidelines or that they risk jeopardising the proper functioning of EMU. It shall act without taking into account the vote of the Member State concerned, whereas “under the present rules, this Member State is judge and defendant at the same time”. It can be argued that “the change of practice introduced by the Constitution will help to strengthen the impartiality of multilateral surveillance. In doing so the Constitution moreover removes the existing bias in favour of large Member States, since under the current arrangements the latter can constitute a blocking minority more easily than the smaller countries because of their larger voting weight”.

In the Excessive Deficit Procedure, the same exclusion of the vote applies when the Council decides whether an excessive deficit exists. Strangely enough, such a vote exclusion has not yet been applied to that decision, although it has already been applied to the other measures taken by the Council in the context of the Excessive Deficit Procedure. The Constitution fills this gap.

As a result, the Constitution ensures that each time the economic or budgetary policy of a Member State is discussed, this Member State cannot take part in the vote. This constitutes an important achievement. As we shall see below, the exclusion mechanism also facilitates the decision-making process, “since the voting threshold will be lowered and will thus be easier to reach”.

The exclusion of a Member State from the vote is not specific to decisions related to economic policies. It also applies when suspending certain rights of the Member States that seriously breach or risk breaching the values of the Union, or if the Member State voluntarily withdraws from the Union. However, this exclusion mechanism is not always exercised in EMU-related decisions concerning a particular Member State. For instance, a Member State with a derogation can take part in votes concerning decisions granting mutual assistance or authorising protective measures in case of difficulties or a crisis in its balance of payments. To provide another example, a Member State with a derogation

31 Article III-179 (4), second indent, of the Constitution.
33 Ibid., pp. 261-62.
34 See Article III-184 (6) of the Constitution.
35 See Article 104 (13) of the EC Treaty.
37 Articles I-59 and I-60 of the Constitution respectively.
38 See Articles III-201 and III-202 of the Constitution.
can participate in the decision to lift its derogation, as well as in the decision that irrevocably fixes the rate at which the euro is to be substituted for its currency.\textsuperscript{39}

\subsection*{3.2.2 THE NEW DOUBLE MAJORITY RULE}

The voting modalities in the Council certainly constitute one of the longest debated institutional issues during the Convention and the IGC. The horse-trading concerning weighted voting in the negotiations of the Nice Treaty led to substantial criticism. Pressure was thus high on the members of the Convention and the IGC to come up with a more democratic and simple system. As a result, they proposed a system of double majority voting.

\section*{A. The final regime (after 1 November 2009)}

Article I-25 (1) of the Constitution introduces the double majority voting system. A qualified majority shall require a minimum of 55\% of the Member States, or a minimum of 15 of them, whichever is the greater, and together they must represent at least 65\% of the EU population. A blocking minority requires more than 35\% of the EU population and at least four Member States. However, according to Article I-25 (2), when the Council does not act on the basis of a Commission proposal, a qualified majority requires 72\% of Member States, representing at least 65\% of the EU’s population.

Does this higher threshold of 72\% of the Member States and 65\% of the population apply within the context of economic policy?

The answer is yes in the following instances:

- The adoption of the Broad Economic Policy Guidelines (Article III-179 (2));
- The adoption by the Council, acting on the basis of an ECB recommendation, of complementary legislation defining the limits and conditions of certain powers of the ECB\textsuperscript{40} (Articles III-187 (4) and III-190 (3));
- Mutual assistance and protective measures in case of difficulties or a crisis in the balance of payments in a Member State with a derogation (Articles 201 and 202 (3));
- Appointment of the members of the Executive Board of the ECB by the European Council on a recommendation from the Council (Article III-382(2)).

Conversely, the higher threshold does not apply when the Constitution establishes specific voting rules, either because the Member State concerned cannot take part in the vote, or because only euro area Member States may participate in the vote. This concerns:

- The multilateral surveillance procedure (Article III-179 (4));
- The Excessive Deficit Procedure (Article III-184 (6 and 7));
- Measures specific to the euro area (Articles III-194 (2) and III-197 (2 and 4));

\textsuperscript{39} See Article III-198 (2 and 3) of the Constitution.

\textsuperscript{40} However, the lower voting threshold will apply when the Council is acting on a proposal from the Commission. This therefore creates an uneven level playing-field between Commission proposals (which are easier to adopt) and ECB recommendations (which need a higher majority in the Council). This situation could have been corrected by applying the special voting rules in both cases.
– The external representation of the euro area (Article III-196 (3));
– The recommendation of the euro area Member States for the abrogation of
  a derogation (Article III-198 (2)).

In the latter cases, a qualified majority shall require 55% of the Member States
representing at least 65% of the population of the Member States participating
in the vote. A blocking minority shall include more than 35% of the population
of the Member States participating in the vote, plus one other Member State.

By not applying the higher threshold in these cases, as normally required when
the Council does not act on the basis of a Commission proposal, it can be argued
that the Constitution mitigates to a certain extent the consequences of the limited
role of the Commission in these areas.

B. The transitional period (until 1 November 2009)
The new voting rules, including the specific ones, will enter into force on
1 November 2009. Until then, Protocol No 34 on the transitional provisions
relating to the institutions and bodies of the Union determines, among other
aspects, the applicable voting rules within the Council. In actual fact, the
Protocol merely upholds the current weighted voting rules. According to Article
2 (2) of the said Protocol, Acts of the European Council and of the Council
requiring a qualified majority shall be adopted if there are at least 232 votes
in favour out of a total of 321, and if they represent a majority of the Member
States, when decisions are taken on the basis of a Commission’s proposal. Otherwise,
232 votes and two-thirds of the Member States will be needed.41

C. Comparison between the weighted voting and double majority regimes
This section seeks to assess the impact of the two regimes on the decision-
making process by comparing their main characteristics.
– The weighted voting rules are applicable until 31 October 2009:
  In the EU25, a qualified majority requires 232 votes out of a total of 321
  (i.e. 72%). Thus, 90 votes are required to constitute a blocking minority
  (i.e. the combined votes of at least three large Member States (29 votes each),
  plus one other Member State). In other words, four Member States are
  sufficient to block any decision.42
– The double majority regime is applicable as from 1 November 200943:
  In the EU25, a qualified majority shall require at least 55% or 72% of the
  Member States, representing at least 65% of the population of the Union. A
  blocking minority thus requires more than 35% of the population and at least

41 A member of the Council may request a check to ensure that the Member States comprising the qualified
majority represent at least 62% of the total population of the Union. If that proves not to be the case, the act
shall not be adopted (Article 2 (2), last indent, of the Protocol).
42 In some circumstances, three Member States are sufficient to block a decision. For instance, if either the United
Kingdom or Poland (both with 29 votes) is excluded from a vote in one of the cases described above, the total
number of votes will be reduced from 321 to 292. Therefore, only 210 votes are needed to attain a qualified
majority. A blocking minority then requires at least 83 votes, i.e. the cumulated voting rights of three “big”
Member States, which would comprise 87 votes combined.
43 If at least three-quarters of the blocking minority (in terms of population or number of Member States) indicate
their opposition to the Council adopting an act by a qualified majority, the Council shall discuss the issue and
do everything in its power to reach a satisfactory solution to address the concerns raised by the minority.
four Member States (or more than 35% of the population of the Member States participating in the vote, plus one Member State in those cases where a Member State has been excluded from the vote, as explained above).

To conclude, the overall balance remains more or less the same under the double majority rule as under the present weighted voting regime as far as the EU25 is concerned. The impact of this reform on future decision-making processes in the euro area is commented on below (see section 4.3).

### 3.3 THE ROLE OF THE EUROPEAN PARLIAMENT

The Constitution brings only limited changes to the role of the European Parliament.

In the context of the Broad Economic Policy Guidelines, the Constitution holds that detailed rules for the multilateral surveillance procedure may be laid down in a European law (i.e. via the co-decision procedure), whereas they are to be adopted through the so-called cooperation procedure in the current Treaty. The role of the European Parliament is hereby strengthened or, more precisely, will be strengthened if and when new rules are adopted for the multilateral surveillance procedure.

With regard to fiscal discipline, the Council may, in accordance with the cooperation procedure, adopt legal acts specifying the definitions for the application of the prohibitions relating to overdraft facilities with central banks (monetary financing prohibition), privileged access to financial institutions, and the so-called no-bailout rule. On this basis, the Council has adopted two regulations. However, these are not considered of a legislative nature, but rather of an implementing nature. Therefore, in accordance with the new hierarchy of norms introduced in the Constitution, Article III-183 (2) has opted for regulations or decisions (i.e. non-legislative and implementing acts) for the adoption of which the European Parliament does not play any role. By way of compensation, Article III-183 (2) states that the European Parliament will however be consulted. If this seems to constitute a downgrading of the European Parliament’s role, it should be noted that the existing regulations are not expected to be amended in the foreseeable future.

Finally, there are two other amendments that increase the powers of the European Parliament. In Article III-187 (3), which lays down a specific amendment procedure for some provisions of the Statute of the European System of Central Banks and the European Central Bank (“the Statute”), the Constitution moves from a Council decision to a European law. Moreover, in Article III-191, which

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44 Article 252 of the Treaty.
45 The agreement reached by the European Council on 22-23 March 2005 on the reform of the SGP will entail an adaptation of the rules for multilateral surveillance.
46 These prohibitions are laid down in Articles 101, 102 and 103 of the Treaty.
allows the enactment of necessary measures for the use of the euro, the Constitution also opts for legislative acts instead of mere measures adopted by the Council.48

3.4 THE STABILITY AND GROWTH PACT

The exclusion from the vote of the Member State concerned, together with the exclusion of the votes of those Member States with a derogation in case the budgetary position of a euro area Member State is discussed (see section 4.2), represent the only changes brought to the Excessive Deficit Procedure. On the substance, the Constitution leaves the current rules – the so-called corrective arm of the SGP – unchanged.

However, a “Declaration on Article III-184” is attached to the Constitution. This Declaration simultaneously:
– reaffirms the commitment to the provisions concerning the SGP as the framework for the coordination of budgetary policies in the Member States;
– underlines the importance of sound budgetary policy throughout the economic cycle; and confirms that a rule-based system is the best guarantee for commitments to be enforced and for all Member States to be treated equally;
– considers that the orientations of budgetary decisions should reflect the right priorities towards economic reforms, innovation, competitiveness and strengthening of private investment and consumption in periods of weak economic growth;
– states that the Member States will take all necessary measures to raise the growth potential of their economies.

It concludes however that “this Declaration does not prejudge the future debate on the Stability and Growth Pact”, a rather cautious conclusion. Thereafter, the European Council reached an agreement to reform the SGP on 22-23 March 2005 and invited the Commission to bring forward rapidly proposals to amend the Council Regulations.

4 THE ECONOMIC GOVERNANCE OF THE EURO AREA

As we have seen, the provisions relating to the coordination of economic policies apply, as a rule, to the whole Union. However, when the authors of the Maastricht Treaty drafted the provisions of EMU, they anticipated that not all EU Member States would adopt the single currency at the same time. Hence, they laid down transitional provisions according to which the Member States with a derogation would not be able to participate in votes to adopt certain measures or decisions to be taken by the Council in the field of EMU. Later, with the adoption of the euro, the ministers of economy and finance of the euro area Member States decided to gather informally to exchange views on their respective economic situations. This resulted in the creation of the so-called Euro Group.

48 For more details in this regard, see sections 5.5 and 5.2 respectively.
In view of EU enlargement, it has become increasingly evident that the transitional period could be prolonged for many years and that the euro area Member States could not and would not indefinitely delay any further coordination of their economic policies. The ministers of the euro area have persistently requested more autonomy both in the Convention and later during the IGC. The authors of the Constitution had to find a way to enable enhanced economic coordination among the euro area Member States without overly widening the gap between them and the Member States with a derogation.

The Constitution contains a number of provisions designed to achieve this delicate balance. Formally, it includes a new heading on “provisions specific to Member States whose currency is the euro”, and recognises the existence of the Euro Group through the inclusion of a special protocol. On the substance, it extends the number of cases where only the euro area Member States vote in the Council, and introduces a new provision which enables the euro area Member States to adopt specific measures in order to enhance their economic coordination.

4.1 MEASURES SPECIFIC TO THE EURO AREA MEMBER STATES

As mentioned above, Article III-194 of the Constitution introduces a new provision which enables the euro area Member States to adopt measures specific to them with regard to budgetary discipline and the Broad Economic Policy Guidelines.

4.1.1 IMPACT ON BUDGETARY PROVISIONS

Concerning budgetary discipline, Article III-194 (1) enables the euro area Member States to adopt measures “to strengthen the coordination and surveillance of their budgetary discipline”. Article III-194 (1) also stipulates that these measures are to be enacted “in accordance with the relevant procedure from among those referred to in Article III-179 and III-184, with the exception of the procedure set out in Article III-184(13)”. What then is the exact scope of this provision?

Article III-184 sets out the so-called Excessive Deficit Procedure, and refers in paragraph 13 to the Protocol on the Excessive Deficit Procedure, which contains further provisions relating to the implementation of this procedure. In addition, it states that a European law shall lay down the appropriate measures to replace the Protocol, and that the Council may also adopt European regulations or decisions laying down detailed rules and definitions for the application of the Protocol.

If, in accordance with Article III-194 (1), we except the procedures laid down in Article III-184 (13), the euro area may not:

49 See de Poncins, op. cit., pp. 300 and 310.
50 This new heading comprises three Articles: Article III-194 on the measures specific to the euro area, Article III-195 on the Euro Group and, lastly, Article III-196 on the external representation of the euro area. All are commented on below.
– Adopt a European law replacing the Protocol and laying down further provisions applicable to the euro area Member States to implement the Excessive Deficit Procedure;
– Enact for the euro area Member States any European regulations or decisions laying down detailed rules and definitions for the application of the Protocol or of the above-mentioned European law.

In our view, because of the exclusion of Article III-184 (13), Article III-194 does not allow the euro area Member States to adopt any measures specific to the euro area that implement the Excessive Deficit Procedure or complement the European laws, regulations or decisions applicable to the whole Union in this field. This means that the content of the so-called corrective arm of the SGP should remain the same for both the euro area and the non-euro area Member States. Some euro area Member States were perhaps afraid by the possible consequences of a new (stricter) Excessive Deficit Procedure for the euro area. Another explanation could be that because of the serious consequences that the Excessive Deficit Procedure entails, non-euro area Member States should also agree to changes that would be applicable to them when they finally join the euro area.51

Instead, through Article III-194, the Constitution now offers a clear legal basis for a possible preventive arm of the SGP that is specific to the euro area.52 A European law based on Article III-179 (6) and III-194 could for instance define additional rules relating to the medium-term budgetary objective, the adjustment path to achieve it, and the content of the stability programmes applicable to the euro area Member States. The euro area could also develop new instruments, e.g. new statistics, qualitative data and other indicators.

4.1.2 THE BROAD ECONOMIC POLICY GUIDELINES
With regard to the economic policy guidelines, Article III-194 (1) allows the euro area Member States “to set out economic policy guidelines for them”. Two questions immediately arise: How can this provision be combined with the adoption of the Broad Economic Policy Guidelines for the whole EU? And does the new provision also allow the euro area to adopt individual Broad Economic Policy Guidelines for its Member States?

As far as the first question is concerned, Article III-194 (1) states that the Broad Economic Policy Guidelines specific to the euro area Member States ought to be “compatible with those adopted for the whole of the Union and are kept under surveillance”. Consistency is thus ensured. Furthermore, we expect that from

51 Jean-Victor Louis suggests another interpretation, according to which the authors’ intention was to forbid the euro area Member States to replace the Protocol by provisions specific to the euro area, while allowing them to adopt complementary or additional rules to Regulation 1467/97 on speeding up and clarifying the implementation of the Excessive Deficit Procedure (OJ L 209, 2.8.1997, pp. 6-11), in order to give effect to the reference made in Article III-194 to Article III-184. (see J. V. Louis, “The Stability and Growth Pact: Experiences and Future Aspects”, preliminary draft, Colloquium organised by ECSA Austria, Vienna, 10-11 March 2005). This means however that the wording of Article III-194 should be read as follows: “with the exception of the procedure set out in Article III-184(13) alinea 1 and 2”.
52 The procedure referred to should be the procedure laid down in Article III-179 (6), which enables the Council to adopt detailed rules for multilateral surveillance.
a political point of view, the Broad Economic Policy Guidelines of the euro area and its individual Member States will continue to form an integral part of the whole EU Broad Economic Policy Guidelines exercise.

With regard to the second question, it is worth recalling that, under Article 99 (2) of the present Treaty, the Council (i.e. the 25 Member States) adopts general Broad Economic Policy Guidelines for both the EU and the euro area, as well as individual Broad Economic Policy Guidelines for each Member State. In other words, the same legal basis is used for the adoption of the different parts of the Broad Economic Policy Guidelines. In the Constitution, the legal basis for the adoption of the Broad Economic Policy Guidelines is laid down in Article III-179 (2). However, the Constitution also provides in Article III-197 (2) (a) that the Member States with a derogation do not vote on the “adoption of the parts of the broad economic policy guidelines which concerns the euro area generally”. In other words, only the euro area Member States take part in the vote for the adoption of the general Broad Economic Policy Guidelines for the euro area. However, Article III-197 (2) (a) cannot serve as a legal basis for the adoption of the individual Broad Economic Policy Guidelines for the euro area Member States. Therefore, it would seem logical to consider the provision of Article III-194 as the legal basis which allows the euro area Member States to adopt individual Broad Economic Policy Guidelines for each of them, without the Member States with a derogation participating in the vote.

As a result, where the adoption of the Broad Economic Policy Guidelines currently rests on a single legal basis (Article 99 (2) of the Treaty), the Constitution introduces a complex construction whereby the different parts of the Guidelines rest on three distinct legal bases:

- The general EU Broad Economic Policy Guidelines and the individual Broad Economic Policy Guidelines of the Member States with a derogation will be adopted by the Council with the vote of all Member States, on the basis of Article III-179 (2);
- The general euro area Broad Economic Policy Guidelines will be adopted by the Council without the vote of the Member States with a derogation, in accordance with Article III-197 (2) (a);
- The individual Broad Economic Policy Guidelines of the euro area Member States will be adopted by the Council with the vote of just the euro area Member States, on the basis of Article III-194.

The increase in the number of legal bases certainly creates complexity but can also be regarded as a necessary step to enhance the autonomy of the euro area. By doing so, the Constitution gives the euro area the possibility to set out its general and individual Broad Economic Policy Guidelines. However, these Guidelines will retain the status of a recommendation. As a consequence, their structural weakness (i.e. their non-binding nature) will remain not only for the EU but also for the euro area.

53 Article III-197 (2) (a) refers to the “adoption of the parts of the broad economic policy guidelines which concern the euro area generally”.
4.2 CASES WHERE ONLY THE EURO AREA MEMBER STATES VOTE IN THE COUNCIL

As indicated above, the current Treaty contains some transitional provisions according to which a list of Articles do not apply to the Member States with a derogation. Article 122 (3) of the Treaty includes in this list the following provisions:

– Coercive means of remedying excessive deficits;
– Objectives and tasks of the ESCB;
– Issuance of the euro;
– Acts of the ECB;
– Monetary agreements and measures related to exchange rate policy as well as the external representation of the euro;
– Appointment of the members of the Executive Board of the ECB.

In addition, Article 122 (5) of the Treaty suspends the voting rights of the Member States with a derogation for the Council decisions referred to in these instances.

The Constitution extends the list of provisions which do not apply to Member States with a derogation and for which their vote is suspended. Article III-197 (2) and (4) adds new instances where only euro area Member States can decide, namely:

– Adoption of the parts of the Broad Economic Policy Guidelines concerning the euro area as a whole;
– Recommendations made to the euro area Member States in the framework of the multilateral surveillance procedure, including on stability programmes and early warnings;
– All measures relating to excessive deficits concerning euro area Member States.

For the sake of completeness, it should be mentioned that in both Article 123 of the Treaty and Article III-191 of the Constitution, the measures governing the use of the euro are adopted by the Council with just the votes of euro area Member States.54 Furthermore, the same rule applies when the Council adopts the measures set out in the new heading on “provisions specific to Member States whose currency is the euro”.

By comparison with the current situation, the autonomy of the euro area is increased, since it will be able to take all decisions concerning its members, without the Member States with a derogation participating in the vote, in the framework of:

– The coordination of their economic policies, through the adoption of the euro area general and individual Broad Economic Policy Guidelines55;
– The multilateral surveillance procedure of their national measures implementing the Broad Economic Policy Guidelines and of their individual stability programme;

54 This provision is commented on below.
55 With regard to the adoption of the individual Broad Economic Policy Guidelines of the euro area Member States, please refer to the above considerations on Article III-194.
– The Excessive Deficit Procedure (i.e. when the Council decides that an excessive deficit exists, addresses recommendations to the Member State concerned, gives notice to that Member State and when it adopts coercive means ofremedying such an excessive deficit).

4.3 VOTING MODALITIES WHEN ONLY THE EURO AREA MEMBER STATES VOTE IN THE COUNCIL – TOWARDS A NEW EURO AREA ECOFIN COUNCIL CONFIGURATION?

In a Communication to the Convention, the Commission proposed to set up a formal decision-making body for the euro area. This body would be composed of euro area Member States only, and would act as the euro area ECOFIN Council. In other words, the proposal added a new Council configuration, restricted to euro area Member States, alongside the existing EU Council of Ministers of Economic Affairs and Finance (ECOFIN) Council. The new euro area ECOFIN Council configuration would take all decisions related to the euro area and its Member States. However, in its final report to the Convention plenary, the Working Group on Economic Governance was split over whether “decisions related exclusively to the Eurozone should be taken by the ECOFIN Council, bringing together the participating Member States only”.

The Convention and the IGC were confronted with a dilemma. On the one hand, they recognised the need for enhanced coordination within the euro area and therefore the need to increase the autonomy of the euro area. This has even become all the more necessary now that the euro area currently constitutes a minority of EU Member States (12 out of 25), whereas before the 2004 enlargement it constituted the majority (12 out of 15). On the other hand, bearing in mind that all EU Member States will in principle adopt the single currency, the authors of the Constitution did not want the euro area to become a sort of closed club. Therefore, they chose not to create a euro area ECOFIN Council. Instead, they decided that decisions will be taken by the ECOFIN Council in its full composition, but the voting rights of the non-euro area Member States shall be suspended when the Council adopts measures specific to the euro area or to its individual Member States.

As we have seen above, the voting modalities in the Council when only the euro area Member States take part in the vote can therefore be summarised as follows.

The voting modalities in the Council will differ before and as from 1 November 2009. For our calculations below, we will work on the basis of a euro area composed of 12 Member States.

Until 31 October 2009, the Council will decide on the basis of weighted voting. In a euro area composed of 12 Member States, a qualified majority requires 138 votes.

58 This is illustrated in the transitional provisions contained in Article III-197 (2) and (4) or in Article III-194, which provides that the Council will act, but that “only members of the Council representing Member States whose currency is the euro shall take part in the vote”.

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votes out of a total of 191 (i.e. 72%)\(^{59}\). Thus, 54 votes are necessary to constitute a blocking minority. In other words, just two large Member States are sufficient to block a decision.\(^{60}\)

From 1 November 2009 onwards, however, the double majority regime will apply. In a euro area comprising 12 Member States, a qualified majority shall require at least 55% of the participating Member States, representing together at least 65% of the population of those Member States. A blocking minority must include Member States representing more than 35% of the population of the participating Member States, plus one other Member State. Taking into account the respective share of the Member States in the population of the euro area, we come to the conclusion that at least three Member States will be needed to block a decision.\(^{61}\) This new regime should therefore facilitate the decision-making process as it will be slightly harder to block a decision (i.e. requiring three Member States instead of two).

Decisions relating to the euro area and its Member States are taken by the Council without the Member States with a derogation participating in the vote, but not in their absence. Hence, those Member States can take part in the deliberations, which does not facilitate enhanced coordination among euro area Member States.\(^{62}\) The authors of the Constitution were well aware of the fact that enhanced coordination among euro area Member States needed an appropriate forum in which not all Council members are present. Therefore, they decided to formalise the role of the Euro Group, which was originally set up as an informal body where euro area Member States could openly discuss questions of common interest but were not able to take formal decisions.

### 4.4 MAKING THE EURO GROUP AN OFFICIAL ENTITY

Article III-195 of the Constitution declares that the “arrangements for meetings between ministers of those Member States whose currency is the euro are laid down by the Protocol on the Euro Group”.

Protocol No 12 on the Euro Group is rather brief. It contains two Articles which lay down rules of a procedural nature. According to Article 1, the ministers of the euro area will be able to meet informally to discuss questions related to the specific responsibilities they share with regard to the single currency. The Commission shall take part in the meetings, and the ECB shall be invited. The meetings will be prepared by the representatives of the ministers of finance and

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59 See Article 2 (4) of Protocol No 34.
60 Or 72% of the votes of the other Member States when the Member State concerned does not take part in the vote, for instance when the Council decides on the existence of an excessive deficit. In such a case, the threshold to form a blocking minority will also be different.
61 Or, again, of the other Member States when the Member State concerned does not take part in the vote. However, according to our calculations, the threshold to form a blocking minority (at least 35% of the population of the Member States participating in the vote plus one member) remains the same, i.e. at least three Member States are needed.
62 In this respect, a parallel can be drawn with the conditions relating to the functioning of the enhanced cooperation (see Article III-416 et seq. of the Constitution). For an analysis of the working conditions of the enhanced cooperation, see D. Servais, P. Vigneron and R. Ruggeri, “Le Traité de Nice. Son impact sur l’Union économique et monétaire”, *Euredia*, 4 (2000), pp. 477-509.
the Commission. Article 2 adds that the ministers shall elect their president for two and a half years.

On the substance, the Recitals of the Protocol contain some interesting considerations. The High Contracting Parties declare their desire to promote growth in the EU and, to that end, to develop an ever-closer coordination of economic policies (which includes both the Broad Economic Policy Guidelines and fiscal discipline) within the euro area. They also affirm that they are “conscious of the need to lay down special provisions for enhanced dialogue between the Member States whose currency is the euro, pending the euro becoming the currency of all Member States of the Union”. The objectives of the Euro Group are thus clearly stated: close coordination and enhanced dialogue. In addition, the Recitals also make it clear that the Euro Group is of a temporary nature and will only exist until all Member States have adopted the euro.

What is the exact nature of the Euro Group? Article III-195 refers to arrangements and meetings among ministers. In addition, the first Article of the Protocol expressly stresses the informal nature of the Euro Group, which may only discuss issues of common interest but does not take decisions, except to elect its president.

In conclusion, the Protocol gives a legal basis to an existing body, which has become the place where the euro area Member States can discuss issues that are then (only) formally decided upon in the Council. As an increased number of decisions will be decided with the votes of just the euro area Member States, the role of the Euro Group should continue to increase. Moreover, the two and a half year presidency introduced by the Constitution is a novelty. These elements will certainly help assert the identity, the role and the economic governance of the euro area, although much will depend on the personality of the president and on the willingness of the euro area Member States to explore the ways that the Constitution offers them.

5 OTHER RELEVANT ASPECTS OF EMU

In Chapters 3 and 4, we examined the economic governance of the Union and the euro area, in particular regarding the budgetary rules and the coordination of economic policies. We also mentioned the new voting rules within the Council, when deciding in a Union or a euro area format. These rules also apply to other provisions which were discussed in the IGC, some of which were regarded as particularly sensitive by the Member States. In this last chapter we will comment on the external representation, the measures governing the use of the euro, entry into EMU, withdrawal from the Union and the revision procedures.

63 This is the role of the Euro Group Working group, which is a special configuration of the Economic and Financial Committee (EFC).
The provisions of the Treaty with regard to the position of the Community and its external representation for issues relevant to EMU have never been implemented. Instead, in 1998, the European Council of Vienna agreed on an informal arrangement with regard to the external representation of the Community in International Monetary Fund (IMF) and G7 meetings, and urged the institutions to come up with common positions on issues which are of particular importance to EMU. This agreement has not been fully applied. Lastly, the Treaty of Nice modified the voting requirement in the Council to decide on the external representation of EMU from unanimity to qualified majority voting. However, the Council has not yet adopted such a decision. Therefore, it is no wonder that, in its final report to the Convention plenary, the Working Group on Economic Governance called for improved euro area representation in international organisations. Unfortunately, the group could not agree on the means to achieve this goal. While some group members favoured better coordination, others considered that the President of the Euro Group should have a stronger role. Finally, some members held the view that the Commission should represent the euro area, as it represents the EU in trade policy.

Under the current Article 111 (4) of the Treaty, the Council shall decide on the position of the Community at international level with regard to issues of particular relevance to EMU and on its representation. The Council acts by a qualified majority, on a proposal from the Commission and after consulting the ECB. When adopting its decision, the Council shall comply with the allocation of powers between economic policy and monetary policy, i.e. pay due respect to the powers of the ECB in monetary matters. According to Article 122 (3) to (5), the voting rights of the Member States with a derogation shall be suspended, among others, for the decision referred to in Article 111 (4). In other words, Council decisions relating to the position of the Community and its representation at the international level with respect to EMU are adopted by the euro area Member States.

Article III-196 (1) of the Constitution deals with the “euro’s place in the international monetary system” and “common positions on matters of particular interest for the EMU within the competent financial institutions and conferences”. The second paragraph of Article III-196 provides that the Council “may adopt appropriate measures to ensure unified representation within the international financial institutions and conferences”. These provisions clearly refer to the definition of the euro area’s position and representation in the IMF and G7/G8 meetings. The responsibility to establish common positions and to adopt measures ensuring a unified representation belongs to the Council, acting on a proposal from the Commission and after consulting the ECB. The third
paragraph expressly states that decisions taken under the first or the second paragraph will be adopted by those Member States whose currency is the euro, and according to a qualified majority.

It should also be noted that neither Article 111 (4) nor Article III-196 involves the European Parliament in the decision-making process.

In conclusion, be it on the substance or on the procedure, the two provisions are very similar. However, a few differences should be noted:

- First, whereas the Council “shall adopt” a decision establishing common positions under the first paragraph of Article III-196, the second paragraph merely provides that the Council “may adopt” appropriate measures to ensure unified representation. When the Council has an obligation to act in the first case, it does not have such an obligation in the second. Article 111 (4) does not make such a distinction. In both cases, the latter provides that the Council “shall decide” and is therefore under an obligation to do so.
- Second, unlike Article 111 (4), Article III-196 does not refer to the allocation of powers between the Council and the ECB with regard to economic and monetary matters. Moreover, Article III-196 (1) seems to give the Council a mandate “to secure the euro’s place in the international monetary system”, possibly adding to the confusion. However, the duty to consult the ECB is maintained in Article III-196 (1) and (2). Conflicts of competence should therefore be avoided. In any case, the Council has to respect the exclusive competence of the Eurosystem in the field of monetary policy.
- Third, another difference is to be found in the form of representation of the euro area. Whereas Article 111 (4) does not specify how this representation should be organised, Article III-196 (2) expressly refers to a “unified” representation. Despite this new wording, a change in the present situation seems unlikely as the Member States are still reluctant to abandon their seat to a Union representative.

5.2 MEASURES GOVERNING THE USE OF THE EURO

Article 123 (4), third sentence of the Treaty has often been compared to Article 308 (ex 235): a sort of implied powers clause for the euro area. It allows the Council, acting by a qualified majority of the Member States without a

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68 This also holds true for the other provisions of Article 111 which are taken over in Article III-326 of the Constitution.
69 One could argue that the legal personality given to the Union under Article I-7 of the Constitution could allow it to become a member of international organisations and make it easier for the EU to speak with one voice in these fora. However, membership of international organisations and conferences usually pertains to the realm of Member States. Other constraints also have to be taken into account. First, the asymmetry of competence between the Member States and the ECB with regard to economic and monetary matters is unchanged. Second, not all EU Member States have adopted the euro as their single currency. Thus, the representation of the Union would still be divided between the euro area and the other EU Member States. Third, it might be difficult for third parties to accept these internal EU arrangements.
70 However, Article 123 (4) of the Treaty does not apply to Member States with a derogation. Thus the Council has to adopt a special legal act based on Article 308 of the Treaty each time it deems it necessary to extend the effects of the measures adopted on the basis of Article 123 (4) to the Member States with a derogation.
71 Until the Treaty of Nice, the unanimity of the Member States without a derogation was required. In this respect and more generally concerning the changes brought by the Treaty of Nice to the functioning of EMU, see Servais, Vigneron and Ruggeri, op. cit., p. 483.
Article III-191 of the Constitution introduces some changes in this provision. On the substance, the scope of the provision has been widened. It allows measures to be taken that are necessary for the use of the euro in a broad sense rather than just those measures necessary for its rapid introduction, as this was considered too narrow a drafting. For instance, the Council Regulation on the fight against counterfeiting was adopted on the basis of Article 123 (4). No one would argue that measures to protect the single currency are unnecessary, but equally no one would say that they are linked to its rapid introduction either. The letter of Article III-191 will thus better match its spirit and the reality. On the procedure, Article III-191 expressly refers to European laws or framework laws (which are legislative acts, based on a Commission proposal and adopted according to the so-called co-decision procedure, whereby the Council and the European Parliament are on an equal footing). Under the current procedure, the European Parliament, though not mandatorily involved, is usually consulted. Although many measures have already been adopted, there might still be room for using the new provision, which clearly reinforces the role of the European Parliament. The new wording also provides that the measures to be adopted may not prejudice the powers of the ECB and, as is now the case, that the latter has to be consulted. As one of the merits of consulting the ECB is precisely to avoid any interference with its powers, we do not think that the provision of Article III-191 adds anything new in this respect. Finally, as mentioned above, Article III-191 is listed in Article III-197 (2) as one of the cases where only the euro area Member States can take part in the vote.

5.3 ENTRY INTO THE MONETARY UNION

To join the Monetary Union, a Member State must fulfil the convergence criteria. The question of who should decide on whether these criteria have been fulfilled gave rise to long discussions while the Maastricht Treaty was being negotiated. The main conclusion was that one should avoid establishing a “club” whereby the euro area Member States would co-opt new members. Therefore, according to the Treaty, if the necessary conditions are met, the Council, acting by a qualified majority on a proposal from the Commission, shall abrogate the derogation of the Member State concerned. Then the Council shall, acting this

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72 Article III-191 reads: “Without prejudice to the powers of the European Central Bank, European laws or framework laws shall lay down the measures necessary for use of the euro as the single currency. Such laws or framework laws shall be adopted after consultation of the European Central Bank”.
74 For instance, the European Parliament has been consulted on Council Regulation 974/98 on the introduction of the euro, or on Council Regulation 1338/2001, which lays down measures necessary to protect the euro against counterfeiting.
75 This is also the case under Article 123 (4) of the Treaty.
76 The fulfilment of the criteria is first discussed in the Council meeting in the composition of Heads of State or Government, on the basis of reports from the Commission and the ECB and after consulting the European Parliament.
77 Article 122 (2) of the Treaty.
time “with the unanimity of the euro area Member States and the Member State concerned”, upon a proposal from the Commission and after consulting the ECB, adopt the conversion rate at which the euro shall be substituted for the currency of the Member State concerned, and then take the other measures necessary for the introduction of the euro in that Member State.78

The Constitution introduces an additional step in this procedure. According to Article III-198 (2), second indent, besides the above-mentioned elements, the Council shall act only after “having received a recommendation of a qualified majority of those among its members representing Member States whose currency is the euro”. It is further specified that “these members shall act within six months of the Council receiving the Commission’s proposal”. On the other hand, with regard to the fixing of the conversion rate, the procedure remains unchanged.

This additional step aimed to give euro area Member States greater say on the entry of new Member States into the euro area. Since the 2004 enlargement, the majority of EU Member States are not members of the euro area. Hence, the euro area Member States feared that the majority would be able to force through the entry of a Member State which does not fulfil the criteria by making the entry of another Member State that fulfils the criteria conditional upon the entry of the one that does not. If there is definitely merit in increasing the role of the euro area in the process, one may wonder whether adding a new step in an already long and complex procedure was the best way of achieving this objective. Besides, from a legal perspective, a “euro area recommendation” does not offer the euro area Member States watertight protection: without such a recommendation the Council may not act, but it does remain free to choose not to follow it. To achieve the pursued objective, another solution could have been to require that the final Council decision be taken by a qualified majority of the euro area Member States as well as of the whole EU.

5.4 WITHDRAWAL FROM THE UNION

Voluntary withdrawal from the Union is quite a novelty.79 Indeed, the European integration process has often been considered as irreversible – or at the least, the adoption of the euro is, as Jean-Victor Louis recalls in his contribution to this volume.

Although the new provision does not explicitly deal with the possible withdrawal of a euro area Member State from the EU, it goes without saying that the ECB should be formally consulted in such a case for matters falling within its field of competence. Nor does it deal with the case of a euro area Member State that wants to recover its monetary sovereignty while still remaining a member of the EU.

78 Article 123 (5) of the Treaty.
79 See Article I-60 of the Constitution.
5.5 SIMPLIFIED REVISION PROCEDURES

The Convention and later the IGC aimed at making future amendments to the Constitution and to the annexed protocols easier by introducing simplified amendment procedures besides the ordinary revision procedure.

However, such flexibility is not completely new. Back in 1992, a specific procedure was introduced in the EMU Chapter of the Treaty. Article 107 (5) of the Treaty allows parts of the Statute to be revised according to a simplified procedure\(^\text{80}\), under which the Council may act “either by qualified majority on a recommendation from the ECB and after consulting the Commission or unanimously on a proposal from the Commission and after consulting the ECB. In either case, the assent of the European Parliament shall be required”. This provision is however only applicable to some provisions of a very technical nature. The Constitution takes over this specific procedure in Article III-187 (3), and moves it to the legislative procedure. The Statute may therefore be amended by a European law, which means that the European Parliament will co-decide with the Council. It should be noted that the ECB’s right of initiative is nevertheless preserved.\(^\text{81}\)

The Constitution introduces two further simplified revision procedures. As a result, EMU provisions can be subject to four different revision procedures:

a) The above-mentioned specific procedure, which is applicable to the revision of some parts of the Statute.

b) A simplified revision procedure with regard to Part III of the Constitution, which may allow to move from unanimity to qualified majority voting in the Council, as well as from a special legislative procedure to an ordinary legislative procedure (i.e. the so-called co-decision procedure).\(^\text{82}\) This procedure could apply to two EMU provisions:
   - In Article III-184 (13), where the Council may adopt a European law acting unanimously on a Commission proposal and after consulting the European Parliament to adopt measures relating to the implementation of the Excessive Deficit Procedure.
   - In Article III-185 (6), where the Council may, acting unanimously and after consulting the European Parliament and the ECB, adopt a European law conferring specific tasks upon the ECB regarding the prudential supervision of credit institutions and other financial institutions.\(^\text{83}\)

Such changes require a European Decision adopted by unanimity by the European Council after obtaining the consent of the European Parliament, and in the absence of any opposition notified by a national Parliament.

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\(^{80}\) Article 107 (5) of the Treaty and Article 41 of the Statute.

\(^{81}\) In this case, however, the qualified majority requirement will be higher than in the case of a Commission proposal (see section 3.2 on the new double majority rule).

\(^{82}\) For more details concerning this procedure, see Article IV-444 of the Constitution.

\(^{83}\) It is worth noting that a move from unanimity to qualified majority in the Council was proposed in Nice and during the last IGC. However, the Member States could not reach agreement on this proposal.
c) A simplified revision procedure, which opens the door for revising all or part of the provisions of Title III of Part III on the internal policies and action of the Union (including Chapter II on economic and monetary policy). The Member States, as well as the European Parliament and the Commission, all have a right of initiative to submit a proposal for revision to the European Council. After consulting the European Parliament, the Commission and the ECB in case of institutional changes in the monetary area, the European Council shall decide by unanimity. This decision, which may not increase the competences of the Union, shall then be ratified by all the Member States before it comes into force.\textsuperscript{85}

Such a revision procedure could have a significant impact on the EMU provisions as it allows all provisions of Chapter II to be amended. This includes the procedure for coordinating economic policies, the fiscal rules (i.e. the Excessive Deficit Procedure), and the tasks and organisation of the ESCB and the ECB. It even allows the specific procedure applicable to the revision of some parts of the Statute to be amended. As an illustration, Professor Jean-Victor Louis recalls in his contribution a failed attempt to extend the list of provisions contained in Article III-187 (3) to Articles 10 to 12 of the Statute (this attempt aimed at modifying the composition, the functioning and the respective responsibilities of the Governing Council and the Executive Board), and mentions the strong opposition of the Eurosystem in this respect.\textsuperscript{86} Now, the simplified revision procedure of Article IV-445 would precisely allow such an extension of the list of provisions referred to in Article III-187 (3). It should also be recalled that the Eurosystem advocated a reference to price stability in Part I of the Constitution in order to protect its primary objective from a hasty revision under the procedure of Article IV-445.\textsuperscript{87}

d) The ordinary revision procedure will apply to the amendments to Part I (and II) of the Constitution and to the annexed protocols. As regards EMU, it means in particular the objectives of the Union, the euro as a symbol of the Union, the categories of competence, the establishment of the ECB/ESCB/Eurosystem as well as the protocols regarding the Statute, the Excessive Deficit Procedure, the convergence criteria, the Euro Group and the specific position of the UK and Denmark. The procedure can be initiated by any Member State, the European Parliament or the Commission, but the ECB does not have such a right. The procedure includes the convening of a Convention, prior to the IGC, unless the

\textsuperscript{84} See Article IV-445 of the Constitution.
\textsuperscript{85} For more details, see Article IV-445 of the Constitution.
\textsuperscript{86} Under the present governance structure, monetary policy decisions are taken by the Governing Council of the ECB, which is composed of the governors of the national central banks (NCBs) of the euro area and the six members of the Executive Board of the ECB. For the sake of efficiency, some observers consider that monetary policy decisions should instead be taken by a restricted Monetary Policy Committee. Based on our participation in the Maastricht Treaty negotiations, we would like to note that this suggestion would run against one of the basic principles of the Maastricht Treaty negotiations on EMU, i.e. that Member States abandon their monetary sovereignty under the condition that they will continue to participate in the monetary policy decision-making process. To reconcile this requirement with the need for independence of the monetary authority, it was decided that, on the one hand, the governors of the NCBs would participate in the Governing Council but would not receive or seek instructions and, on the other, that each member of the Governing Council would receive the same voting power except when acting in his/her capacity as a shareholder of the ECB (with a weighted vote according to the share of his/her respective NCB in the capital of the ECB). This compromise could explain why the concept of participation “in a personal capacity” is only implicit in the Treaty.
\textsuperscript{87} See section 1.1 of this paper.
European Council does not consider this to be justified by the extent of the proposed amendments.

**CONCLUSION**

In a very synthetic way, the impact of the Constitution on EMU can be summarised as follows:

– Looking at the substantive provisions that will apply when the Constitution enters into force, no real progress has been achieved towards enhanced coordination of economic policies: the structural weakness of the economic pillar of EMU remains, since, as a rule, it only relies on non-binding instruments (e.g. Broad Economic Policy Guidelines). Generally, the core provisions still do not make any distinction between euro area and non-euro area Member States. On the positive side, there are some minor achievements to note (including the reference to the euro and more leeway to adopt measures necessary for the use of the euro as the single currency).

– Progress has been made on economic governance: as an independent referee, the Commission may address an early warning to a Member State, especially in the case of a significant budgetary deviation; a Member State will no longer vote on decisions regarding its economic and budgetary policies; the autonomy of the euro area is increased, since in the field of economic and budgetary policies it will now be able to take all decisions regarding its members without the Member States with a derogation participating in the vote; and the euro area Member States will also have a greater say regarding entry into EMU, at least from a political point of view. However, the new voting rules will not facilitate the decision-making process, and indeed the large Member States will even see their position strengthened further.

– Some doors are still open: the Constitution allows the euro area Member States to strengthen multilateral surveillance in the euro area, including the preventive arm of the SGP. The revision procedures are more complex, but at the same time make it possible to change rules, including important ones, without convening an IGC.

This result can be explained by the need to maintain a delicate balance between conflicting desires:

– The authors of the Constitution had to find a way to reconcile, on the one hand, the request of the euro area Member States for enhanced economic coordination among themselves and for greater autonomy, with, on the other, the interests of non-euro area Member States, which were particularly opposed to any weakening of the role of the ECOFIN Council.

– The euro area Member States had to reconcile their aspiration for more symmetry between the economic and the monetary pillars of EMU and their concern about losing autonomy in the conduct of their economic and budgetary policies. As mentioned above, Member States were particularly keen to avoid anything that could be seen as conferring on the Union itself a competence to coordinate the economic policies of the Member States. This also explains why no progress has so far been reached in the field of external representation.
To sum up, the Constitution does not introduce any important changes with regard to the EMU provisions, nor does it create any new instruments. The real added value is that the Constitution opens the door for an improved economic and budgetary policy in the euro area, combined with reinforced multilateral surveillance. As the autonomy of the euro area is increased for all decisions that concern its members, euro area governance should in turn gain in consistency. The rest depends on political will.
ADJUSTING ECB DECISION-MAKING TO AN ENLARGED UNION

Thomas Wagner and Gerd Grum

ABSTRACT

Nel 1992 i Capi di Stato o di Governo europei hanno firmato il Trattato di Maastricht sull’Unione Europea che apriva la strada dell’Unione monetaria e gettava le basi del SEBC e della BCE. La struttura del più importante organo decisionale della BCE e del SEBC, il Consiglio direttivo, prevedeva la partecipazione, in qualità di membri, dei governatori delle banche centrali nazionali di tutti gli Stati membri dell’area dell’euro.

Successivamente alla firma del Trattato di Maastricht il numero degli Stati membri della UE si è più che raddoppiato, e si attende ora il relativo allargamento dell’area dell’euro. Di conseguenza la qualità di membro per tutti i governatori delle BCN (“un paese, un voto”) nel Consiglio direttivo non può essere sostenuta a tempo indefinito: la salvaguardia dell’efficienza del processo decisionale richiede una limitazione di questo impianto.

Il Trattato di Nizza ha introdotto le modifiche fondamentali per adeguare i processi decisionali degli organi della UE in un’Unione Europea allargata. Di conseguenza, esso conteneva anche una disposizione per adeguare le modalità di voto della BCE. A tal fine è stata inserita nello Statuto del SEBC/BCE la cosiddetta “clausola di abilitazione” (articolo 10.6), che dava facoltà al Consiglio UE nella composizione dei Capi di Stato o di Governo di emendare la procedura di voto del Consiglio direttivo della BCE (articolo 10.2). I Capi di Stato e di Governo hanno adottato tale emendamento il 21 marzo 2003, su Raccomandazione della BCE, ed esso è entrato in vigore all’inizio di giugno 2004, a seguito della ratifica da parte degli Stati membri (tutti gli Stati membri ad eccezione di quelli che sono entrati a far parte dell’Unione il 1° maggio 2004). Il nuovo regime avrà applicazione concreta soltanto quando il numero degli Stati membri dell’area dell’euro sarà superiore a 15 o a 17, ove così decida il Consiglio direttivo con una maggioranza dei due terzi. Da quel momento in poi il processo decisionale del Consiglio direttivo della BCE sarà basato su uno schema piuttosto complicato, caratterizzato da gruppi di paesi con differenti rappresentatività nel voto.

Il contributo intende discutere e analizzare l’adeguamento delle modalità di voto del Consiglio direttivo della BCE e paragonarlo con gli adeguamenti previsti dal Trattato di Nizza per il futuro assetto istituzionale della Commissione Europea. Viene infine valutato in che misura la Decisione del Consiglio UE riguardante le nuove modalità di voto della BCE abbia raggiunto il suo obiettivo, sia fondata su criteri adeguati e abbia trattato tutti gli Stati membri in una logica di uguaglianza.
I  INTRODUCTION

European integration is a fascinating peace project of a more or less unprecedented dimension.

What is unique about this process is that so many Member States have been willing to transfer sovereign powers, in a democratic process, to a supranational level. The political commitment to transfer sovereign rights to the European Union (EU) and its institutions and bodies is even more impressive if one considers that the loss of national self-determination is hardly ever offset by equivalent gains in national influence in EU bodies. The enlargement of the EU as envisaged by the Treaty of Nice and implemented in May 2004 through the accession of ten new Member States has further limited individual countries’ possibilities of influencing European decision-making.

The decision to give up national competences did not come easily for the Member States in any of the successive stages of European integration. This is obviously also true for the transfer of monetary sovereignty to the European System of Central Banks (ESCB) and the European Central Bank (ECB), as monetary sovereignty and monetary policy-setting have always been key elements of national sovereignty. The difficult struggle with the loss of national influence became particularly clear when the EU Council agreed that the national central bank governors’ permanent voting rights in the Governing Council of the ECB, the EU’s supreme decision-making body in the field of monetary policy, would have to be abandoned in the wake of euro area enlargement.

European Economic and Monetary Union (EMU) was established by the Treaty on European Union (“the Maastricht Treaty”) signed in Maastricht on 7 February 1992. At that time the European Community consisted of 12 countries; the number of its members had already doubled since its foundation, and six further states were already in the waiting room for EU membership.¹

Nevertheless, the basic organisational structure which had been in place since the beginning of the European Economic Community was retained by the Maastricht Treaty.

¹ In addition to Austria, Finland, Norway and Sweden, which at that time had already entered accession negotiations and which, with the exception of Norway (a negative referendum), joined the EU on 1 January 1995, by 1992 Cyprus and Malta had also already submitted their applications for membership.
One of the fundamental ideas underlying this structure was that, in addition to representation in the European Parliament, a representative of each state should also contribute to decision-shaping in the other bodies involved in the legislative process, i.e. the Council of the European Union and the European Commission.

The Maastricht Treaty extended this principle to include the newly established Governing Council of the ECB, which has ultimate authority over monetary decision-making in the ESCB and the ECB. The Governing Council was to consist of the six members of the Executive Board of the ECB and the governors of the national central banks (NCBs) of all euro area Member States.

This “one representative per Member State principle” remained firmly in place until the second amendment to the Maastricht Treaty, namely the Treaty of Nice, introduced a scheme which paved the way for the abandonment of this principle. Based on this option, the Council (Heads of State or Government) decided that, should the EU reach a certain number of Member States, no EU/EMU Member State was to have permanent voting rights in the European Commission and Governing Council of the ECB.

In the remainder of this paper, we will outline the adjustment of voting modalities in the Governing Council of the ECB as envisaged by the Treaty of Nice and compare it with the rotation scheme provided for the European Commission (Section 2), before assessing the related EU Council Decision of 21 March 2003 (Section 3). The paper concludes with some final remarks (Section 4).

2 THE TREATY OF NICE

2.1 ADJUSTMENTS TO DECISION-MAKING IN GENERAL

A long time before the establishment of the ESCB and ECB, it had become obvious that the number of European Union Member States was going to grow considerably in the foreseeable future. Cyprus and Malta had applied for membership as early as 1990; Hungary and Poland had followed suit in 1994, and all other Member States which finally joined the EU in 2004, as well as Romania and Bulgaria, had submitted their applications for accession by 1995

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2 As far as the European Commission is concerned, these representatives are not to be understood as guardians of national interests, but as persons nominated by a Member State.
3 It should be stated that the functions of Council and Commission members are completely different when it comes to the consideration of national interests. While Commission members have to act fully independently and must observe purely Community interests, the EU Council is the body that safeguards national interests. However, even EU Council members are limited in pursuing national interests by virtue of Article 10 of the Treaty (see for example A. Egger (2003), in H. Mayer, Kommentar zu EU- und EG-Vertrag, 11. Lieferung (Vienna: Manz Verlag), Articles 202-210, p. 14; and I. Seidl-Hohenveldern (1996), Legal Issues of European Integration, 1, p. 76).
4 Leaving aside the Accession Treaty concerning Austria, Finland and Sweden.
5 A detailed discussion of this Council Decision can be found in the ECB Monthly Bulletin of May 2003. See also S. Dvorsky and I. Lindner (2003), „Anpassung der Stimmrechtsmodalitäten im EZB-Rat“, in Oesterreichische Nationalbank, Berichte und Studien, 2, pp. 144-53, who also review the literature on alternative voting modalities.
6 I.e. 1 June 1998.
or 1996. In the autumn of 1998 the EU formally opened accession negotiations with Cyprus, Estonia, Hungary, Poland and Slovenia (the so-called Luxembourg group). At that point it became inevitable that the structure of the EU as a whole, which dated back to the original Community of six nations, would have to be reformed to adapt its bodies to a steadily increasing number of Member States, in order to ensure and improve the efficiency of the decision-making process.

Adjusting the size and composition of the European Commission and reweighting the votes in the EU Council had in fact already been on the agenda of the Intergovernmental Conference (IGC) convened in 1996 and concluded in 1997. This conference, which resulted in the Treaty of Amsterdam (signed on 2 October 1997 and effective from 1 May 1999), did not, however, resolve these issues. Thus, another reform of the Maastricht Treaty was needed in a further attempt to solve structural deficiencies.

In February 2000 a new IGC was convened to prepare further amendments to the Maastricht Treaty. The key objective of this conference was to find a solution to those problems which had not been solved by the Treaty of Amsterdam (the so-called Amsterdam leftovers). These issues included the size and composition of the European Commission, an expansion of those areas which only require qualified majority voting in the EU Council, and the reweighting of votes in the EU Council.

The result of this Conference, the Treaty of Nice, which was signed on 26 February 2001 and came into effect from 1 February 2003, was largely met with sceptical, critical and sometimes sneering comments in the media. According to a Monitoring European Integration report by the Centre for Economic Policy Research, the Treaty of Nice failed almost completely in two of the above-mentioned areas: measures directed toward reforming the European Commission’s composition and size and expanding those areas only requiring qualified majority voting were considered insufficient.

Nevertheless, the results of the Treaty of Nice do not seem to deserve such harsh criticism, as formally the objectives of dealing with the “Amsterdam leftovers” and of creating suitable conditions for enlargement were met. Even if the proposed solutions were neither perfect nor self-sufficient, they still paved the way for enlargement.

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7 The legal basis for calling this conference was a clause on amending the EU Treaties in Article 48, paragraph 2, of the Maastricht Treaty (ex Article N).
8 The “Protocol on the institutions with the prospect of enlargement of the European Union” annexed to the Treaty of Amsterdam merely stated that a conference of representatives of the governments of the Member States was to be convened at least one year before the membership of the European Union exceeded 20 countries; at the same time, it shifted the focus for further amendments to the Treaty on the Commission’s size and composition and on the weighting of votes to the EU Council.
9 See document SN 300/99, Recital 16.
10 See for instance a report entitled “Nice Try”, published in European Economic Perspectives (issue 29) of the Centre for Economic Policy Research. The Times regarded it as “an ingenious voting system reminiscent of the annual machinations of the Eurovision Song Contest”, while The Independent summarised the achievements of the Nice Treaty as representing “hardly a great step forward for the European ideal”.
12 Article 10.6, which was added by the Treaty of Nice, merely opened up the possibility to alter voting procedures in the Governing Council of the ECB through a unanimous decision of the Heads of State or Government.
In the following sub-section we will compare the regulatory adjustments for the European Commission and the Governing Council of the ECB, and will elaborate on the similarities and differences between the two.

2.2 ADJUSTING THE COMPOSITION OF THE EUROPEAN COMMISSION

With respect to the size and composition of the European Commission, the EU Heads of State or Government reached the following compromise:\footnote{Article 4 of the “Protocol on the enlargement of the European Union” annexed to the Maastricht Treaty and to the Treaties establishing the European Communities by the Nice Treaty.}

– When the first Commission takes up its duties after 1 January 2005, the Commission is to include one national of each of the Member States. The number of Members of the Commission may be altered by the Council, acting unanimously.

– When the first Commission takes up its duties after the number of Member States has reached 27, the following regulation shall apply: “The number of Members of the Commission shall be less than the number of Member States. The Members of the Commission shall be chosen according to a rotation system based on the principle of equality, the implementing arrangements for which shall be adopted by the Council, acting unanimously.” The implementing arrangements shall contain all the criteria and rules necessary for determining the composition of successive colleges automatically and shall comply with the following principles:\footnote{Article 4, paragraph 3, of the above Protocol.}

– Member States shall be treated on a strictly equal footing as regards determination of the sequence of, and the time spent by, their nationals as Members of the Commission; consequently, the difference between the total number of terms of office held by nationals of any given pair of Member States may never be more than one;

– subject to the latter, each successive college shall be so composed as to reflect satisfactorily the demographic and geographical range of all the Member States of the Union.

With this formula, the European Union for the first time abandoned the existing rule that each Member State should have at least one representative in all EU bodies involved in legislation (even if this change was only to take effect in the future). Although this principle had not been explicitly laid down anywhere, it had nonetheless represented a driving element of EU legislation and thus probably also of the EU’s identity up to this point – irrespective of the fact that members of the Commission have always had to act exclusively in the interest of the EU regardless of individual national concerns.

As from the accession of the 27th Member State, the “one member, one vote” principle will be abandoned in the first European Commission to be subsequently installed, and the number of Commissioners will have to be lower than the number of Member States. The size of the Commission and all further details will then have to be determined by the Council on the basis of a unanimous vote. What has been decided by the Nice Treaty, however, is that the rotation system
has to treat Member States on a strictly equal footing with regard to the sequence of, and the time spent by, nationals as Members of the Commission. In addition, the composition shall satisfactorily reflect the demographic and geographical range of all Member States.

With respect to the size and composition of the Commission, the Treaty of Nice thus resorted to a flexible model which provides a regulatory framework as well as basic principles, while leaving more detailed, later specifications to another body (or several other bodies).

2.3 ADJUSTING THE VOTING PROCEDURES OF THE GOVERNING COUNCIL OF THE ECB

In addition to the rotation system for the European Commission, the Treaty of Nice resorted to a similar model for the ECB concerning the voting rights of its Governing Council. By inserting a new provision (Article 10.6) in the Statute of the European System of Central Banks and of the European Central Bank (“the Statute”), the Treaty of Nice directly altered the Statute and offered the possibility for the Heads of State or Government (“enabling clause”) to change the voting procedures in the Governing Council of the ECB.

Article 5 of Part One ("Substantive Amendments") of the Treaty of Nice added the following paragraph in Article 10 of the Statute:

- “10.6 Article 10.2 may be amended by the Council meeting in the composition of the Heads of State or Government, acting unanimously either on a recommendation from the ECB and after consulting the European Parliament and the Commission, or on a recommendation from the Commission and after consulting the European Parliament and the ECB. The Council shall recommend such amendments to the Member States for adoption. These amendments shall enter into force after having been ratified by all the Member States in accordance with their respective constitutional requirements. A recommendation made by the ECB under this paragraph shall require a decision by the Governing Council acting unanimously.”

Thus the newly added Article 10.6 of the Statute introduced a specific and somehow challenging procedure for amendments to the Statute. The amendment procedure as defined by Article 10.6 in fact resembles the procedure for amending the Treaty, one significant difference being that the former does not require a previous IGC.

15 Article 10.2 of the Statute, later amended by Decision 2003/223/EC of the Council, meeting in the composition of the Heads of State or Government, of 23 March 2003, on an amendment to Article 10.2 of the Statute (OJ L 83, 1.4.2003, p. 6), used to read as follows: “Subject to Article 10.3, only members of the Governing Council present in person shall have the right to vote. By way of derogation from this rule, the Rules of Procedure referred to in Article 12.3 may lay down that members of the Governing Council may cast their vote by means of teleconferencing. These rules shall also provide that a member of the Governing Council who is prevented from voting for a prolonged period may appoint an alternate as a member of the Governing Council. Subject to Articles 10.3 and 11.3, each member of the Governing Council shall have one vote. Save as otherwise provided for in this Statute, the Governing Council shall act by a simple majority. In the event of a tie, the President shall have the casting vote. In order for the Governing Council to vote, there shall be a quorum of two-thirds of the members. If the quorum is not met, the President may convene an extraordinary meeting at which decisions may be taken without regard to the quorum.”
2.4 DIFFERENCES IN ADJUSTMENTS TO THE COMMISSION AND THE GOVERNING COUNCIL OF THE ECB

Like the new provision of the Treaty of Nice reforming the size of the European Commission, Article 10.6 of the Statute requires unanimous action on the part of the Council before pertinent measures can be implemented. Unlike the regulation on the size of the Commission, however, Article 10.6 additionally requires ratification by all Member States. On the one hand, this can be explained by the fact that the Nice Treaty further specifies the framework for a restructured composition of the Commission, while it does not outline any criteria for a new voting procedure in the ECB Governing Council. On the other hand, this may, to a certain extent, reflect the particular sensitiveness of decision-making in the field of monetary policy in Europe. Changes to the regulatory framework of the Governing Council of the ECB or a curtailment of voting rights in this supreme monetary policymaking body – whatever form they might take – apparently should not be possible without being confirmed by national parliaments, which somehow compensates for the lack of any specifications concerning the new Governing Council voting structure.

The adjustments introduced by the Treaty of Nice to increase the efficiency of the Commission and those targeted at the Governing Council of the ECB also differ significantly in that the number of Commissioners is supposed to be downsized once EU membership exceeds a certain number, while Article 10.6 of the Statute does not affect the composition of the Governing Council of the ECB or the right of participation therein, but merely members’ voting rights and their execution. Although the voting rights of varying members are to be temporarily suspended, all members of the Governing Council of the ECB shall maintain the right to participate in Governing Council meetings.

The provisions pertaining to the Commission’s size also comprise the important stipulation that the number of Members of the Commission shall be less than the number of Member States once the EU consists of 27 Member States, and that the Members of the Commission shall be chosen according to a rotation system based on the principle of equality expressed in predetermined criteria.\footnote{These criteria, which are to determine the composition of successive colleges automatically, are to be based on the following principles: (a) Member States shall be treated on a strictly equal footing with regard to determination of the sequence of, and the time spent by, their nationals as Members of the Commission; consequently the difference between the total number of terms of office held by nationals of any given pair of Member States may never be more than one; (b) subject to point (a), each successive college shall be so composed as to reflect satisfactorily the demographic and geographical range of all the Member States of the Union.}

Thus, the Council is only to determine the limit for the number of Commission Members and the exact implementing arrangements for the rotation system, but has in fact little room to manoeuvre. Article 10.6 of the Statute, by contrast, does not specify how voting procedures in the Governing Council of the ECB should be determined. It neither contains any indication with regard to timing nor does it stipulate a limitation to the number of members with voting rights, nor a fixed procedure for their allocation. Although it might seem that this lack of specification is politically compensated for by the requirement that all Member States have to ratify prospective regulatory adjustments, it is nevertheless
striking, given that an important aspect of primary Community law has thus formally been delegated to a Community body. In comparison with the new provisions on the European Commission laid down in the Treaty of Nice, the provisions enabling new voting modalities for the Governing Council of the ECB are thus even more flexible and leave the Heads of State or Government with a broad margin of discretion – even if the ratification requirement does not give them exclusive responsibility. This does not, however, mean that the EU Council (in the composition of the Heads of State or Government) is entirely free to decide on whatever regulatory provisions it chooses. Every regulatory provision which is issued in accordance with Article 10.6 of the Statute must correspond to the general fundamental principles of Community law. In particular, such decisions have to meet standards of proportionality and equal treatment as endorsed by the European Court of Justice in the context of legislative acts.

3 COUNCIL DECISION OF 21 MARCH 2003

On 3 February 2003 the ECB issued a Recommendation18 which completely corresponded to the later Decision 2003/223/EC19 regarding new voting modalities for the ECB Governing Council in a future, enlarged euro area (Article 1 of this Decision is set out in Annex 1).

3.1 BASIC CONCEPT OF THE COUNCIL DECISION

The new system of voting rights as adopted on 21 March 2003 by the EU Council in Decision 2003/223/EC can be summarised as a two-tier rotation model which allocates NCB governors to different groups with specific numbers of voting rights. Governors will exercise their voting rights with different frequencies depending on the size of their NCB’s economy within the euro area. Within each group, governors have a voting right for equal amounts of time. The allocation of governors to groups depends on the ranking of their NCBS’ Member State (see Annex 2, showing a ranking based on the prospective Member States at that juncture) measured against a weighted two-component indicator: The first component, to which a 5/6 weight is attributed, is the gross domestic product at market prices (GDP mp), while the second component, accounting for a weight of 1/6, is the total aggregated balance sheet of the monetary financial institutions (TABS-MFIs) of the respective Member State.

The following charts for the first and second tier show the basic concept of the selected rotation model:

Tier one, which provides for two groups of governors, will start as soon as the overall number of governors exceeds 15.

17 In practice, however, the Heads of State or Governments’ scope of discretion is similar to that of a Treaty amendment, the only difference being that no IGC has to intervene and the Council is strictly limited to the given Treaty framework.
18 Recommendation ECB/2003/1, under Article 10.6 of the Statute, for a Council Decision on an amendment to Article 10.2 of the Statute (OJ C 29, 7.2.2003, p. 6).
19 Cf. footnote 15.
With regard to tier one, it is explicitly stated that the frequency of voting rights allocated to the first group will not be lower than the frequency of voting rights for the second group.

The second tier, which already provides for three groups, will commence when the number of governors exceeds 21.

The detailed implementing procedures are to be adopted by the Governing Council, acting by a two-thirds majority of its members with and without a voting right. By applying the same procedure, the Governing Council may also decide to postpone the start of the rotation system until the date on which the number of governors exceeds 18.

### Table 1 The two-group rotation system (first stage) – voting frequencies of governors in each group

<table>
<thead>
<tr>
<th>Governors in the Governing Council</th>
<th>First group</th>
<th>Second group</th>
<th>Sum</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Voting rights/governors</td>
<td>Voting frequency (percentage)</td>
<td>Voting rights/governors</td>
</tr>
<tr>
<td>16</td>
<td>5/5</td>
<td>100</td>
<td>10/11</td>
</tr>
<tr>
<td>17</td>
<td>5/5</td>
<td>100</td>
<td>10/12</td>
</tr>
<tr>
<td>18</td>
<td>5/5</td>
<td>100</td>
<td>10/13</td>
</tr>
<tr>
<td>19</td>
<td>4/5</td>
<td>80</td>
<td>11/14</td>
</tr>
<tr>
<td>20</td>
<td>4/5</td>
<td>80</td>
<td>11/15</td>
</tr>
<tr>
<td>21</td>
<td>4/5</td>
<td>80</td>
<td>11/16</td>
</tr>
<tr>
<td>22 and more</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Second stage: rotation system with three groups (see Table 2)*


### Table 2 The three-group rotation system (second stage) – voting frequencies of governors in each group

<table>
<thead>
<tr>
<th>Governors in the Governing Council</th>
<th>First group</th>
<th>Second group</th>
<th>Third group</th>
<th>Sum</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Voting rights/governors</td>
<td>Voting frequency (percentage)</td>
<td>Voting rights/governors</td>
<td>Voting frequency (percentage)</td>
</tr>
<tr>
<td>16-21</td>
<td>4/5</td>
<td>80</td>
<td>8/11</td>
<td>73</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*First stage: rotation system with two groups (see Table 1)*


The detailed implementing procedures are to be adopted by the Governing Council, acting by a two-thirds majority of its members with and without a voting right. By applying the same procedure, the Governing Council may also decide to postpone the start of the rotation system until the date on which the number of governors exceeds 18.
3.2 CONSULTATION OF THE EUROPEAN COMMISSION AND THE EUROPEAN PARLIAMENT

Recommendation ECB/2003/1\(^{20}\) triggered the Commission’s and the Parliament’s right to be consulted.

The Commission presented its Opinion\(^{21}\) on the matter on 19 February 2003. It supported the rotation model recommended by the ECB and checked it against several criteria\(^{22}\) the Commission had developed.

The Commission noted that the rotation model was in line with the Treaty of Nice and that it would prepare the ECB for a substantially enlarged euro area. However, the Commission also saw some room for improvement and reached the following conclusions:

- It could be advisable to lower the maximum number of voting rights, as this could further increase the speed and efficiency of decision-making.
- In view of the weighting formula intended to govern the frequency at which the individual NCB governors are assigned voting rights in the Governing Council of the ECB, the Commission emphasised the relevance of the population criterion for reforming the voting rules in other institutions (notably the EU Council), and stated that it deemed the ECB’s key for capital subscription (50% GDP component, 50% population component) more appropriate for assigning individual Member States to the various groups of the rotation model, as this would more strongly reflect an unbiased and neutral approach.
- To increase transparency, some issues should be regulated in greater detail (e.g. rotation frequency, the order according to which voting rights are to be assigned within each group), and the effective start of the rotation system should be explicitly mentioned in Article 10.2.
- Large-scale adaptations are not to be based on the enabling clause, but require decisions taken within the framework of the EU Convention or IGCs.\(^{23}\)

By comparison, the Opinion of the European Parliament on the ECB’s Recommendation\(^{24}\) is much more critical. The European Parliament states that it is fully conscious of the need to reform the voting procedures of the Governing Council of the ECB in view of a possible enlargement of EMU. Nevertheless, it rejects the ECB’s Recommendation. It points to the excessive complexity of the proposed rotation model and to the fact that it has been widely criticised for that reason. At the same time, it takes into account the difficulty of coming up with reform measures within the limits set by Article 10.6 of the Statute.

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20 Cf. footnote 18.
21 COM (2003) 81 final, which has to the best of our knowledge not yet been published in the Official Journal.
22 The Commission named the following conditions: “decisions should continue to be taken in a swift and efficient manner; the decision-making bodies should act with the interests of the whole euro area in mind; the system must be considered as neutral and unbiased by both existing and future Member States; the markets and the general public should be able to understand the logic and the functioning of the new voting system.” However, the Commission deemed that these criteria had not been fully met.
23 However, the Treaty establishing a Constitution for Europe did not introduce any further adaptations to the decision-making procedures of the ECB Governing Council.
According to the European Parliament, the present voting procedure in the Governing Council of the ECB should be maintained for the time being. Reform proposals should be left up to the European Convention, and decisions could be taken in the course of the next IGC.²⁵

As far as the composition of the Executive Board is concerned, the European Parliament leans toward increasing the number of members to nine persons who are to be competent for operational decisions. Moreover, the Parliament envisages a Governing Council responsible for “strategic and general monetary policy decisions”, acting on a double majority “based on the population of the Member States, the total size of the economy and the relative size within it of the financial services sector”.

After consulting the European Commission and Parliament, the EU Council unanimously adopted an amendment to Article 10.2 of the Statute on 21 March 2003 (see Annex 1), which was fully based on the above-mentioned ECB Recommendation.

### 3.3 THE MOTIVATION OF THE SELECTED ROTATION MODEL AS SET OUT IN THE DECISION

The reasons and explanations for this complex regulation are laid out in the “whereas” clauses of Decision 2003/223/EC:

In an introductory remark, the EU Council stresses that there “is a need to maintain the Governing Council’s capacity for efficient and timely decision-making in an enlarged euro area, irrespective of the number of Member States that adopt the euro. [...] A rotation system is an equitable, efficient and acceptable way of assigning voting rights among the governors in the Governing Council.” A number of 15 voting rights for the governors is deemed to strike “an appropriate balance between, on the one hand, continuity with the existing set-up including a balanced assignment of voting rights between the six members of the Executive Board and the other members of the Governing Council and, on the other hand, the need to ensure efficient decision-making in a substantially enlarged Governing Council” (“whereas” clause (1)).

“Whereas” clause (2) indicates clearly that changes to the permanent voting rights of the Executive Board members in the Governing Council have never been an issue, as they are appointed at European level by a Treaty procedure. The clause also makes reference to the fact that the Executive Board Members are the only members of the Governing Council operating solely in the euro area context and for the ECB without performing any NCB function at the same time.

As far as the composite indicator (the 5/6-1/6 GDP mp and TABS-MFIs split) is concerned, the economic weight of a Member State as reflected by its GDP mp is said to be “an appropriate component as the impact of central bank
decisions is greater in Member States with larger economies than in those with smaller economies. At the same time, the size of a Member State’s financial sector also has a particular relevance for central bank decisions, since the counterparties of central bank operations belong to this sector. [...] This choice of weights is suitable, as this will mean that the financial sector is sufficiently and meaningfully represented.”26

The shares of each Member State in the aggregate GDP mp and in the TABS-MFIs of the Member States which have adopted the euro should be adjusted whenever the aggregate GDP mp is adjusted in accordance with Article 29.3 of the Statute or whenever the number of governors in the Governing Council increases.

According to “whereas” clause (4), the chosen rotation principle reflects five fundamental principles:
1. “One member, one vote”: this is said to be the Governing Council’s core decision-making principle; it continues to apply to all members of the Governing Council that have a voting right;
2. “Ad personam representation”: this refers to the fact that all members of the Governing Council will continue to participate in its meetings “in a personal and independent capacity”;
3. “Automaticity”: this means that the rotation system will be able to accommodate any euro area enlargements up to the presently envisaged maximum number of Member States27;
4. “Representativeness”: this principle pursues the objective of avoiding insufficient representation of the euro area economy as a whole;
5. “Transparency”.28

3.4 ANALYSIS AND EVALUATION

An analysis of Decision 2003/223/EC on the new voting modalities must above all deal with the achievement of the objective of the Decision, the appropriateness of its criteria and with the issue of equal treatment of Member States.

3.4.1 DO THE NEW VOTING MODALITIES MEET THE OBJECTIVE FOR WHICH THEY WERE ESTABLISHED?

The objective of making the decision-making process more efficient in a larger Governing Council of the ECB, which was implicitly set by the Treaty of Nice, has been met to a certain extent through the establishment of a rotation system. As a result of the thresholds introduced by Decision 2003/223/EC, the number of persons voting on decisions of the Governing Council will gradually become smaller than the overall number of Governing Council members, and will never exceed 15. Yet

26 See “whereas” clause (5) of Decision 2003/223/EC.
27 The rotation system should be able to accommodate a number of Member States up to 27 (the present 25 Member States as well as Bulgaria and Romania, which already had the status of accession candidates when the Treaty of Nice was signed). The ECB’s Recommendation also labelled this principle as the “robustness principle”.
28 With regard to this principle, the EU Council Decision does not offer any further explanation.
the merits of the rotation system and its practical gains for the decision-making process in the Governing Council are significantly reduced by one factor: the rotation system does not reduce the number of governors actually participating in the meetings of the Governing Council of the ECB – the non-voting members are free to join the voting members in their discussions. (In this respect, it must be noted that the new voting modalities do not necessarily effect a shift from present practice, because so far the Governing Council has adopted the overwhelming majority of its decisions by consensus rather than by formal voting.)

The fact that the practical relevance of Decision 2003/223/EC is limited must, however, not be blamed on the Heads of State or Government that took this decision. After all, the EU Council’s mandate under the Treaty of Nice to amend, by unanimous vote, the Statute (Article 10.6, the “enabling clause”) is limited to Article 10.2 of the Statute. As the enabling clause does not extend to Article 10.1, which regulates the basic composition of the Governing Council of the ECB, the right to participate in Governing Council meetings that the Maastricht Treaty granted to all Eurosystem NCB governors – including future members without voting rights – was here to stay.

Moreover, while the Governing Council has so far adopted most of its decisions without a formal voting procedure, this need not be the case in the future. The very reason for which the enabling clause was inserted by the Treaty of Nice was to secure an efficient decision-making procedure in a Eurosystem comprising more (than the current 12) NCBs.

Accordingly, the European Commission noted in its Opinion of 3 February 2003 that the three-group rotation model fully responds to the mandate received in Nice and prepares the ECB for a substantially enlarged euro area.

3.4.2 ARE THE CRITERIA ON WHICH THE DECISION WAS BASED APPROPRIATE AND ADEQUATE?

Without any doubt, the principles of transparency and of involving the NCB governors in a personal and independent capacity are appropriate and adequate. The latter concept reflects the ESCB’s guiding principle enshrined in Article 108 of the Treaty establishing the European Community (“the Treaty”), according to which decision-making bodies shall seek or take no instructions from third parties, as well as the principle that governors are to vote in a personal capacity as laid down in Article 10.2 (substitution only being allowed in case of absence for a prolonged period), plus the ESCB’s commitment to fully autonomous decision-making. Indeed, it goes beyond this concept in so far as it rejects the idea that several members should have to represent other members of the Governing Council or the overall interest of a constituency. 29 Furthermore, the principle of automatic accommodation to any euro area enlargement up to the presently envisaged maximum number of Member States seems very reasonable, because this principle obviates the need for making adjustments upon every single enlargement of the Eurosystem (up to 27 members, which appeared

29 At the International Monetary Fund (IMF), for instance, each Executive Director represents the countries allocated to his/her constituency.
realistic when the Treaty of Nice was signed). This criterion is derived from the Nice Treaty itself, which prescribed it for the Commission rotation model.

An interesting aspect that is not immediately understandable is that one of the criteria by which the rotation system was chosen was the “one member, one vote” principle. After all, the new voting modalities no longer reflect this principle. Yet the Council Decision is based on the interpretation that this principle should apply to all those members of the Governing Council that have been assigned voting rights. In other words, one voting member, one vote. This principle would not seem to be a key criterion. In the rotation model, votes are treated differently by allocating them to different groups; in theory, it would also have been possible to establish such an indirect form of weighting with a system of multiple voting rights. From this perspective, this criterion does not appear to affect significantly the adequacy of the chosen system. The decision to weight voting rights by assigning different frequencies to them is at best the more “elegant” option, as a system of staggered voting also implements the weighting principle, but in a less obvious way.

Finally, the criterion of “representativeness”, which is designed to avoid situations of insufficient representation of the euro area economy as a whole, is of crucial importance.30 This criterion basically prescribes that the rotation model must contain some kind of weighting element. It requires governors whose Member States account for a greater share of the euro area economy to be allocated larger shares in the voting key. A weighting based on the economic role of the Member States within the euro area was not stipulated by the Treaty of Nice, but reflects a policy judgement that the EU Council, meeting in the composition of Heads of State or Government, endorsed on the basis of a recommendation by the Governing Council of the ECB. As such, this judgement is not to be contested and appears to be an adequate criterion, even though it strongly restricts the range of options.

To sum up, the criteria recommended by the Governing Council and eventually endorsed by the EU Council which were to define the requirements for the rotation model appear to be broadly appropriate and adequate. This brings us to the question as to whether those criteria were sufficient or whether additional criteria would have been called for. In this respect two criteria listed in the European Commission’s Opinion of 3 February 2003 should be mentioned:

- “the system must be considered as neutral and unbiased by both existing and future Member States”;
- “the markets and the media should be able to understand the logic and the functioning of the new voting system”.

The first of these two criteria is linked to the question discussed under sub-section 3.4.3, i.e. whether the rotation system may lead to an unequal treatment of Member States.

30 This criterion is related to the requirement mentioned by the European Commission in its Opinion that “the decision-making bodies should act with the interests of the whole euro area”. The European Commission’s concept appears, however, more neutral than the criterion of “representativeness”.
However, the neutrality of a given system cannot be evaluated in an abstract manner, but only in relation to a reference model – something that the Treaty of Nice did not provide. Choosing a weighting model which is referred to in the Treaty in a different context (such as the voting weights of EU Council members or the ECB’s subscribed capital key) as a reference model again implies a policy judgement, even if contextual differences are rather small. Against this backdrop, it is not easy to recognise any objective assessment of the rotation system as being fully neutral. The crucial point is that Member States must not be treated unequally in a discriminatory way (see also sub-section 3.4.3).

The second of the two Commission criteria mentioned above, which underlines the importance of an understandable framework, is broadly in line with the transparency principle advocated in Decision 2003/223/EC. However, the Commission formulated this requirement in a more detailed and explicit way.

The Commission could have gone further than that – it could have called for the new voting modalities to cut back significantly the number of voting governors in the Governing Council. In fact, the Commission did argue along those lines by indicating that it would be advisable to reduce the maximum number of voting rights in order to strengthen the speed and efficiency of decision-making, but it did not actually go so far as to specify a criterion to this effect. This argument was not followed through for political reasons. A stronger reduction of voting rights would clearly have hit the smaller Member States most, which would have made it unrealistic to expect unanimous support for a more sweeping reform of the Governing Council.31

### 3.4.3 HAVE THESE CRITERIA BEEN MET, AND ARE THE NEW VOTING MODALITIES IN LINE WITH THE PRINCIPLE OF EQUAL TREATMENT FOR ALL EU MEMBER STATES?

At any rate, the voting modalities that were adopted in the end meet the criteria that the governors shall act in a personal and independent capacity and that the system shall be accommodated automatically for enlargements of the Eurosystem. With regard to the transparency principle, however, a qualification is called for: the logic of the system may not be deemed the most straightforward, and its high degree of complexity does not foster immediate understanding. Yet as the causal relationship on the basis of which the new voting modalities work is obvious, it cannot be said that this criterion has not been met.

The new regime also reflects the principle of “one member, one vote” (in the sense interpreted above). As mentioned earlier, this principle would not appear to be particularly relevant for judging the adequacy of the system, as there are different approaches to weighting votes, including the assignment of votes for different frequencies, as at the ECB.

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31 The number of voting rights for governors never sinks below 15, which implies that the Governing Council will at all times have at least 21 voting members. Moreover, this system does not take effect until the Eurosystem consists of 16 NCBs.
What matters most for an overall assessment is whether the chosen rotation system meets the criterion of a sufficient representation of the euro area economy as a whole, or whether there is a bias in the system that clashes with the principle of equal treatment.

In this respect it must be noted that the weighting formula governing the frequency at which the individual NCB governors are assigned voting rights is somewhat out of the ordinary. As indicated above, the ranking is based on a two-component indicator, where a 5/6 weight is attributed to the shares that the individual Member States have in the euro area’s gross domestic product at market prices (GDP mp), and a 1/6 weight to the shares that the total aggregated balance sheet of the monetary financial institutions (TABS-MFIs) of each Member State has in the euro area’s TABS-MFIs.

The reason why this particular composite indicator was chosen is specified in “whereas” clause (5): “The economic weight of a Member State as reflected in its GDP mp is an appropriate component as the impact of central bank decisions is greater in Member States with larger economies than in those with smaller economies. At the same time, the size of a Member State’s financial sector also has a particular relevance for central bank decisions, since the counterparties of central bank operations belong to this sector. [...] This choice of weights is suitable, as this will mean that the financial sector is sufficiently and meaningfully represented.”

Using GDP mp to rank the Member States’ economic significance is a fairly widespread and adequate approach. Yet applying a “correction factor” (TABS-MFIs) to adjust this measure – be it at a weight of just 1/6 – introduces a discretionary element into this formula that cannot be deduced clearly or conclusively from the Treaty or from the Statute. At the same time, it can be argued that the size of the financial sectors of the Member States should indeed be adequately reflected in the voting frequencies defined for the highest monetary policy decision-making body of the euro area.

A comparison of frequencies based on GDP mp alone with frequencies adjusted for TABS-MFIs at a weight of 1/6 shows that small Member States with comparatively high TABS-MFIs tend to benefit most from taking TABS-MFIs into account. This is particularly true for Luxembourg. Once the Governing Council has been divided into three groups (i.e. once the number of governors reaches 22), the Governor of the Banque centrale du Luxembourg will probably be assigned to the second group, and not to the third, owing to the TABS-MFI criterion.\(^\text{32}\)

The ranking of Member States defined for the chosen rotation model, which determines the NCB governors’ voting frequencies (see Annex 2), begs the question whether this ranking may put certain Member States at a disadvantage.

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or discriminate against them in a legally problematic way. At a first glance, the chosen weighting – 5/6 GDP mp and 1/6 TABS-MFIs – would appear to be discretionary to a certain extent. A certain institutional uneasiness is also evident from the fact that the EU Council stated in its minutes that the model “should not be seen as a precedent for the future composition and decision-making of other Community institutions.”\textsuperscript{33} Basically, however, the new voting modalities are not discriminatory in a contestable way insofar as the NCB governors are measured by a single criterion. The two elements of the chosen composite indicator are not inadequate as such; only the percentages applied appear deliberate. Yet at the same time, one could argue that the NCBs’ shares in the capital of the ECB, which have been determined so as to reflect the shares of the Member States in the euro area’s GDP and the individual Member States’ share in the population of the Eurosystem in equal parts, were set with a certain amount of discretion as well; they could also have been determined on the basis of a different calculation model.\textsuperscript{34}

Besides, given the legal format applied in the Treaty of Nice, which empowered the Heads of State or Government to adopt primary legislation (Article 10.2 of the Statute), it would not have been easy to measure Decision 2003/223/EC against other pieces of primary Community legislation. Only in the event that this Decision had violated structural principles of EU legislation, such as the principle of equal treatment of Member States, would it have been possible, in theory, to take the Decision of the Heads of State or Government to the European Court of Justice.\textsuperscript{35} The Decision contains no such contradiction.

To sum up, the criteria defined by the EU Council, meeting in the composition of the Heads of State or Government,\textsuperscript{36} for adjusting the voting modalities of the Governing Council are broadly met by the chosen rotation system.

4 \hspace{1cm} \textbf{FINAL REMARKS}

The complexity of the new voting modalities for the Governing Council of the ECB, as adopted by the EU Council meeting in the composition of the Heads of State or Government on 21 March 2003, and in particular the discretionary design of the composite indicator, are political weaknesses that cannot be glossed over. The Council itself stated, as mentioned above, that the established rotation model for the Governing Council of the ECB should not be seen as a precedent for the future composition and decision-making process of other Community institutions. The EU Council may thus have simply underlined the one-off nature of its decision. At the same time, this statement reflects the understanding that a complex regime which appears to have been tailored to produce specific results

\textsuperscript{33} See ECB Monthly Bulletin, May 2003, pp. 81-82.
\textsuperscript{34} In its Opinion the Commission highlights the particular relevance of the population criterion for reforming the voting rules in other institutions (notably the Council), and refers to the option to use the ECB’s key for capital subscription as an indicator.
\textsuperscript{35} To institute such a proceeding would, pursuant to Article 230, subparagraph 5, of the Treaty, have been conceivable only within two months of the publication of the Decision in the Official Journal.
\textsuperscript{36} These criteria were already contained in Recommendation ECB/2003/1.
may not be deemed a “best practice” model for cooperation at the European level. Moreover, it also reflects the awareness that such a model is hard to communicate to the citizens of Europe.

The EU Council, meeting in the composition of Heads of State or Government, may however rightfully claim to have applied the enabling clause of the Treaty of Nice with its Decision 2003/223/EC and to have managed to improve, by unanimous vote as required, the efficiency of the decision-making process in a future, substantially larger Eurosystème to the extent that this was politically feasible. By adopting this Decision, the Heads of State or Government also signalled to the financial markets as well as the general public their willingness to safeguard a smoothly working monetary policy framework, thereby also fostering the stability of the euro.

**ANNEX I**

Article 1” of the “Decision of the Council, meeting in the composition of the Heads of State or Government of 21 March 2003 on an amendment to Article 10.2 of the Statute of the European System of Central Banks and of the European Central Bank”, reads as follows:

**Article 1**
The Statute of the European System of Central Banks and of the European Central Bank is hereby amended as follows:

Article 10.2 of the Statute shall be replaced by the following:

– (10.2) Each member of the Governing Council shall have one vote. As from the date on which the number of members of the Governing Council exceeds 21, each member of the Executive Board shall have one vote and the number of governors with a voting right shall be 15. The latter voting rights shall be assigned and shall rotate as follows:

– as from the date on which the number of governors exceeds 15, until it reaches 22, the governors shall be allocated to two groups, according to a ranking of the size of the share of their national central bank’s Member State in the aggregate gross domestic product at market prices and in the total aggregated balance sheet of the monetary financial institutions of the Member States which have adopted the euro. The shares in the aggregate gross domestic product at market prices and in the total aggregated balance sheet of the monetary financial institutions shall be assigned weights of 5/6 and 1/6, respectively. The first group shall be composed of five governors and the second group of the remaining governors. The frequency of voting rights of the governors allocated to the first group shall not be lower than the frequency of voting rights of those of the second group.

37 Article 2 of the Council Decision states that this Decision shall be ratified by all Member States in accordance with their respective constitutional requirements and “shall enter into force on the first day of the second month following that in which the instrument of ratification is deposited by the last signatory state to fulfill that formality.”
Subject to the previous sentence, the first group shall be assigned four voting rights and the second group eleven voting rights;
– as from the date on which the number of governors reaches 22, the governors shall be allocated to three groups according to a ranking based on the above criteria. The first group shall be composed of five governors and shall be assigned four voting rights. The second group shall be composed of half of the total number of governors, with any fraction rounded up to the nearest integer, and shall be assigned eight voting rights. The third group shall be composed of the remaining governors and shall be assigned three voting rights;
– within each group, the governors shall have their voting rights for equal amounts of time;
– for the calculation of the shares in the aggregate gross domestic product at market prices, Article 29.2 shall apply. The total aggregated balance sheet of the monetary financial institutions shall be calculated in accordance with the statistical framework applying in the European Community at the time of the calculation;
– whenever the aggregate gross domestic product at market prices is adjusted in accordance with Article 29.3, or whenever the number of governors increases, the size and/or composition of the groups shall be adjusted in accordance with the above principles;
– the Governing Council, acting by a two-thirds majority of all its members, with and without a voting right, shall take all measures necessary for the implementation of the above principles and may decide to postpone the start of the rotation system until the date on which the number of governors exceeds 18.

The right to vote shall be exercised in person. By way of derogation from this rule, the Rules of Procedure referred to in Article 12.3 may lay down that members of the Governing Council may cast their vote by means of teleconferencing. These rules shall also provide that a member of the Governing Council who is prevented from attending meetings of the Governing Council for a prolonged period may appoint an alternate as a member of the Governing Council.

The provisions of the previous paragraphs are without prejudice to the voting rights of all members of the Governing Council, with and without a voting right, under Articles 10.3, 10.6 and 41.2. Save as otherwise provided for in this Statute, the Governing Council shall act by a simple majority of the members having a voting right. In the event of a tie, the President shall have the casting vote. In order for the Governing Council to vote, there shall be a quorum of two-thirds of the members having a voting right. If the quorum is not met, the President may convene an extraordinary meeting at which decisions may be taken without regard to the quorum.”
## ANNEX 2

### Weighted two-component indicator

(5/6 GDP mp and 1/6 TABS-MFIs (%))

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Source: Dvorsky and Lindner, op. cit. footnote 5; data derived from publications from EUROSTAT, ECB and NCBs for periods until 2001; GDP data calculated in accordance with Article 29.3 of the Statute.
LEGAL INTERPRETATION WITHIN THE EUROPEAN SYSTEM OF CENTRAL BANKS: IS THERE METHOD IN 'T?

Frank Elderson

ABSTRACT

Che cosa significano le parole? Come arriviamo a stabilirne il significato? E’ questo ancora possibile? Il contributo si incentra sull’utilizzo delle tecniche stabilite di interpretazione giuridica nel contesto del Sistema Europeo di Banche Centrali (SEBC). È stato pubblicato un ampio e crescente corpus di pareri della Banca Centrale Europea (BCE) che ha posto in luce l’utilizzo dell’interpretazione giuridica all’interno del SEBC. Analogamente si può dire dei vari rapporti di convergenza e, inter alia, delle lettere inviate dalla BCE sulla bozza del Trattato che istituisce una Costituzione per l’Europa. L’interpretazione giuridica rappresenta il lavoro quotidiano del Comitato Legale (LEGCO) del SEBC. Se già l’interpretazione giuridica è di per sé una sfida, lo diventa ancora di più nell’ambiente multilinguistico e spesso multigiurisdizionale in cui opera il LEGCO. Negli anni, i membri del LEGCO hanno fornito un contributo a tali pareri, rapporti e lettere, per cui questi documenti possono essere rappresentativi del loro lavoro. Tale rassegna mostra che la BCE (e prima ancora il suo predecessore, l’Istituto Monetario Europeo) ha utilizzato un’ampia gamma di metodi e tecniche per poter interpretare i provvedimenti giuridici del caso, e ciò nell’ambito della struttura giuridica generale comunitaria di metodi e tecniche interpretative. Vengono fatte alcune raccomandazioni, tra cui quella di essere trasparenti sui metodi e sulle tecniche di interpretazione utilizzati, e quella di usare una terminologia il più coerente possibile. Questo studio chiarisce il lavoro quotidiano del Comitato Legale (LEGCO) del SEBC. Se già l’interpretazione giuridica è di per sé una sfida, lo diventa ancora di più nell’ambiente multilinguistico e spesso multigiurisdizionale in cui opera il LEGCO. Negli anni, i membri del LEGCO hanno fornito un contributo a tali pareri, rapporti e lettere, per cui questi documenti possono essere rappresentativi del loro lavoro. Tale rassegna mostra che la BCE (e prima ancora il suo predecessore, l’Istituto Monetario Europeo) ha utilizzato un’ampia gamma di metodi e tecniche per poter interpretare i provvedimenti giuridici del caso, e ciò nell’ambito della struttura giuridica generale comunitaria di metodi e tecniche interpretative. Vengono fatte alcune raccomandazioni, tra cui quella di essere trasparenti sui metodi e sulle tecniche di interpretazione utilizzati, e quella di usare una terminologia il più coerente possibile. Questo studio chiarisce che la BCE, tramite “interpretazione anticipativa”, cerca di evitare problemi interpretativi futuri già quando gli strumenti giuridici sono ancora in bozza, dimostrando così una lodevole consapevolezza dei problemi interpretativi. Lo studio mostra anche come la BCE tenti di realizzare i suoi obiettivi giuridici e di politica legislativa tramite le sue interpretazioni, pratica che può essere paragonata all’atteggiamento tradizionale pro comunitarie della Corte di Giustizia e che è anche ben accetta.
I INTRODUCTION

“Words, words, words”; thus Hamlet’s reply to Polonius’ inquiry as to what he was reading. What do words mean? How do we arrive at establishing their meaning? Is this even possible? Great minds have struggled with these questions. Theories of interpretation have been constructed, including a theory of theories of interpretation. This contribution does not propose to add yet another such theory, but will instead focus on the use of established methods and techniques of legal interpretation in the context of the European System of Central Banks (ESCB). Legal interpretation is the daily work of the Legal Committee of the ESCB (LEGCO). While legal interpretation is a challenge in itself, it is even more so in the multilingual and, often, multi-jurisdictional environment in which LEGCO operates. Its Opinions, proceedings and documents are however prevented from being published by the requirements of professional secrecy as laid down in Article 38 of the Statute of the European System of Central Banks and of the European Central Bank (“the Statute”). Fortunately for the purposes of this contribution, a wide and increasing body of European Central Bank (ECB) Opinions have been published which shed light on the use

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1 Dig. 1,3,3,10. IULIANUS libro LVIII digestorum. “Neither laws nor decrees of the Senate can be formulated so as to include any case that might ever occur; it will suffice if they comprise matters that occur frequently” (translation courtesy of the translation department of De Nederlandsche Bank).

2 Dig. 1,3,3,11. IULIANUS libro LXXXX digestorum. “Therefore [the sense of] that which has been originally decided, must be […] determined further by interpretation.”

3 Dig. 25,4,1. ULPIANUS libro vicesimo quarto ad edictum. “Although the praetor’s edict may be perfectly clear, yet its interpretation should not be disregarded.”

4 Shakespeare, Hamlet, Act two, Scene two.


7 Currently, the legal basis for LEGCO is Article 9 of the ECB Decision ECB/2004/2 (2004/257/EC) of 19 February 2004 adopting the Rules of Procedure of the European Central Bank (OJ L 080, 18.3.2004, p. 33 et seq.). Article 9.1 of this Decision provides: “The Governing Council shall establish and dissolve committees. They shall assist in the work of the decision-making bodies of the ECB and shall report to the Governing Council via the Executive Board”. Article 9.2 provides, inter alia, that “Committees shall be composed of up to two members from each of the Eurosystem NCBS and the ECB”.

of legal interpretation within the ESCB. The same holds true for the various convergence reports and, inter alia, the letters sent by the ECB regarding the draft Treaty establishing a Constitution for Europe. Over the years, all LEGCO members have contributed to these Opinions, reports and letters. These documents, therefore, may serve as a useful proxy for the work of that Committee. Together they constitute a small window through which the interpretative work of LEGCO may be observed and commented on. Peeking, as it were, through this window, this contribution is structured as follows. First of all, Section 2 provides a very brief overview of what the Court of Justice of the European Communities (“the Court of Justice”) and the learned writers have had to say on legal interpretation within Community law. A small catalogue of methods and techniques of legal interpretation is proposed for the purposes of this contribution. Section 3 examines if and how these techniques are used in the body of ECB Opinions and other documents mentioned above, while Section 4 considers some related subjects. Finally, Section 5 draws some conclusions. It is then for the reader to establish whether we may agree with Polonius’ conclusion that “[t]hough this be madness, yet there is method in ‘t.”

2 A SMALL CATALOGUE OF METHODS AND TECHNIQUES OF LEGAL INTERPRETATION

According to Article 220 of the Treaty, “[t]he Court of Justice shall ensure that in the interpretation and application of this Treaty the law is observed”. The Court of Justice has ruled in a great number of cases on the aspects of what such “interpretation” may entail. For the purposes of this section, it suffices to mention some of the more general statements made by the Court of Justice regarding the interpretation of Community law. According to consistent case-law, in interpreting a provision of Community law it is necessary to consider “not only its wording but also the context in which it occurs and the objects of the rules of which it is part”. The Court of Justice sometimes uses slightly different wording to express the same idea: “it is necessary to examine, apart from their [i.e. the two secondary law instruments under scrutiny] wording and structure, their context and purpose” and “since the interpretations […] based on their wording and the history and the scheme of the Regulation do not permit their precise scope to be assessed […] the legislation in question must be assessed in the light of its object and purpose”.

9 On the basis of Articles 121 (1) and 122 (2) of the Treaty.
10 See the letter dated 5 June 2003 from Willem Duisenberg, President of the ECB, to President Valérie Giscard d’Estaing, Chairman of the Convention on the Future of Europe; the letter dated 19 September 2003 from Willem Duisenberg to Franco Frattini, President of the Council of the European Union, and the letter dated 16 April 2004 from Jean-Claude Trichet, President of the ECB, to Brian Cowen, President of the Council of the European Union.
11 As a by-product of this search for interpretative methods, the examples given below show the wide variety of legal issues dealt with within the ESCB and LEGCO.
12 Shakespeare, op. cit.
14 Case C-286/02 Bellio v Prefettura di Treviso of 1 April 2004, paragraph 40.
interpreted by reference to its purpose". The Court of Justice sometimes also refers to the “spirit” of the Treaty: in the Continental Can case it held that in order to answer the question whether Article 82 (now 86) of the Treaty applies to changes in the structure of an undertaking, “one has to go back to the spirit, general scheme and wording of Article [82], as well as to the system and objectives of the Treaty”. It follows from these citations that the Court of Justice attaches importance to a wide range of factors, including, inter alia, wording, structure, scheme, context, history, purpose and objectives. In the literature on the methods of interpretation of the Court of Justice, these and other elements have been categorised in various manners and under different headings.

This diversity in categorisation indicates the subjective character of any such exercise. The lowest common denominator seems to be a division into three principal methods of interpretation: the (i) textual, (ii) systematic and (iii) teleological methods. It is proposed for the purposes of this paper to follow these three principal methods, each of which may serve as an umbrella for various sub-techniques and principles. It should be noted that some of these techniques can be used in the course of more than one of the principal methods. For example, references to the preliminary considerations, or “whereas” clauses, of a legal instrument, can be used both in a systematic approach (reading a provision in the light of other provisions of the instrument) and in a teleological approach (as the preliminary considerations often shed light on the purpose and objective of the instrument). This is however not the place for academic hair-splitting about the finesses of categorisation. Therefore, the following observations regarding the various methods and techniques of interpretation are limited to what seems necessary to bring some order into the subsequent discussion of the interpretative endeavours within the ESCB.

We start with the textual method of interpretation and the various techniques it has at its disposal. Although it certainly does not end there, interpretation starts by simply reading the text. This basic idea is famously laid down in the maxim, attributed to Vattel, that “in claris non fit interpretatio”. Vattel notwithstanding, a purely literal interpretation is not sufficient, although the textual method might be considered as primus inter pares in relation to the other

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18 From the ancient Greek word telos, meaning the end, the purpose.
19 Usher, op. cit., p. 162, refers to his former student textbook containing a grand total of “61 rules, presumptions, maxims or aids to be used in statutory interpretation”, adding that “since that particular student textbook is one of the more slender of its ilk, no doubts there are others which contain many more”. Usher in his article did not endeavor to go through all these 61 rules. Neither will I.
methods. The textual method of interpretation therefore comprises as a starting point the strict literal and grammatical techniques of interpretation. In the Community context, these include references to the various language versions of the provision being interpreted, and elements such as the principle that Community law is normally to be given its autonomous interpretation, without reference to national legal orders, unless such express reference is provided for in the Community provisions being interpreted. As a purely linguistic approach does not always guarantee a single outcome, logic needs to be adhered to in order to eliminate possible inconsistencies. Under the heading of logical interpretation (which still falls within the realm of the textual method of interpretation), many maxims have been coined over the centuries, such as *lex specialis derogat generali, lex posterior derogat priori, expressio unius est exclusio alterius, expressum facit cessare tacitum, a contrario, a fortiori, ab absurdo*, to name but a few. Although recourse to logic can hardly be deemed inappropriate under any circumstances, logical interpretation has been criticised when reduced to a list of maxims which are not always as useful in practice as they are well-known in theory. The principle that exceptions to general rules are to be interpreted restrictively is also part of such logical interpretation. The ECB sometimes uses these maxims to arrive at its interpretative conclusions.

Under the systematic method of interpretation, emphasis is shifted from the meaning of the words in isolation to what they mean in the context of the paragraphs, articles and the legal instrument as a whole. Systematic interpretation comprises techniques such as references to the place of the provision within the structure of the legal instrument and to its preliminary considerations. In addition, the phenomenon termed “legalising interpretation” has been brought under the denominator of systematic interpretation, i.e. the view of the Court of Justice that where the wording of secondary Community law is open to more than one interpretation, preference should be given to the interpretation which renders the provision consistent with the Treaty, rather than the interpretation which leads to it being incompatible with the Treaty. As has been seen, the references to the preliminary considerations of a legal instrument may also be used when engaged in a teleological analysis. This is particularly true for techniques such as the study of the legislative history and the *travaux préparatoires* of the provision being interpreted, and to declarations and

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21 Mertens de Wilmars, op. cit., p. 10. This view is echoed by Schermers and Waelbroeck, op. cit., pp. 11 and 12, who observe that “the Court rightly still attributes most importance to the text of the law itself. In most cases, the Court will first study the text of the provisions involved in all official languages. It is only when it finds that the text remains ambiguous that the Court may rule that the question may be examined in the light of the purpose which the provision was intended to serve”.

22 See Bredimas, op. cit., p. 34, who also includes references to the context of a provision in the textual method of interpretation. I prefer to categorise such contextual references under the heading of systematic interpretation.

23 See for this criticism (and more maxims), Bredimas, op. cit., p. 17.

24 See, among numerous examples, Case C-103/01 Commission v Federal Republic of Germany [2003] ECR I-5369, paragraph 32: “Since that provision constitutes an exception to the principle of free movement of goods […] it must be interpreted strictly”.

25 For an example of the restrictive interpretation of exceptions to general rules, see Opinion of the ECB of 4 November 2004 at the request of the Belgian Ministry of Finance on a draft law introducing a tax on exchange operations involving foreign exchange, banknotes and currency (CON/2004/34), paragraph 15. This ECB Opinion, as are all those cited below, has been published on the ECB website at www.ecb.int.

reservations made by (one or more of) the authors of the act at the time of its adoption. For the purposes of this paper, these last techniques will be discussed in the third of the three methods, the teleological method, as it is in this realm that they have surfaced most often in ECB Opinions.

This brings us to the third principal method of interpretation: the teleological method. The teleological or functional method of interpretation puts the emphasis on the function, utility (effet utile), aim and purpose that the legal instrument has to fulfil: “l’interprétation téléologique […] explique un texte à la fois par les objectifs spécifiques qu’il poursuit et à la lumière de la contribution qu’il apporte à la réalisation des objectifs généraux des traités”. Teleological interpretation is usually used for three purposes: to promote the objective for which the provision was made; to prevent unacceptable consequences to which a literal interpretation might lead; and to fill lacunae which would otherwise exist in the legal order. Although the Court of Justice will generally try to combine all methods of interpretation, it would seem that a certain preference is given to interpretation by reference to the purpose of the law. This teleological or purposive approach has been identified in the literature as “peculiarly appropriate in Community law where […] [t]he Treaties provide mainly a broad programme or design rather than a detailed blueprint”. In addition, as every contemporary observer knows all too well, the Treaties are difficult to amend. Therefore, their development largely depends on the (often teleological) interpretation accorded to them by the judiciary over the years. To a certain extent it could be argued that in the realm of the objectives and tasks of the ESCB, the ECB plays a similar role by way of, principally, its Opinions.

3 APPLICATION WITHIN THE CONTEXT OF THE ESCB OF METHODS AND TECHNIQUES OF LEGAL INTERPRETATION

3.1 EXAMPLES OF THE APPLICATION OF METHODS OF TEXTUAL INTERPRETATION

3.1.1 LITERAL INTERPRETATION AND DIFFERENT LANGUAGE VERSIONS

In its Opinions the ECB takes as a starting point the ordinary meaning of the words of the provisions it is asked to analyse. Probably because of the self-evident nature of this premise, there are few instances of the ECB explicitly engaging in literal interpretation in its Opinions. One example of a literal approach is the suggestion in the Opinion of the European Monetary Institute (EMI) of 6 April 1998 that the words “or continuing implementation” should be deleted from the

27 Mertens de Wilmars, op. cit., p. 16.
28 Schermers and Waebroecq, op. cit., p. 21.
29 Note, for example, the quotation from Continental Can above, which mixes together textual, systematic and teleological approaches.
30 Schermers and Waebroecq, op. cit., p. 10.
proposed Article 1 (2) of the Council Decision of 29 June 1998\textsuperscript{32} (as was subsequently carried out). The stated reason for this suggestion was that “[t]he meaning of these words is not clear and this uncertainty might give rise to problems for the interpretation and application of the proposal”\textsuperscript{33}. A second example of a literal approach can be found in the EMI’s Opinion of 23 February 1998, in which the EMI notes that “the wording of Article 10 of the draft law [on the Autonomy of Banco de España] does not explicitly and unambiguously recognise that the information to be given by the Governor to Parliament and Government is an ex post information”, and stated that this wording should be revised “in order to enhance legal clarity and certainty”.\textsuperscript{34} As is the case with all European Union (EU) institutions and bodies, the ECB operates in a multilingual environment. As lawyers within the ESCB might take as a starting point of their legal analysis different language versions of the Treaties, the ESCB Statute and the secondary legislation, the comparison of such versions is an inherent feature of the legal discourse within the ESCB. However, no clear examples have been identified in the body of studied ECB Opinions of the ECB that explicitly engage in the comparison of different language versions. Nevertheless, given that this issue is ever-present, and as a possible guide for future instances, some of the main findings of the Court of Justice regarding different language versions are mentioned here. The starting point is that the Treaties are authentic in all official languages.\textsuperscript{35} It is consistent case-law of the Court of Justice that the “interpretation of a provision of Community law involves a comparison of the language versions”.\textsuperscript{36} This means all language versions, without discrimination according to the size of the population speaking a particular tongue: “to discount two language versions, as the applicants in the main proceedings suggest, would run counter to the Court’s settled case-law to the effect that the need for a uniform interpretation of Community regulations makes it impossible for the text of a provision to be considered in isolation but requires, on the contrary, that it should be interpreted and applied in the light of the versions existing in the other official languages. […] Lastly, all the language versions must, in principle, be recognised as having the same weight and this cannot vary according to the size of the population of the Member States using the language in question.”\textsuperscript{37} What happens if, despite the identical weight to be given to them, there is nevertheless a discrepancy between language versions? According to settled case-law, “the need for a uniform interpretation of Community law requires in the case of divergence between different language versions of a provision, that it be interpreted by reference to the purpose and


\textsuperscript{33} Opinion of the EMI at the request of the Council of the EU on a proposal from the Commission for a Council Decision on the consultation of the ECB by national authorities on draft legislative provisions (CON/98/14), OJ C 190, 18.6.98, p. 6, paragraph 4.

\textsuperscript{34} Opinion of the EMI of 23 February 1998 at the request of the Banco de España on a draft Law amending Law 13/1994 of the 1st of June on the Autonomy of Banco de España (CON/98/05), paragraph 5.

\textsuperscript{35} See for example Article 53 of the EU Treaty, Article 314 of the EC Treaty and Article 29 of the Rules of Procedure of the Court of Justice.


general scheme of the rules of which it forms part”. This is an illustrative example of how the Court of Justice combines various methods of interpretation in order to safeguard the “uniform interpretation of Community law”.

3.1.2 THE UNIFORM INTERPRETATION AND APPLICATION OF COMMUNITY LAW

Part of the textual method of interpretation in Community law is the issue of the “autonomous meaning” of Community law terms. The Court of Justice has held consistently that words in Community law provisions have Community law meanings. In the words of the Court of Justice: “The need for uniform application of Community law and the principle of equality require that the terms of a provision of Community law which makes no express reference to the law of the Member States for the purpose of determining its meaning and scope must normally be given an autonomous and uniform interpretation throughout the Community”. Even without such a reference, however, national law is not off-limits when interpreting Community law: “in the absence of an express reference, the application of Community law may sometimes necessitate reference to the laws of the Member States where the Community court cannot identify in Community law or in the general principles of Community law criteria enabling it to define the meaning and scope of such a provision by way of independent interpretation.” One example of the ECB granting weight to, inter alia, national laws when interpreting a Community legal instrument can be found in its Opinion of 20 January 2000. In assessing a provision in the draft Luxembourg law implementing Article 9 of Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems (OJ L 166, 11.6.98, p. 45) (the Settlement Finality Directive), the ECB had to interpret the conflict of law rules in the Directive. In doing so, the ECB noted that these (Community) rules are consistent with “(i) the rule contained in Article 8 of the US Uniform Commercial Code, (ii) the national laws already in place in several Member States, and (iii) the current trend of academic authority on the complex matter of the cross-border trading of securities”. Whereas such references by the ECB to national law (and indeed US law as well as academic authority) while interpreting Community law are rare, there are many examples of the reverse


42 CON/99/19, paragraph 24.
situation, i.e. the interpretation of national law in conformity with Community law. The latter may also take the form of specific drafting suggestions, as in its Opinions the ECB comments on draft legislative provisions. This illustrates how the ECB seeks to ensure the uniform application of Community law, and is indeed a logical consequence of the primacy of Community law. The following examples should suffice to illustrate how the ECB typically addresses this issue: “it would be advisable to adjust Article 39(1) of the Act [regarding Banka Slovenije] more closely to the wording of Article 14.2 of the [ESCB] Statute since differences in interpretation cannot be excluded”\footnote{ECB Convergence Report 2004, p. 233.}; “it would be beneficial to reproduce more literally the text of Article 2(i), first indent of the [First Banking Co-ordination Directive (77/780/EEC)] Directive, since Article 3(1) of the Draft Law could be interpreted in the sense that private persons would not fall under its scope”.\footnote{Opinion of the ECB of 30 March 2000 at the request of the Portuguese Ministry of Finance on a draft decree-law that aims to implement, in the Portuguese legal system, Directive 98/26/EC of 19 May 1998 on settlement finality in payment and securities settlement systems (CON/00/04), paragraph 5.} Instead of volunteering specific drafting suggestions, the ECB might also subtly attempt to draw the attention of the guardian of the Treaties, the Commission, to proposed national law provisions which in the ECB’s opinion might not comply with Community law. One such example concerns the Finnish so-called Rounding Act, which provides for the rounding downwards or upwards of cash payments to the nearest multiple of five euro cents. The principal aim of the Rounding Act is to restrict the use of one and two euro cent coins, the reason being that the production costs of one and two cent coins greatly exceed their face value. In its Opinion of 30 April 2002 the ECB had to evaluate a draft proposal to extend the rounding rules for euro cash payments to cover payments effected by bank or other payment cards as well.\footnote{Opinion of the ECB of 30 April 2002 at the request of the Finnish Ministry of Finance on a draft proposal concerning the rounding of payments denominated in euro (CON/2002/15).} The ECB found that such an extension runs the risk of breaching Community law, in particular Article 2 of Council Regulation (EC) 974/98 of 3 May 1998 on the introduction of the euro. The ECB then alerted the Commission to the Finnish legislative proposal: “[t]he ECB considers it important for the competent Community institutions to assess the compatibility of the proposed rule with Community law”.\footnote{CON/2002/15, paragraph 7.} The same concern with the uniform application of Community law plays a role in another specific instance of the delicate interplay between Community law and national law, i.e. the question whether Member States may reproduce in national legal instruments parts of Community legislation that have all the features of direct applicability and direct effect. Three arguments can be advanced against such practice. First, “copy-pasting” in national law of directly effective Community law provisions is unnecessary precisely because of their direct effect: the Community acts are part of the legal order of each Member State without any further national step. Second, when the reproduction is not identical to the wording of the Community acts, it may jeopardise the simultaneous and uniform application of those acts in the whole of the Community.\footnote{Case C-39/72 Commission v Italian Republic [1973] ECR 101.} Third, it may cast doubt on the hierarchy of legal sources, as the reader may be confused whether the provision originates in Community or national law. As regards this third objection, the Court of
Justice has held that “Member States are under an obligation not to introduce any measure which might affect the jurisdiction of the Court to pronounce on any question involving the interpretation of Community law [...] which means that no procedure is permissible whereby the Community nature of a legal rule is concealed from those subject to it”. However, under certain circumstances the technique of incorporating Community provisions in a national act may be acceptable. This may be the case, first, when a national law incorporates some elements of Community regulations for the sake of coherence and in order to make the national law comprehensible to the persons to whom it applies, but only if the Community nature of the legal rule is clearly shown or disclosed.

A second instance in which the incorporation of Community provisions into a national act may be allowed is when the Community provision leaves room for interpretation and demands a national supplementary act that grants a certain discretion to the national legislator. In such instances, the Community provision lacks the clarity, precision and unconditionality required for it to be directly effective.

In various of its Opinions, the ECB has had occasion to apply this case-law. A first such example is the ECB Opinion of 21 July 1998 on the Spanish draft law on the introduction of the euro (the so-called Umbrella law). The aim of the Umbrella law was to supplement the EU Council Regulations 1103/97 of 17 June 1997 and 974/98 of 3 May 1998, concerning the introduction of the euro. The overall intention was on the one hand to be pedagogic as far as the public was concerned, while on the other hand to facilitate the smooth introduction of the euro. While welcoming these intentions and the Umbrella law in general, the ECB took issue with the specific application of the legislative technique of incorporating parts of the said Council Regulations. The ECB pointed to instances in the draft Umbrella law which contained incomplete reproductions of Community provisions and variations on and additions to the Community wording, all of which it recommended should be remedied invoking the above mentioned case-law. The ECB even went as far as to deem it immaterial whether or not the draft national law provisions constituted improvements vis-à-vis the Community wording: “[w]hile it may be said that the draft article improves the Community text, the above considerations would warrant identical wording or deletion”. Another clear application of this “leave to the Community what is the Community’s” doctrine can be found in the ECB Opinion of 26 January 2001. Here the ECB drew attention to a provision in the Portuguese draft decree-law under scrutiny which required in so many words that only a specific

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49 Case C-272/83 Commission v Italian Republic [1985] ECR 1057, paragraphs 26 and 27.
51 Opinion of the ECB at the request of the Spanish Ministry of Economy and Finance on a draft law on the introduction of the euro (“Umbrella law”) (CON/98/31).
53 CON/98/31, paragraph 4.
54 Opinion of the ECB of 26 January 2001 at the request of Portuguese Minister of Finance concerning two draft decree-laws concerning (i) the dual circulation of banknotes and coins denominated in euro and in escudos; and (ii) amendments to the Organic Law of the Banco de Portugal (CON/2001/01).
conversion rate (1 euro = 200.482 escudos) be applied for the exchange and withdrawal of banknotes and coins and for the redenomination of bank accounts. The ECB expressed doubt about the appropriateness of this provision in the light of its content already directly following from the relevant Council Regulations. The ECB first recalled that “consistent case-law of the Court of Justice has established that Member States should not pass any measures having the effect of transposing a Community regulation into national legislation”. The ECB continued by stating that “Community regulations are an integral part of the national legal order and Member States are under the obligation not to introduce measures that might affect the uniform interpretation and application of Community law”. The ECB then warned that such uniform interpretation and application of Community law might indeed be affected by converting the provisions of a Community regulation into national legislation. However, the ECB stopped short of advising that these references be struck out entirely, acknowledging that “these provisions may be intended for reasons of clarity and to reinforce the principle that the exchange and withdrawal of banknotes and coins and the redenomination of bank accounts should be made without charge and without mark-up or commission”. Therefore, the ECB argued for a cross-reference to be incorporated into the Portuguese decree-law to the applicable Community law provisions. The ECB seems to lean even further in the direction of the national legislator in its assessment of another provision in the draft decree-law, which unnecessarily mirrored Article 5 of Council Regulation (EC) 1103/97. The ECB admitted that such mirroring “would contribute to clarity and legal certainty for the cash changeover in Portugal”. Here the ECB did not plead that the draft decree-law should limit itself to a cross-reference to the applicable Community law provision, apparently considering a “mirroring provision” justified under the circumstances. The EMI also had to deal with national law provisions which, given the Community law background, were unnecessary at best. A clear example is a provision in the Austrian draft law amending the Central Bank Act, stating that banknotes denominated in Austrian schillings would cease to be legal tender on a date set specifically by Austrian federal law. The EMI noted that this provision “has to be interpreted in the light of the fact that the latest date on which banknotes will cease to be legal tender will be defined by directly applicable Community legislation.” In the light of the relevant case-law of the Court of Justice, the EMI might have added that the provision should therefore be deleted. The considerations in the cited ECB Opinions seem to indicate that on a case-by-case basis, the ECB seeks to strike a fine balance between safeguarding the Community law origin of provisions on the one hand, and acknowledging that national law provisions may play a useful explanatory role on the other. However, following in the footsteps of the Court of Justice, the ECB makes it clear that national law wording can never stand in the way of the fundamental importance of the uniform application of Community law.

56 Opinion of the EMI at the request of the Austrian Ministry of Finance on a draft law amending the Central Bank Act and other related laws (CON/97/30).
57 CON/97/30, paragraph 12.
3.2 EXAMPLES OF THE APPLICATION OF SYSTEMATIC METHODS OF INTERPRETATION

3.2.1 PLACE OF A PROVISION

The place of a provision in a particular chapter of the Treaty or under a particular heading of an instrument of secondary law is relevant for its interpretation. Provisions may be interpreted by examination of the system of the Treaty and by comparison with other passages of the legal instrument. A telling example of the application of such systematic thinking is laid down in the letter of 19 September 2003 from the President of the ECB to the President of the Council at the occasion of the issuance of the ECB Opinion on the draft Treaty establishing a Constitution for Europe (the Constitution). In this letter the ECB proposed the “swapping of the headings of Title IV of Part I (currently ‘The Union’s Institutions’) and Chapter I of Title IV (currently ‘The Institutional Framework of the Union’), so as to clearly indicate that the ECB, as an ‘other institution’ of the Union, is part of the institutional framework of the Union even though it is not in the list of the ‘Union’s Institutions’ in Article I-18 [now I-19]”. Although this suggestion was not followed exactly, it shows the importance attached to the systematic approach. What is in a name?, one might at first be tempted to ask, but the Court of Justice has also attached importance to the wording of titles and headings: “It is settled case-law that where there is a discrepancy between the wording of a provision and the title thereof, both must be construed in such a manner that all the terms employed serve a useful purpose”. The ECB Opinion on the Constitution also offers an example of the use of systematic interpretation when the ECB observes that the term ‘monetary policy’ in Article I-12 (now I-13) is to be read in a broad sense, namely “as reflecting the title of Section 2 of Chapter II of Title III of Part III of the draft Constitution and therefore considers that it encompasses all exclusive competences related to the euro as described in the relevant provisions of the draft Constitution, in particular Articles III-77 and III-78 (now III-185 and III-187)”.

3.2.2 PRELIMINARY CONSIDERATIONS AND EXPLANATORY MEMORANDA

The systematic method of interpretation includes the examination of the preliminary considerations (“whereas” clauses, statements of reasons) of legal instruments as well as, if available, explanatory memoranda. The Court of Justice has recognised “the general principle that the operative part of an act is indissociably linked to the statement of reasons for it, so that, when it has to

59 Letter dated 19 September 2003 from Willem Duisenberg to Franco Frattini, and the letter dated 16 April 2004 from Jean-Claude Trichet to Brian Cowen, President of the Council of the European Union, which contains the same suggestion, albeit in somewhat different wording.
60 In the officially published version of the Treaty establishing a Constitution for Europe (OJ C 310, 16.12.2004, p. 1), Title IV of Part I now reads “The Union’s Institutions and Bodies” and Chapter I of Title IV now reads “The Institutional Framework”. Chapter II of Title IV reads “The other Union Institutions and Advisory Bodies”, while the heading of Article I-30 (the first Article of this Chapter II) reads “The European Central Bank”.
62 CON/2003/20, paragraph 9. The ECB wanted to make clear that in the context of Article I-12 the term ‘monetary policy’ is not to be read in a narrow and technical sense as referring only to the basic task of the ESCB to which Article III-77 (2) (a) (now Article III-185) of the draft Constitution refers (i.e. “to define and implement the Union’s monetary policy”).
be interpreted, account must be taken of the reasons which led to its adoption”. Examples can also be found in the so-called European Anti-Fraud Office (OLAF) judgement of the Court of Justice: “the contested decision must be read in the light of its recitals”. In similar fashion, Article 253 of the Treaty provides, inter alia, that “[r]egulations, directives and decisions […] shall state the reasons on which they are based”. In its Opinions the ECB very frequently refers to the explanatory memoranda attached to the draft legislative provisions under examination, for example using the contents of an explanatory memorandum to help it interpret the draft legislation in question. The ECB might also suggest that in order to achieve legal certainty, discrepancies should be remedied between the explanatory memorandum and the provisions it is supposed to explain or with the Treaty. A few examples may illustrate these uses: “[t]he ECB deduces from the wording of the Explanatory Memorandum that these securitisation entities will not be considered to be credit institutions for supervisory purposes”;

“in order to properly reflect the wording and meaning of Article 106 of the Treaty, the ECB recommends to redraft the explanatory memorandum”;

“it might be useful to confirm this interpretation in the explanatory note”;

“it would […] be useful to clarify [in the draft royal decree], in line with what is set out in the explanatory memorandum, that the data coverage relates to transactions and positions which should both be reported”. (Further examples are provided below in sub-section 4.3 “Anticipative interpretation”).

3.2.3 “LEGALISING INTERPRETATION”

It is consistent case-law of the Court of Justice that “where it is necessary to interpret a provision of secondary Community law, preference should as far as possible be given to the interpretation which renders the provision consistent with the EC Treaty and the general principles of Community law […] and, more specifically, with the principle of legal certainty”. This principle also applies within the hierarchy of secondary legislation: “An implementing regulation must also be given, if possible, an interpretation consistent with the provisions of the basic regulation”. Interpreting in such a manner so as to uphold the inner
coherence of the body of Community legal norms has been termed “legalising interpretation”.71 An example in the context of the ECB of the application of this legalising interpretation can be found in the judgment of the Court of Justice in the already mentioned OLAF judgement.72 The ECB had submitted that Regulation No 1073/1999 concerning investigations conducted by OLAF73 must be interpreted so as to exclude the ECB from its scope. It argued that “the expression ‘bodies, offices and agencies established by, or on the basis of, the Treaties’ in Article 1(3) of the regulation lacks precision so that […] it may be construed as not applying to ‘bodies’ whose financial interests are distinct from those of the European Community and are not linked to the latter’s budget”. According to the ECB’s submission, “such an interpretation is the only one which preserves the legality of the regulation, for which reason it should, in accordance with the Court’s case-law, be preferred”. Although this argument was rejected by the Court (which, on the basis of an analysis of the preamble, the provisions and the “clear terms” of the Regulation, concluded that there is no doubt that the Community legislature intended the Regulation to apply to the ECB, thus grouping together in typical fashion all three principal methods of interpretation), it is an illustrative example of legalising interpretation at work.

3.3 EXAMPLES OF THE APPLICATION OF TELEOLOGICAL METHODS AND TECHNIQUES OF INTERPRETATION

3.3.1 PURPOSE AND SPIRIT

As already noted in Section 2, the teleological or functional method of interpretation puts the emphasis on the function, utility (effet utile), aim and purpose that the legal instrument has to fulfil. There are a number of examples of the ECB employing such teleological reasoning: “taking into account the spirit of these provisions”74; “the spirit of the Treaty”75; “[t]he ECB understands that this interpretation does not represent the intention of the drafters”76; “the true underlying intention”; “the reasoning behind this provision”; “the overall aim [of Articles 101 of the Treaty and 21.2 of the Statute]”.77 Another example of the use of teleological interpretation in the context of the ESCB can be found in the Opinion of the Advocate General in the OLAF case.80 The ECB had

75 Opinion of the EMI of 13 May 1996 regarding a consultation by the Finnish Ministry of Finance on draft legislation establishing the statute of the Bank of Finland (CON/96/05), paragraph 4 (b).
76 Opinion of the ECB of 19 November 2003 at the request of the Irish Department of Finance on a draft Central Bank and Financial Services Authority of Ireland Bill (No 2) 2003 (CON/2003/24), paragraph 5.
77 CON/2003/24, paragraph 5. This wording is particularly intriguing, as it raises the question of a potential difference between a mere underlying intention and some apparently deeper, “truer” underlying potential.
78 Opinion of the EMI of 13 February 1998 at the request of the Austrian Federal Ministry of Finance on a draft law introducing a federal law which stipulates measures in fiscal law accompanying the introduction of the euro and amending the 1998 “Einkommenssteuergesetz” as well as the “Zollrechtsdurchführungsgesetz”; Euro Fiscal Accompaniment Act (CON/98/02), paragraph 5.
79 Opinion of the ECB of 2 December 2003 at the request of the Austrian Federal Ministry of Finance on a draft Federal law on the National Foundation for Research, Technology and Development (CON/2003/27), paragraph 9(i).
80 Case C-11/00 Commission v ECB [2003] ECR I-7147
brought Article 105 (4) of the Treaty into play by arguing that because the Council had failed to consult the ECB on the proposed Regulation\textsuperscript{81}, the latter had been adopted in breach of Article 105 (4) of the Treaty and should therefore be declared inapplicable on the basis of Article 241 of the Treaty. When examining the scope of the “fields of competences” clause in Article 105 (4) of the Treaty, the Advocate General, after resorting to practically all other methods of interpretation available (systematic, historic and grammatical (in that order))\textsuperscript{82}, had recourse to a teleological interpretation, stating that the purpose of the consultation under Article 105 (4) of the Treaty is “to ensure that the legislature is well informed when it adopts measures relating to subjects of which the ECB has particular knowledge or expertise, in particular, monetary policy”. The purpose of Article 105 (4) of the Treaty is “to enhance the quality of the Community legislation to the advantage of the European polity as a whole”.\textsuperscript{83} The Court of Justice followed this teleological approach, although it held that with regard to the specific subject at hand (i.e. the prevention of fraud), the ECB did not enjoy such a high degree of expertise as to make it particularly well placed to play a useful role in the legislative process envisaged. Thus, the Court of Justice rejected the ECB’s argument that Regulation No 1073/1999 should be declared inapplicable on the ground that it was adopted in breach of Article 105 (4) of the Treaty.

3.3.2 LEGISLATIVE HISTORY, TRAVAUX PRÉPARATOIRES

As noted in Section 2, while the study of the legislative history of a provision may not be the exclusive domain of the teleological method of interpretation, it is in that context that this technique is used most frequently. One may distinguish travaux préparatoires stricto sensu, i.e. various written documents reflecting the attitudes of the negotiators of the Treaties through the successive stages of drafting, and travaux préparatoires lato sensu, i.e. opinions of governments submitted to parliaments in the course of ratification debates.\textsuperscript{84} The first category of travaux of the Community Treaties are secret and therefore cannot be used by the Court of Justice.\textsuperscript{85} However, the second category of travaux are available with regard to the Treaties. In addition, the Court of Justice can make use of the preparatory documents of secondary Community legislation. An example of the latter can be found in the Mecklenburg case: “[t]hat interpretation is borne out by the history of the directive. Article 8(1) of the proposal for a directive submitted by the Commission […] was as a result of the opinion given by the Economic and Social Committee”.\textsuperscript{86} The Stauder case offers another example: “[t]his interpretation is […] confirmed by the Commission’s declaration that [the] amendment […] was proposed by the Management Committee to which the draft of [the] Decision was submitted for its opinion”.\textsuperscript{87} However, even in the context of secondary legislation, the Court of Justice remains cautious with the use of travaux préparatoires: “As regards the applicant’s arguments relating to the

\begin{itemize}
\item \textsuperscript{81} Regulation (EC) No 1073/1999.
\item \textsuperscript{82} See Opinion of the Advocate General, paragraphs 136, 138 and 139 respectively.
\item \textsuperscript{83} Ibid., paragraph 140. See also Elderson and Weenink, op. cit., pp. 294-300.
\item \textsuperscript{84} See Bredimas, op. cit., p. 57.
\item \textsuperscript{85} See Schermers and Waelbroeck, op. cit., p. 16.
\item \textsuperscript{87} Case C- 29/69 Stauder v City of Ulm – Sozialamt [1969] ECR I-419, paragraph 5.
\end{itemize}
legislative history of the Regulation, it is necessary, when interpreting a legislative measure, to attach less importance to the position taken by one or other Member State when the measure was drawn up than to its wording and objectives”.88 Unilateral declarations by a Member State issued at the time of the adoption of the instrument being interpreted, even if laid down in the minutes of the meeting concerned, hardly ever serve the Court of Justice as interpretative guidance: “it should be borne in mind that declarations recorded in minutes are of limited value, since they cannot be used for the purposes of interpreting a provision of Community law where no reference is made to the content of the declaration in the wording of the provision in question and the declaration therefore has no legal significance”.89 It remains to be seen whether the Court of Justice will make a more liberal use of the travaux préparatoires of the Treaty establishing a Constitution for Europe, which to a great degree have been made available on the internet.90 Regarding the use of travaux préparatoires within the context of the ESCB, it should be noted that although the travaux regarding the relevant Articles of the Treaty are secret, as are all those regarding the Treaty, to a large extent those regarding the ESCB Statute (which forms part of the Treaty) are not.91 One explicit example of the ECB referring to travaux préparatoires can be found in its Opinion of 3 February 2005. The ECB had to evaluate the compatibility of a draft Italian law with the prohibition of monetary financing laid down in Article 101 of the Treaty, which prohibits, inter alia, overdraft facilities or any other type of credit facility with the national central banks in favour of central governments. In making its analysis, the ECB delved into legislative history: “[a]lready in 1993 the Committee of Governors of the central banks of the Member States of the EEC notes that this prohibition is of ‘essential importance’ to ensure that ‘monetary policy [is not] hindered in the pursuit of its primary objective of price stability. Furthermore, central bank financing of the public sector lessens the pressure for fiscal discipline’”.92 Although there are few such explicit examples, the preparatory documents of the Committee of Governors constitute a wealth of legislative history which lawyers within the ESCB frequently turn to when interpreting the ESCB Statute.

### 3.3.3 FURTHERANCE OF EU AND EUROSYSTEM OBJECTIVES

As we have seen, teleological methods of interpretation focus on the purpose, the aim and the function of the provision to be interpreted. From here, it is but

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90 See www.european-convention.eu.int.
92 Opinion of the ECB of 3 February 2005 at the request of the Italian Ministry of Economic Affairs and Finance on a draft law amending Law Decree No 7 of 25 January 1999, as converted by Law No 74 of March 1999, concerning urgent provisions on Italian participation in the International Monetary Fund’s interventions to confront severe financial crises of its member countries (CON/2005/1), paragraph 6. The ECB cites a letter dated 20 April 1993 of the Committee of Governors to the Commission President, Jacques Delors.
a small step to introducing the furtherance of the objectives of the EU and the ESCB in the interpretative activity undertaken by the ECB when drafting its Opinions or other instruments. In this context, the objectives of the ESCB are to be understood not just as the primary objective to maintain price stability and the secondary objective to support the economic policies in the Community as laid down in Article 105 (1) of the Treaty and Article 2 of the ESCB Statute, but as the policy objectives it pursues within its mandate embodied by these primary and secondary objectives. There are a number of examples of the ECB playing such a proactive role. A first such example shows the ECB promoting the creation of a Single Euro Payments Area in its Opinion of 23 December 2004.93 The ECB started by noting that a certain interpretation of a provision in the draft Spanish law “would theoretically allow for direct remote participation in SNCE [Sistema Nacional de Compensación Electrónica, National Automated Clearing System], which the ECB considers should in principle be possible". Then the ECB recalled that “a very important Eurosystem objective and European banking industry project is the creation of a Single Euro Payments Area (SEPA). […] Decisions related to the next generation of national systems should in the future be made from a pan-European perspective to ensure compliance with SEPA instruments and standards and the overall SEPA infrastructure”.94 In the same vein of furthering its objectives, sometimes the ECB advances an interpretation which is not strictly necessary for providing an opinion on the draft national provisions at hand (obiter dicta, one might say): “The ECB has no objection with regard to the proposed abolition of the liquidity criterion for certain monetary policy operations, though would observe that the requirement of ‘adequate collateral’ may be interpreted as also containing an element whereby the collateral must be realisable without undue delay. However, to expressly maintain a specific statutory liquidity requirement in addition to the requirement of adequate collateral is not necessary for the operations now under consideration”.95 Another example of such reasoning which borders on obiter dicta is the ECB Opinion on two draft Directives amending Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (the UCITS Directive).96 First, the ECB stated that instead of expressing its opinion in two different Opinions on these two draft Directives, for the sake of clarity, transparency and legal certainty, a discussion of a complete and integral new version of the UCITS Directive would be preferable. Then the ECB added: “This is all the more the case since the UCITS Directive appears to have been interpreted differently by Member States. Such

94 CON/2004/39, paragraphs 10 and 11.
95 Opinion of the ECB of 14 August 2002 at the request of Sveriges Riksbank on a draft legislative proposal to amend the Sveriges Riksbank Act (1988:1385) with regard to the collection of balance of payments statistics and the liquidity for securities used in monetary policy operations (CON/2002/21), paragraph 9.
different interpretations are undesirable in the context of a single money and financial market and may lead to competitive distortions and misallocation of funds.” Yet another example: “[t]he ECB welcomes that proposed introduction of a harmonised definition of public offer, which will avoid different interpretations of Community rules and ensure the same level of investor protection throughout the EU”. While directives are good, regulations are better. At least, this appears to follow from the ECB’s citing in its Opinion of 12 June 2003 of the Committee of Wise Men statement that “[directives] leave more latitude for Member States to implement Community Law but too often lead to uneven transposition and different interpretations”. Then the ECB added: “The ECB notes that indeed regulations offer significant advantages as opposed to directives, as they are directly applicable in the Member States without any need of implementation through national legislation.” Yet another example of the ECB’s proactive approach is that although the obligation of the authorities of the Member States to consult the ECB on draft legislative provisions within the field of competence of the ECB does not apply to “draft provisions, the exclusive purpose of which is the transposition of Community directives into the law of Member States”, nevertheless, when asked, the ECB might gladly accept the invitation and take the opportunity to promote its own objectives. An example can be found in the ECB Opinion of 20 January 2000 at the request of the Luxembourg Ministry for the Treasury and the Budget on the implementation of the Settlement Finality Directive in Luxembourg. Although noting that the Luxembourg authorities “were not, strictly speaking, legally obliged to consult the ECB”, the ECB stated that it “very much welcomes the opportunity to give its opinion on the Draft Law”. The ECB justified this stance as follows: “[t]he ECB is seeking to promote pro-actively a harmonised EU-wide implementation of the Directive in the legislation of the Member States, in order to foster maximum transparency and legal certainty for the closely connected payment and securities settlement systems, and to ensure a level playing-field throughout the European Union”. In a nutshell, we see that (i) the ECB is willing to issue an Opinion although, strictly speaking, the national authority was under no obligation to consult; (ii) the ECB does not hesitate to pronounce itself in favour of the rethinking of existing Community directives and of the use of regulations when possible; and (iii) promotes a series of policy objectives, among which “the creation of a Single Euro Payments Area”, “the promotion of a single money and financial market”, “the avoidance of competitive distortions and

97 CON/98/54, paragraph 3.
102 CON/99/19, paragraph 2.
misallocation of funds”, “ensuring the same level of investor protection throughout the EU”, “the promotion of the harmonised EU-wide implementation of directives in the legislation of the Member States”, “the fostering of maximum transparency and legal certainty for the closely connected payment and securities settlement systems” and “ensuring a level playing-field throughout the European Union”.

4 SOME FURTHER OBSERVATIONS

4.1 CONSISTENCY IN THE DENOMINATION OF METHODS OF INTERPRETATION

Words, as it is hoped should be clear from the above, obviously matter. Given the complications that arise when seeking to establish their meaning, they should be chosen with great care. This is all the more so because the very act of describing how one arrives at certain interpretations of words requires in turn more words. Hence, the need to employ consistent terminology when using methods and techniques of interpretation is paramount. Unfortunately, in its Opinions the ECB does not always use such consistent language. This may be illustrated most clearly by quoting from a number of the examples mentioned in sub-section 3.3.1 of the ECB, which employ a single (the teleological) method of interpretation, while using all sorts of terminology: “the spirit of these provisions”103; “the spirit of the Treaty”104; “the intention of the drafters”105; “the true underlying intention”106; “the reasoning behind this provision”107; “the overall aim [of Articles 101 of the Treaty and 21.2 of the Statute]”.108 As single words – especially vague ones like “spirit”, “aim” and “intention” – may already have different meanings, different words may have many different meanings. Many vague words could end up being meaningless. Therefore, it is proposed that the ECB should henceforth attempt to use as consistent a wording as possible. Though this be not madness, there might be a little more method in ‘t.

4.2 TRANSPARENCY REGARDING THE METHOD OF INTERPRETATION

As we have seen, the ECB uses a wide range of interpretative techniques. Often it specifies which method it uses, although, as noted above, improvements might be made in the consistency of the terminology used. However, sometimes the

104 Opinion of the EMI of 13 May 1996 regarding a consultation by the Finnish Ministry of Finance on draft legislation establishing the statute of the Bank of Finland (CON/96/05), paragraph 4 (b).
105 Opinion of the ECB of 19 November 2003 at the request of the Irish Department of Finance on a draft Central Bank and Financial Services Authority of Ireland Bill (No 2) 2003 (CON/2003/24), paragraph 5.
106 CON/2003/24, paragraph 5.
107 Opinion of the EMI of 13 February 1998 at the request of the Austrian Ministry of Finance on a draft law introducing a federal law which stipulates measures in fiscal law accompanying the introduction of the euro and amending the 1998 “Einkommensteuergesetz” as well as the “Zollrechtsdurchführungsgezetz”; Euro Fiscal Accompaniment Act (CON/98/02), paragraph 5.
ECB simply “interprets” and the reader is left guessing which method of interpretation the ECB has used to arrive at the stated conclusion. A number of examples may serve to illustrate this point: “[t]he ECB is [...] of the view that interests in securities held through one or several financial intermediaries can be [...] interpreted as [...]”\(^{109}\); “[t]he ECB understands that [...] all credit institutions in the EU can be considered as ‘operating in Spain’”\(^{110}\); “[t]he ECB understands that this interpretation does not represent the intention of the drawers”\(^{111}\); “[t]he reference in Article 1 of the draft law to Articles 105(1), 105(2) and 105(5) may be interpreted as an exhaustive enumeration”\(^{112}\); “[t]he ECB interprets Article 9(1) as setting out mandatory obligations of the competent authorities to cooperate and share information, both generally and in specific instances”.\(^{113}\) By “being of the view that”, “understanding” and “interpreting as”, the ECB makes it clear that it is engaged in an interpretative process, but it leaves the reader in the dark as to the method used. By enhancing the transparency regarding the method of interpretation used, the ECB’s reasoning in its Opinions would be easier to verify and thus be more convincing.

4.3 “ANTICIPATIVE INTERPRETATION”

This sub-section does not deal with a specific method of interpretation, but instead with the many instances in the body of ECB Opinions and other relevant instruments that show that the drafters are acutely aware of the importance of interpretation and the need to avoid misunderstandings when drafting legal instruments.\(^{114}\) Thus, also in this indirect and often implicit way, these Opinions shine light on the use of methods of interpretation within the ESCB. It should be recalled that interpretation is not the exclusive domain of the courts. Indeed, interpretation is an inherent feature of all the links in the entire chain from the very initial stages of drafting a legal provision right up to the establishment of its meaning by the highest court in the land. Precisely because of the length of this chain, and the many actors engaging in interpretative activity along it, it

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109 Opinion of the ECB of 9 October 2000 at the request of the Luxembourg Ministry of Finance on (1) a draft law pertaining to the circulation of securities and other financial instruments; and (2) a draft law (a) concerning transfers of title intended to serve as security; (b) amending and completing the law of 21 December 1994 concerning repurchase transactions carried out by credit institutions; (c) amending and completing the amended law of 5 April 1993 concerning the financial sector; (d) amending and completing the law of 21 June 1984 concerning the options and futures markets of the Luxembourg exchange and concerning the forward markets in which a credit institution operates (CON/2000/18), paragraph 4.


111 Opinion of the ECB of 19 November 2003 at the request of the Irish Department of Finance on a draft Central Bank and Financial Services Authority of Ireland Bill (No 2) 2003 (CON/03/24), paragraph 5.

112 Opinion of the EMI at the request of the French Ministry of Economy, Finance and Industry on a draft law amending Act 93/980 of 4 August 1993 on the Statute of the Banque de France and the activities and supervision of credit institutions (CON/98/12), paragraph 5.


114 An unexpected example of such awareness of the importance of interpretation can be found in Article 20 of the Headquarters Agreement between the ECB and the Government of the Federal Republic of Germany concerning the seat of the ECB: “Consultations on the interpretation [...] of this Agreement shall take place at the request of either party to the Agreement” (translation of the German original (which is the only authentic version) dated 18 September 1998, available at www.ecb.int).
falls upon the shoulders of those drafting a legal instrument in the first place to anticipate how it might be interpreted at a later stage, and to draft the legal instrument, its considerations, preamble, structure and explanatory memorandum in such a way as to ensure as far as possible the coherence between its intended meaning and its later actual interpretation. The ECB’s Opinions on draft legislative provisions places the ECB at the very beginning of the chain just depicted. Hence a need to anticipate how draft provisions might be interpreted in the future and to evaluate in a proactive manner whether such interpretations are to be welcomed or whether the draft provisions should be reworded to avoid undesired interpretative outcomes. There are many examples of drafting proposals based on such “anticipative interpretation”. A number of those anticipate textual methods of interpretation: “[i]t is suggested that […] the words [a, b, c] are deleted. The meaning of these words is not clear and uncertainty might give rise to problems for the interpretation”\textsuperscript{115} (anticipation of literal interpretation). A clear example of the anticipation of a contrario reasoning, and thus another example of the anticipation of a textual method of interpretation, is the following: after first expressing “its concern that the exclusions listed under Stage I should not be interpreted as being the only adjustments which may be made to the national price indices”, the EMI suggests to add “in particular” in order to express the non-exhaustive character of the enumeration.\textsuperscript{116} Another example of the anticipation of a contrario reasoning is the following: “to avoid misinterpretations when comparing Section 14 (1) (containing a reference to Article 106 (1) of the Treaty) and Section 14 (2) (which does not include that reference), the ECB recommends either that both sub-sections of Section 14 of the Bundesbank Act be merged or that an explicit reference to Article 106 (1) of the Treaty be made in Section 14 (2) so as to mirror the wording of Section 14 (1)”.\textsuperscript{117} Examples of drafting proposals based on the anticipation of systematic methods of interpretation may also be found: “in order to properly reflect the wording and meaning of Article 106 of the Treaty, the ECB recommends to redraft the explanatory memorandum on Article 3 [of the Drittes Euro-Einführungsgesetz] […] accordingly”\textsuperscript{118} (anticipation of interpretation by reference to the explanatory memorandum); “some uncertainty could possibly arise […] from the combined reading of the relevant articles of the draft proposal and the comments on these articles. […] The ECB would appreciate a clarification of this issue”\textsuperscript{119} (another example of anticipation of interpretation by reference to the explanatory memorandum); “the EMI expresses its concern about the fact that […] the reader might conclude that the Community, contrary to the Treaty provisions, does not envisage the start of Stage Three of EMU until

\textsuperscript{115} Opinion of the EMI at the request of the Council of the EU on a proposal from the Commission for a Council Decision on the consultation of the European Central Bank by national authorities on draft legislative provisions (CON/98/14), OJ C 190, 18.6.98, p. 6, paragraph 4. The proposal the EMI provides an opinion on is the very Council Decision which regulates the consultative procedure on the basis of Article 105 (4) of the Treaty, i.e. Council Decision 98/415/EC.

\textsuperscript{116} Opinion of the EMI on a consultation from the Council of the EU on a draft proposal for a Council Regulation concerning Harmonised Consumer Price Indices (CON/95/1), paragraph 5 (E).

\textsuperscript{117} Opinion of the ECB of 3 September 1999 at the request of the German Federal Ministry of Finance on a bill amending currency-related provisions with respect to the introduction of the euro (Drittes Euro-Einführungsgesetz) (CON/99/10), paragraph 6.

\textsuperscript{118} CON/99/10, paragraph 6.

\textsuperscript{119} Opinion of the ECB of 24 April 2002 at the request of the Belgium Ministry of Finance on a draft proposal for a law on prudential supervision of the financial sector and financial services (CON/2002/13), paragraph 10.
after January 1998. To avoid this interpretation, it is suggested that: (a) The following paragraph is included in the Preamble”¹²⁰ (anticipation of systematic interpretation). No examples of drafting proposals by the ECB based on the anticipation of teleological methods of interpretation have been identified, although these may very well be imagined in theory.

5 CONCLUDING REMARKS

This overview shows that in its Opinions and other cited instruments, the ECB (and before it, its predecessor, the EMI) has used a wide range of methods and techniques in order to interpret the legislative provisions before it. It has done so within the overall Community law framework of interpretative methods and techniques, many of which stem from centuries and even millennia-old legal traditions. A few recommendations are made, including the suggestion to be transparent about the methods and techniques of interpretation used and the suggestion to use as consistent a terminology as possible. This paper clearly demonstrates that the ECB, by means of “anticipative interpretation”, tries to prevent future interpretative problems already in the drafting stages of legal instruments, which shows a commendable awareness of interpretative issues. The paper also shows how the ECB attempts to further its legal and policy objectives through its interpretations, a practice which can be compared with the traditional pro comunitate stance of the Court of Justice and can be welcomed. Through all this, albeit in an indirect way, the lawyers within the ESCB and among them the LEGCO members may be seen at work, as they have contributed over the years to this growing body of “jurisprudence”. As the Union grows, and with it the number of jurisdictions and languages, the meaning of words, whether examined on their own, in the context of the relevant legal instrument or seen in the light of the purpose thereof, will continue to be the subject of legal debate and interpretation. It is unlikely that on the subject of words, anyone will ever have the final word.

¹²⁰ CON/95/1, paragraph 5 (D).
NATIONAL EMERGENCY POWERS AND EXCLUSIVE COMMUNITY COMPETENCES – A CRACK IN THE DAM?

Chiara Zilioli

ABSTRACT

Alla metà degli anni cinquanta sei Stati europei decisero di impegnarsi insieme in una sfida senza precedenti: rafforzare i loro legami a tal punto da prevenire guerre future. Vincolandosi al raggiungimento di un medesimo obiettivo, ovvero la realizzazione di una unione sempre più stretta tra popoli e mercati europei, istituirono una Comunità che fin dalle sue origini si differenziò da altre entità sovranazionali per la sua capacità di elaborare le proprie politiche in modo autonomo attraverso l’adozione, da parte delle sue istituzioni, di norme direttamente applicabili ai cittadini.

Con l’adesione, altri Stati accettarono in seguito di limitare la sovranità nazionale trasferendo alla Comunità e alle sue istituzioni alcuni dei propri poteri, fino al punto di rinunciare totalmente al potere decisionale in campi specifici per i quali la Comunità gode di competenze esclusive. Di fatto, con l’ingresso della Comunità nella terza fase dell’unione monetaria, la maggior parte dei suoi Stati membri ha trasferito irrevocabilmente alla Banca centrale europea la competenza in materia di politica monetaria.

Dopo l’attacco alle torri gemelle del World Trade Center, mentre gli Stati occidentali riesaminavano gli strumenti, anche giuridici, atti a far fronte ad attacchi terroristici, il governo finlandese modificò la propria legislazione autorizzando, in situazioni di emergenza e previa adozione di un decreto presidenziale, l’introduzione di misure in conflitto con il diritto comunitario e con l’esercizio della politica monetaria unica. Secondo il governo finlandese, l’articolo 297 del trattato consentirebbe agli Stati membri, in situazioni di emergenza, di adottare unilateralmente misure contrastanti col diritto comunitario e persino di “avocare” competenze precedentemente trasferite alla Comunità. L’obiettivo di questo capitolo è di analizzare “il contenuto e l’obiettivo” dell’articolo 297 del trattato per valutare se effettivamente attribuisca agli Stati membri, in situazioni di emergenza, una completa discrezionalità sulle misure da adottare, persino quando tali misure comportino l’esercizio della competenza monetaria esclusiva, trasferita irrevocabilmente dagli Stati che hanno adottato l’euro alla Banca centrale europea. Se così fosse, sarebbe possibile agli Stati membri distruggere in pochi giorni e unilateralmente anni di costruzione della “casa comune”.

Dopo aver esaminato la necessità di uniforme applicazione del diritto comunitario in tutti gli Stati membri (con la conseguente impossibilità per gli Stati di optare unicamente a favore di alcune politiche) e la possibilità di denuncia unilaterale del trattato di Roma, questo capitolo analizza la funzione dell’articolo 297, clausola derogatoria e non norma che riserva una sovranità nazionale, e le condizioni secondo le quali è permesso invocarne l’applicazione.

1 I would like to thank Florence Feyerbacher for her support in the research for the preparation of this article.
Emerge chiaramente dall’analisi che non è possibile dare all’articolo 297 una interpretazione conflittante sia con l’obiettivo primario della Comunità, ossia una unione sempre più stretta fra i suoi Stati membri, che con l’evoluzione dell’intero diritto comunitario verso una maggiore integrazione. Dal punto di vista giuridico, l’articolo 297 non consente agli Stati di recuperare competenze che erano state trasferite alla Comunità affinché siano esercitate su un piano sovranazionale in nome dei cittadini europei. Inoltre, nello stato attuale dello sviluppo comunitario le situazioni di emergenza e gli attacchi terroristici non possono più essere affrontati unilateralmente. È pertanto necessario uno sforzo comune teso ad affinare gli strumenti comunitari di reazione per poter affrontare le sfide del ventunesimo secolo con strumenti adeguati.
When the twin towers of the World Trade Center fell on 11 September 2001, a new era began for the western world and for international law. As terrorist acts have come to be considered acts of war, preventive strikes have been claimed in the US national security strategy to be legitimate means of self-defence. At the same time, all western States, feeling under threat, have reconsidered their emergency legislation and the powers and procedures available to face cases of serious terrorist attack. Most governments have also examined the possible impact of such attacks on financial markets, although this was not a problem on September 11: international cooperation among central banks proved to be very effective in preventing and solving temporary liquidity shortages and in maintaining the stability of the global financial system.

The amendments proposed in 2002 by the Finnish government to the existing national emergency powers legislation, increasing the government’s capacity to regulate the financial markets, has to be seen in this context, as the individual attempt of a State to react to these events. However, since Finland is a Member State of the European Union, the adoption in 2003 of this new legislation raises concerns as to whether, within the Union, individual (re)action is still effective and legally possible, as it may conflict with the Treaty establishing the European Community (the Treaty).

Taking this recent case as the starting-point, this article aims to analyse the scope of Article 297 of the Treaty to answer the question of whether or not it constitutes the legal basis allowing the Member States to take back, unilaterally, the competences attributed to the European Community (the Community) by the Treaty. After discussing the (ir)reversibility of the transfer of competences to the Community and the possibility of and limits to withdrawing from the Community, the article analyses the conditions for invoking the application of Article 297 of the Treaty and the procedural and substantive requirements it imposes on the Member States. The article concludes that Article 297 does not give the Member States a reserve of sovereignty and that there is no legal “crack in the dam” through which the competences of the Community can flow back to a Member State.

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2 Cassese, “Terrorism is Also Disrupting Some Crucial Legal Categories of International Law”, EJIL 2001 (12), at 996/7: “Practically all states ... have come to assimilate a terrorist attack by a terrorist organization to an armed aggression by a state ... Thus, aiding and abetting international terrorism is equated with an ‘armed attack’ for the purpose of legitimizing the use of force in self-defence.” Contra, Bothe in Graf Vitzthum (Eds) Voelkerrecht, 2. Ed., No 15, p. 611, No 11: “Ein weiteres wesentliches Element der Bestimmung des Inhalts des Gewaltverbots besteht darin, dass es sich um Gewalt in den internationalen Beziehungen, d. h. zwischen Staaten handeln muss. ... Die Duldung oder Foerderung terroristischer Aktivitaeten ist deshalb nicht ohne weiteres der eigenen Gewaltausübung des Staates gleichzuachten.”

3 Cf. Bothe, “Terrorism and the Legality of Pre-emptive Force”, 14 European Journal of International Law (2003) No 2, 227-240, at 236 and 239: “the legal reasoning developed in the national Security Strategy may also be understood as an advocacy de lege ferenda .... a change in the law to the effect of opening up broader possibilities for anticipatory self-defence is not desirable.”

II THE AMENDMENTS TO THE FINNISH EMERGENCY POWERS ACT

In the summer of 2002, the Finnish government proposed to the parliament that the Valmiuslaki 1080/1991 (Emergency Powers Act of 1991, or, “the Act”) be amended in order “to secure the livelihood of the population and the national economy, to maintain legal order and constitutional and human rights, and to safeguard the territorial integrity and independence of Finland in emergency conditions”\(^5\). In the Statement of Reasons supporting the proposal, the Finnish legislator argued that the emergency powers as currently embodied in the Emergency Powers Act were insufficient with regard to financial market regulation in emergency situations; that the competencies listed in Section 12 of the Act needed to be amended and a new Section 12a introduced; and that the new powers could be exercised by decrees, enabling the Finnish government also to impose measures on the Finnish national central bank (Suomen Pankki) or on other Finnish public authorities.

The exercise of these emergency powers requires the cumulative fulfilment of three conditions: (a) an emergency situation which the authorities cannot control through the exercise of their regular powers;\(^6\) (b) the adoption of a decree by the President of the Republic recognising the situation and authorising the use of (some of the) powers as provided for in the Emergency Powers Act\(^7\) and (c) the use by the government only of those powers necessary to achieve the aim of the Act (proportionality principle)\(^8\). The proposed Act confers important new competencies upon the government in the event of an emergency, many of which overlap or interfere with monetary policy competencies\(^9\).

According to Section 10 of the Act, its scope of application shall be limited in accordance with the restriction of the scope of national law foreseen in international agreements binding Finland. Therefore, to justify the compatibility of these legislative changes with the Treaty, the Finnish government invoked Articles 58 and 297 of the Treaty, claiming that the latter in particular would allow exceptions from all Treaty rules, and Article 14.4 of the Statute of the European System of Central Banks and of the European Central Bank.
Bank (the Statute)\(^{10}\), which, it was claimed, would authorise the government to assign national tasks to the national central bank.

In accordance with Article 105 (4) of the Treaty and Council Decision 98/415/EC\(^{11}\), the Finnish Ministry of Finance consulted the European Central Bank (ECB) on the draft Act. In its Opinion, the ECB concluded that “the proposal affects some very core principles of Community law”.\(^{12}\) In particular, some of the new competences assigned to the government conflict with the rules on free movement of capital, while others conflict with the exercise of monetary policy and therefore interfere with an exclusive Community competence. The ECB stated that, in the framework of the Community monetary policy, it is first and foremost the task of the competent authority (the Eurosystem) to react to and remedy the consequences of an emergency situation; a unilateral and national approach to what would necessarily be a common problem would be bound to be inappropriate in practice and legally vitiated. Moreover, the ECB criticised the reference to Article 14.4 of the Statute as the legal basis for the attribution of certain tasks to the Finnish national central bank – as this Article, the application of which in any case requires the agreement of the Governing Council, only refers to the non-Eurosystem activities that a national central bank can be asked to perform by its government, and not to the performance of Eurosystem functions. It should be mentioned that, even though most Member States have specific provisions for legislation in the event of an emergency\(^{13}\), the Finnish legislation is the only case in which powers are foreseen that clearly conflict with the rules of the Treaty.

On 13 June 2003 the Finnish parliament adopted the proposed amendments despite the objections of the ECB\(^{14}\). However, on 17 December 2003 the Finnish Ministry of Justice set up a committee to evaluate the need for an overall reform of the Act and to “make the Emergency Powers Act fully compliant with the Constitution, consistent and up-to-date”. On 17 May 2004 the committee issued an interim report\(^{15}\) which focused on matters of Finnish constitutional law; in addition, the report acknowledged that the emergency situations enumerated in the Act were more extensive than the cases foreseen by Article 297.

At the end of 2004 the Commission asked the Under-Secretary of State in the Ministry of Finance, Martti Hetemäki, to consider, in the framework of the work of the committee, various aspect of the Act which appear to be problematic from the perspective of Community law.

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\(^{10}\) According to Article 14.4 of the Statute: “National central banks may perform functions other than those specified in this Statute unless the Governing Council finds, by a majority of two thirds of the votes cast, that these interfere with the objectives and tasks of the ESCB. Such functions shall be performed on the responsibility and liability of national central banks and shall not be regarded as being part of the functions of the ESCB.”


\(^{12}\) ECB opinion, cit., fn. 4, No 14.

\(^{13}\) In one specific case, the Dutch Noodwet financieel verkeer (Emergency Act for Financial Services) of 25 May 1978, as amended, foresees the adoption of emergency legislation to regulate the financial markets by the Minister of Finance, subject to a Royal Decree ascertaining the status of emergency. However, this legislation pre-existed the Maastricht Treaty and therefore has to be interpreted in a way consistent with the principles of Community law as they stand after the adoption of the Maastricht Treaty (ECB opinion, cit., fn. 4, n.13).


\(^{15}\) The Interim Report can be found at www.om.fi/25607.htm.
The mandate of this committee has recently been extended until 30.09.2005. A proposal for amendment of the Act is said to be under preparation, but no information about its contents has been made public. If amendments to the Emergency Powers Act are proposed, the Finnish Constitution states that they will have to be agreed by two parliaments. This means that any amendment to the Act could enter into force, at the earliest, in 2007.

III FIRST QUESTION: IS THE TRANSFER OF COMPETENCES TO THE COMMUNITY IRREVERSIBLE?

With the ratification of the Treaty of Rome, the Member States agreed to assign the Community a number of powers. Through a gradual transfer, the competences of the Community have increased over time and have come to include actions in different fields and of different depth (exclusive, shared and concurrent competences). However, the Treaty (except in the case of Monetary Union\(^{16}\)) does not specify whether this process is an irreversible one\(^{17}\). Given this situation and the steadily evolving European integration process, the question has been raised as to whether Member States may unilaterally take back certain specific powers they have conferred on the Community or, in an extreme case, withdraw from the latter.

a) The national constitutions

Before examining the Treaty itself, it is useful to look at the national constitutions of the Member States. As the competences conferred by the Treaty on the European Community were previously exercised by the Member States which agreed to the transfer, provision needed to be made in each constitution allowing for such transfer.

Looking at the wording of such provisions, one finds a wide variety of definitions. There is the temporary devolution of attributions of the State (Article 49bis of the Luxembourg Constitution), where the temporal limitation clearly underlines the possibility of the State to withdraw at any time. There is the joint exercise, with the other Member States, of certain competences (Article 88-1 of the French Constitution; Article 7.6 of the Portuguese Constitution), which seems to lean towards an intergovernmental approach and supports the idea of a State maintaining full control of its sovereignty\(^{18}\). There is the limitation of sovereignty (Article 11 of the Italian Constitution; Paragraph 15 of the Preamble of the French Constitution), which is clearly unilateral and, it seems,
discretionary. There is the attribution of the exercise of State competences (Article 93 of the Spanish Constitution; Article 34 of the Belgian Constitution), where assigning only the exercise of the competences to the Community (and presumably keeping the competences themselves for the State) implies the possibility to withdraw. There is the transfer of competences (Article 23 (1) of the German Constitution; Article 9 (2) of the Austrian Constitution; only for monetary policy and the free movement of persons, Article 88-2 of the French Constitution), the provision which goes furthest and seems to imply an irrevocable transfer and a permanent loss for the future of such powers in the Community’s favour.

At first sight, it could be concluded that most Member States never really intended to permanently transfer their competences to the Community. However, this conclusion can be challenged on two grounds. First, the national constitutional provisions deal in general with the power of the State to conclude an international treaty: the special nature of the Treaty is, not reflected in these constitutional provisions\textsuperscript{19}. Second, since the signing of the Treaty, there has been, with the participation of the Member States, a progressive process of integration which binds them now in a different way. In this context, it is interesting to note that there has been a development in the French Constitution: Article 88-2 talks of the “transfer of competences”, and not anymore of the joint exercise of competences, in the case of Monetary Union. The question is whether this further concession is a reflection of the higher integration achieved and a sign of development towards the transfer of competences to the Community, or whether it is only determined by the specificity of the subject, Monetary Union, which requires an irrevocable transfer of competences\textsuperscript{20}.

b) Withdrawal from a specific Community policy

In the past, the question has been raised of whether it would be possible for a Member State not to join\textsuperscript{21}, or to unilaterally withdraw from, individual Community policies\textsuperscript{22}. On the second question, the European Court of Justice has stated very clearly in its case law that there may be no reservations of Member States in their membership of the Communities and that Member States

\textsuperscript{19} In some cases however, as in the Article 93 of the Spanish Constitution, the article was specifically drafted for the entry of the country into the European Community.

\textsuperscript{20} Cf. Obradovic, cit. fn. 17, p. 62.

\textsuperscript{21} In two cases Member States have been allowed not to join a Community policy. First, the Protocol on Social Policy was adopted to overcome the disagreement of the United Kingdom: the other 11 Member States wishing to continue along the path laid down in the 1989 Social Charter adopted among themselves an agreement additional to the provision of the Treaty. The United Kingdom subsequently joined the agreement and its provisions became part of the Treaty. Second, the Protocol on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland and the Protocol on certain provisions relating to Denmark were adopted to allow these two Member States to opt out of Stage Three of Economic and Monetary Union while allowing the Community and the other Member States to move into that phase. This is the most extreme example of differentiated integration in Community law, cf. Zilioli, “The Constitution for Europe and its impact on the Governance of the Euro”, in Torres, Verdun, Zimmermann (eds.), Governing EMU, in print, Nomos. The obligation of new Member States to join the Community in its present state of development, the obligation to accept and introduce in their legislation the whole of Community law, without exceptions (acquis communautaire) are also based on the principles of equality of Member States before Community law and Community solidarity, analysed below.

\textsuperscript{22} During the preparations for the IGC on Economic and Monetary Union in 1990, the question was also raised as to whether a third country could join Monetary Union without joining the Community, and was answered in the negative, cf. Zilioli/Selmayr, The Law of the European Central Bank, Oxford and Portland, Oregon 2001, 10.
cannot apply provisions of secondary Community law in an incomplete or selective manner as that would lead to the undermining of Community solidarity. The Court has emphasised that there is an “equilibrium between the advantages and obligations flowing from [a Member State’s] adherence to the Community.” The selective or incomplete application of Community law constitutes a unilateral break of the obligation to respect the Community’s rules, leading to a disturbance in the equilibrium of advantages and obligations and thereby endangering the equality of Member States before Community law. “This failure in the duty of solidarity accepted by Member States by the fact of their adherence to the Community strikes at the very root of the Community legal order.” In another case, the Court similarly concluded that “the complexity of certain situations in a State cannot alter the legal nature of a Community provision …, and this is particularly the case considering that the Community rule must have the same binding force in all Member States.” Finally, as already mentioned, the Court has stated the irreversibility of the transfer of powers to the Community.

Experience confirms that withdrawal from a single Community policy has never been seriously considered. In the only case of withdrawal from the Community of (a portion of the territory of) a Member State, the case of Greenland, even though the problem was only related to the fisheries policy, Greenland withdrew from the Community as a whole. In the case of the 1975 British referendum, the question was on whether or not to withdraw from the European Communities, not from one of its policies. Finally, the possibility explicitly provided for by the Constitution for Europe is to withdraw from the European Union; it is clear that exit from a sole policy is not foreseen.

It is therefore clear that, once certain powers have been conferred on the Community and certain rules have been adopted, there cannot be cherry-picking in Community law and there is a clear obligation on all Member States to abide by the totality of Community law.

In the specific case of monetary policy, this prohibition to withdraw has been stated more explicitly: it is commonly agreed that it is not possible for Member States to take back the monetary competences assigned to the Community by the Maastricht Treaty they have ratified. There are at least two reasons why in this case the irrevocability of the transfer of competences has been stated explicitly. First, differentiated integration implies increased flexibility but also a risk of legal uncertainty; in this situation it is necessary to ensure that the
movement from the different stages of integration is in one direction only.
Second, as monetary policy cannot be efficiently performed unless the decision-making power is fully centralised\(^{31}\), it was always clear\(^{32}\) that monetary policy can only be an exclusive Community competence\(^{33}\). Conceptually, it is even more difficult to imagine the exit of a Member State from an exclusive competence of the Community; this is another reason why the irrevocability of the transfer of competences has been explicitly addressed.

Different from the case of withdrawal is the case where a special differentiated regime has been agreed beforehand, as in the case of the exemption from Stage Three of Economic and Monetary Union foreseen by the UK and Danish Protocols. Even in a situation of differentiated integration, for those who have no exemption there is no possibility to withdraw from the Community policy.

c) Unilateral withdrawal from the Treaty

If it is not possible to unilaterally take back some competences that have been assigned to the Community, is there another way for a Member State to show its disagreement and detach itself from a policy it no longer shares? The question is whether total (unilateral) withdrawal from the Union is possible.

Until the entering into force of the Constitution for Europe\(^{34}\), there will be no provision for the withdrawal of a Member State from the Treaty. The absence of any such provision has led a part of the doctrine\(^{35}\) to the conclusion that Member States may not unilaterally withdraw from the Community\(^{36}\).

According to international law, the non-inclusion of a clause regarding the denunciation of or withdrawal from an international treaty may not in all cases be understood as granting indefinite duration\(^{37}\). If “it is established that the
parties intended to admit the possibility of denunciation or withdrawal; or a right of denunciation or withdrawal may be implied by the nature of the treaty”38, then withdrawal is possible. Accordingly, whether Member States may withdraw from the Community depends on the question of whether they intended to admit this possibility and/or whether it is implied by the nature of the Treaty. Looking at the Preamble of the Treaty, which states that the Treaty serves as a basis for creating “an ever closer union”, as well as at the ever increasing integration and cooperation process already sought by the fathers of the Treaty and at the ever evolving character of the Community, this part of the doctrine concludes that the nature of the Treaty does not imply a right to withdraw. These scholars have found support in the case law of the European Court of Justice. Already in its early days, the Court clarified that the Treaty is “more than an agreement which merely creates mutual obligations between the contracting states. … It is also confirmed more specifically by the establishment of institutions endowed with sovereign rights, the exercise of which affects Member States and also their citizens. …the Community constitutes a new legal order of international law for the benefit of which the States have limited their sovereign rights, albeit within limited fields, and the subjects of which comprise not only Member States but also their nationals”39. At the time, no clear position was taken on the question of whether the Member States could do away with the limitation of sovereignty they had agreed to. More recently, however, the Court has clarified its position and has explicitly stated that the transfer of powers is definitive and irreversible: “powers thus conferred could not … be withdrawn from the Community, nor could the objectives with which such powers are concerned be restored to the field of authority of the Member States alone”40.

On the basis of this case law of the Court of Justice, several scholars41 have identified the peculiarity of Community law and the way in which it differs from international law. While in international law the States always remain the masters of the treaties they conclude, the peculiarity of the Treaty is that the Member States have committed themselves to an irreversible project and have irrevocably transferred, i.e. lost forever, some of their competences to the Community. A very different position has been taken by some national courts, which have stated that, as the Treaty is nothing other than an international law treaty, by an equal and contrary instrument the States can change their agreement, in some

38 Article 56, para. 1 a) and b) of the Vienna Convention, cit. fn. 37.
41 Cf. Barents, The Autonomy of Community Law, 2004, pp. 307-308: “the status of a Member State constitutes an exclusive matter of Community law [which is also] demonstrated in particular by the case law on the division of competences laid down in the Treaty. This division is irreversible in the sense that as long as Community law does not provide otherwise, the competences of the institutions continue to exist. … Member States are not allowed to act unilaterally but are obliged to act in the interest of the Community. … The division of competences between the Member States and the institutions is exclusively based on the Treaty, which precludes Member States from unilaterally changing the scope of Community law or invoking the existence of a ‘domaine reservé’ … for not fulfilling their obligations. … More generally, the case law has made clear that the status of Member State under Community law involves a prohibition of unilateral action”.

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cases even concluding that unilateral withdrawal is also possible. While the latter conclusion is not shared by all scholars in the field, some agree that a consensual exit from the Treaty through an international law agreement is possible.

The inclusion in the text of the Constitution for Europe of Article I-60, explicitly allowing for the withdrawal of a Member State from the EU, now makes clear that the intention of the drafters is to permit, under certain conditions and following certain procedures, such withdrawal. As the foreseen procedure requires negotiations of the modalities for exit, one wonders, however, whether it will still be legitimate to talk of “unilateral” exit. Looking at the question of the transfer of competences, it can be argued that the need for a negotiated procedure arises not only from practical necessity – the complexity of “excluding” a State from the internal market – but also from the very reason that the Community would need to transfer back (the State itself not being in a position to repatriate) the powers and competences previously conferred upon the Community. In this respect, it should be underlined that the withdrawal agreement would be negotiated by the Union (and not by the Member States, as the accession treaties are) and the withdrawing Member State. Not even Article I-60 of the Constitution can, therefore, provide a definitive answer to the question of the irrevocability of the transfer of competences.

42 The possibility of unilateral withdrawal was the conclusion in the Factortame judgement of the House of Lords, Factortame v Secretary of State for Transport (No 2) [1991], 1 AC 603, 659, where it was stated that the Parliament, when adopting the European Communities Act, did not lose the competence to repeal that act in the future, even in a purely unilateral way. It is not clear whether the same conclusion was reached in the Maastricht decision, see below. Cf. Hailbronner, “The European Union from the perspective of the German Constitutional Court” (1994), German Yearbook of International Law, pp. 93-112, 103. Cf. the Maastrichter Urteil of the Bundesverfassungsgerichtshof (Federal Constitutional Court of Germany) (for the English text, see CMLR 1994, p.57), where the Court stated in para. 55 of the judgement that the state could withdraw from the Community by an international law act. On this case, among many interesting articles, cf. Weiler, “Demos, Telos und die Maastricht-Entscheidung des Bundesverfassungsgerichts”, www.jeanmonnetprogram.org/papers/95/9507ind.html; Smits, “A Single Currency for Europe and the Karlsruhe Court” (1994) LIEI, pp. 115-133, 124; Hirsch, Europäischer Gerichtshof und Bundesverfassungsgericht - Kooperation oder Konfrontation?, 38 NJW (1996) 2457-2466. It is clear that political motivations have played a substantial role in the decisions of the national courts: it is very difficult for the judges of the supreme court of a state to recognise the hierarchical superiority of the ECJ, and it is very difficult for a national parliament to recognise that the European Parliament is as democratically legitimate as itself and that, no other all, competences remain with the national parliament, as some have been transferred to the Community. Obradovic, cit., fn. 17, p. 72, considers these national judicial decisions tools for the repatriation of powers.

43 According to the Vienna Convention, unilateral exit from a treaty is possible only under very special circumstances. Cf. Article 56 (in principle, no possibility for unilateral denunciation) and Articles 60 to 62, especially 62, rebus sic stantibus (which contain the extraordinary circumstances in which a unilateral denunciation is possible) of the Vienna Convention, cit., fn. 37. For arguments against unilateral withdrawal, see Herdegen, “Maastricht and the German Constitutional Court: constitutional constraints for an ‘ever closer union’”, 31 CMLR 235-245, 242; Diez Picazo, “Les pièges de la souveraineté”, in Dehousse (ed.), Une constitution pour l’Europe?, Presse de Science Po 2002, 39, 59. Contra, de Witte, “The Process of Ratification of the Constitutional Treaty and the Crisis Option: A Legal Perspective”, EUI Working Paper LAW No 2004/16, 1-19, 16, who mentions the fact that when in 1975 the British government called a referendum on whether the United Kingdom should remain in the EC, none of the other Member States lodged a formal protest.


45 Cit., fn. 34.

46 As a counterargument it could be argued that in case no agreement can be reached, the unilateral withdrawal is effective as from two years after the notification to the European Council of the intention of the Member State to withdraw, Article I-60 (3).
Conclusions: withdrawal from Monetary Union is not possible

The Finnish Emergency Powers Act foresees that, in certain cases of serious emergency, the government can introduce obstacles to the free movement of capital and can assign certain powers, which according to the Treaty belong to the ECB, to the Finnish national central bank (Suomen Pankki) and to other national authorities, thereby (temporarily) separating Finland from the Monetary Union of the Community.

The question of whether the Treaty allows Member States to unilaterally exit from Monetary Union has thus been examined. There is agreement in the doctrine and in the case law on the impossibility of unilaterally withdrawing from a specific Community policy. In particular, it is clear that the movement of the Community into Monetary Union is irreversible and that there can therefore be no “repatriation” of competences. On the other hand, there is no agreement as to whether unilateral withdrawal from the whole of the Treaty is possible as (i) the Treaty does not contain an explicit clause to this effect, (ii) the wording of the national constitutions is diverse and not clear and (iii) the question of whether the nature of the Treaty allows for a withdrawal is answered in different ways by the scholars, the European Court of Justice and the national courts. Once the Constitution enters into force, its Article I-60 will clarify the situation and allow withdrawal, subject to a procedure requiring negotiations involving the European Council, the Commission and the Parliament and, if the withdrawing Member State has adopted the euro, certainly also the ECB.

IV SECOND QUESTION: DOES THE EXCEPTION OF ARTICLE 297 OF THE TREATY ALLOW MEMBER STATES TO UNILATERALLY “SUSPEND” THE TRANSFER OF POWERS TO THE COMMUNITY?

As the Emergency Powers Act does not envisage a withdrawal from the Community, but only a future, conditional and (probably) temporary national exercise of Community powers, the question is whether the legal basis that has been invoked – Article 297 – grants Member States these powers. First, the function of Article 297 and the question of whether it grants, by its nature, a “reserve of sovereignty”, or is rather a hedge clause, will be examined. Thereafter, the conditions for the applicability of Article 297 will be analysed to clarify whether allowing the Member States under certain circumstances to introduce legislation creating obstacles to the free movement of capital and the internal market also allows the Member States to adopt legislation in an area of exclusive Community competence. In substance, the question is whether Article 297 is the crack in the dam through which the monetary policy competences irrevocably attributed by the Treaty to the Community can, under certain conditions, flow back to the Member States.

a) Is Article 297 still necessary?

Article 297 is one of the original articles of the Treaty of Rome (at the time, Article 224). Its main function when it was adopted was to create a link between the (at the time) completely national external politics of the Member States and the Community objective to achieve a common market. While admitting that Member States, in some extremely serious situations, have the right to take emergency measures that might have an impact on the common market, the Article nevertheless prescribes a consultation procedure to prevent such negative effects.

When in 1991 the IGC on political union started to discuss the “Common External Policy”, which would later become the second pillar of the European Union, the Common Foreign and Security Policy (CFSP), the question was raised as to whether it still made sense to allow Member States to adopt individual measures to react to external threats, which would by definition concern the whole European Union, and whether it would not be more appropriate to delete such an anachronistic provision and rely on the reaction of the European Union.

Today, with the adoption of the CFSP, the objectives of which conflict with the adoption in emergency situations of unilateral measures by the Member States, this question is even more topical. It is questionable whether this Article still maintains a function in today’s European Union, particularly if, as in the case of the Finnish Act, the measures to be individually adopted by the Member State are bound by definition, in a single Monetary Union, to cause further disruption to the market rather than stabilising it.

b) “Reserve of sovereignty” or exceptional derogating clause?

It has been argued, in particular by Member States, that Article 297 of the Treaty grants them a “reserve of sovereignty” or that, under certain circumstances, it is a tool for the repatriation of competences from the Community to a Member State. However, such a reading is supported neither by the wording of Article 297, nor by the history or nature of the Communities.

In fact, the historical and legal development of the Community until the establishment of European Union, which provided for a CFSP, clearly indicates another, more restrictive, reading.

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48 Article 297 also talks of “serious internal disturbances affecting the maintenance of law and order”; this aspect relates to internal security. On this aspect, see below, chapter IV c) 1).
49 The deletion was proposed by the Commission, cf. CONF-UP 1788/91 of 15 April 1991, p. 23.
51 This is challenged by Koutrakos, cit., fn. 50.
52 Obradovic, cit., fn. 17, makes the point that it is not clear whether the process of gradual transfer to the Community of Member States’ powers is irreversible or not, with one exception: Monetary Union, p. 61.
53 See below, chapter IV c).
55 Mentioned above, chapter IV a).
Article 297 is one of the five articles\(^\text{56}\) that provide for derogation from the rules of the Treaty. It is settled case law that Member States can derogate from the obligations imposed on them by the provisions of the European treaties only on the conditions laid down in the treaties themselves\(^\text{57}\). All articles of the Treaty allowing derogation are of an exceptional nature and only apply in clearly defined cases\(^\text{58}\), while the derogating measures must be proportionate\(^\text{59}\), i.e. have the least impact on the market\(^\text{60}\).

Therefore, Article 297 has to be interpreted in a restrictive manner. Although Article 297 attaches particular importance to the interests of Member States, “it must be observed that [it] deal[s] with exceptional cases which are clearly defined and which do not lend themselves to any wide interpretation”\(^\text{61}\).

As the special cases listed in Article 297 deal with the issue of public security, it is interesting to examine the position taken by the ECJ on the exceptions allowed in this field. First, the Court stated that “[i]t is not possible to infer from those articles that there is inherent in the Treaty a general exception excluding from the scope of Community law all measures taken for reasons of public security”\(^\text{62}\). Second, even in the case of the CFSP, where what in substance remains a national competence is coordinated, the European Court of Justice has clearly stated that “Member States have retained their competence in the field of foreign and security policy, [but that these] powers retained ... must be exercised in a manner consistent with Community law. ... Consequently, while it is for Member States to adopt measures of foreign and security policy in the exercise of their national competence, those measures must nevertheless respect the provisions adopted by the Community in the field of the common commercial policy. ... It follows from the foregoing that, even where measures have been adopted in the exercise of national competence in matters of foreign and security policy, they must respect the Community rules adopted under the common commercial policy.”\(^\text{63}\). Therefore, even in an area which falls within the competence of the Member States the latter have nevertheless to ensure the respect of measures adopted to achieve the objectives of an exclusive Community competence. In areas which are within the Community competence, as it is the case for Article 297, the conditions under which a State can (temporarily) unilaterally deviate from Treaty provisions must be very stringent and

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\(^{56}\) Articles 30, 39, 46, 296 and 297 of the Treaty.


\(^{59}\) The ECJ has stated, in respect of Article 30, that “the purpose of this Article is not to reserve certain matters to the exclusive jurisdiction of the Member States; it merely allows national legislation to derogate from the principle of free movement of goods to the extent to which this is and remains justified in order to achieve the objectives set out there”, Steiner/Woods, EC Law, 7th ed. (2000), p. 172, referring to Case 153/78 Commission v Germany, [1979] ECR 2555. Cf. also Case 222/84, cit., fn. 58, para. 38; Case C-285/98, cit., fn. 50, para. 23.

\(^{60}\) In addition, it has been argued that where there is a Community measure covering the specific subject, a Member State cannot rely on the derogation provided by the Treaty itself: cf. Steiner/Woods, cit., fn. 59, p. 191.


\(^{62}\) Case C-285/98, cit., fn. 50, para. 16; Case C-273/97 cit., fn. 50, para. 16.

exhaustively described. Finally, concerning the limits of the legal review, the Court has stated that “depending on the circumstances, national authorities have a certain degree of discretion when adopting measures which they consider to be necessary in order to guarantee public security in a Member State”\(^{64}\). However, the Court may question whether the measures taken in exercise of this discretion actually have the purpose of guaranteeing public security and whether they are appropriate and necessary to achieve that aim\(^{65}\).

It is clear that the aim of Article 297 is not to enable Member States, in areas touching the very core of their sovereignty, freedom to act by taking any measure they consider appropriate without any regard for the procedures established in the Treaty. On the contrary, as pointed out by Koutrakos, Article 297 “is focused on the consultation between the Member States rather than the measures ‘which a Member State may be called upon to take’”\(^{66}\). While a certain discretion with regard to the measures to be taken remains to the Member State, respect of the foreseen procedures is of the essence, precisely because this Article contains a “wholly exceptional clause”\(^{67}\) which allows derogation, not from one aspect of the common market (as Article 30 of the Treaty does), but from the rules of the common market in general\(^{68}\). According to Article 297, unilateral measures of Member States are, as a rule, prohibited; the protection of national interest can only take place according to the rules of Community law and the procedure foreseen for this purpose\(^{69}\).

It appears therefore that Article 297 of the Treaty cannot be understood as a reserve of sovereignty, but rather as a hedge clause (“Schutzklausel”)?\(^{60}\).

This is confirmed by the very content and aim of Article 297, which is, as mentioned above, to establish a procedure for consultation and cooperation to prevent negative impacts on the internal market from unilateral action. This consultation should precede, or when this is impossible immediately follow\(^{71}\), the adoption of the national measure. Two further steps, aiming at guaranteeing that Article 297 is used in a restrictive way, are built into the following Article 298. First, in the event of the measure, despite the consultation and cooperation, having negative effects on the internal market, the Commission shall take action with the Member State to adjust the national violating provisions to the Treaty. Second, the question can be submitted directly to the ECJ, without the preliminary stages foreseen in Articles 226 and 227, both by the Commission and by other Member States. These further guarantees that Article 297 be strictly

\(^{64}\) Case C-285/98, cit., fn. 50, para. 24.
\(^{65}\) Case C-285/98, cit., fn. 50, para. 25.
\(^{66}\) Koutrakos, cit., fn. 50, para. 25.
\(^{67}\) Opinion of Advocate General Jacobs in Case C-120/94, Commission v Greece, [1996] ECR I-1513 (emphasis in the original); cf. also Case 222/84, cit. infra, fn. 58.
\(^{68}\) Opinion of Advocate General Jacobs in Case C-120/94, cit. fn. 67.
\(^{71}\) Cf. the well-known \textit{Caroline} formula, pleaded by the United States in 1841: “necessity of self-defense, instant, overwhelming, leaving no choice of means, and no moment for deliberation”, State Secretary Webster, British and Foreign State Papers, 29 (1840-1841), at 1129, 1138.
interpreted and not abused support the interpretation that its objective is not to maintain a reserve of sovereignty for the Member States in the exceptional cases foreseen, but to limit their possibility to act unilaterally even under these exceptional circumstances.

c) **Conditions for invoking Article 297**

1. **Serious internal disturbances affecting the maintenance of law and order**

According to Article 297, a Member State might be called upon to take certain measures in the event of “serious internal disturbances affecting the maintenance of law and order”. This must be “a breakdown of public order on a scale much vaster than the type of civil unrest which might justify recourse to Article 36 … a situation verging on a total collapse of internal security”\(^72\). Where the notion “public security” refers to both a Member State’s internal security and its external security\(^73\), as in Articles 30, 39 and 46 of the Treaty, the notion “serious internal disturbances affecting the maintenance of law and order” must be interpreted in a much narrower manner, in order not to endanger the “wholly exceptional nature” of Article 297. Neither a general strike nor violent demonstrations by agricultural workers\(^74\) nor purely economic reasons\(^75\) can suffice for a State to have recourse to this exceptional Article. Isolated terrorist attacks, environmental catastrophes or temporary supply crises also cannot provide justification for recourse to this Article\(^76\).

2. **War and serious international tension constituting a threat of war**

The concepts of “war” and “threat of war” are not reflected in the UN Charter or the Resolutions of the UN General Assembly, where reference is made instead to “aggression”\(^77\). The first interesting question is whether or not acts of terrorism can be assimilated to a “threat of war” for the purpose of applying Article 297. While experts are divided on the issue\(^78\), Article 3 of the Council Common

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\(^{72}\) Opinion of Advocate General Jacobs, cit, fn. 67, para. 47


\(^{74}\) Case C-265/95, *Commission v France*, ECR 1997, I-6959, para. 54-58.

\(^{75}\) Case C-367/98, *Commission v Portugal*, [2002] ECR I-4809, para. 52: “it is settled case law that economic grounds can never serve as justification for obstacles prohibited by the Treaty”.


\(^{77}\) The UN Charter does not use the expression “war”, but refers to “threats and breaches to international peace and security”, “aggression”, “international disputes”, “local disputes”, “threats and use of force”. The UN General Assembly Resolution 3314 (XXIX) defines “Aggression” as “the use of armed force by a State against the sovereignty, territorial integrity or political independence of another State, or in any other manner inconsistent with the Charter of the United Nations, as set out in this Definition. … Any of the following acts … qualify as an act of aggression:

(a) The invasion or attack by the armed forces of a State of the territory of another State, or any military occupation however temporary, resulting from such invasion or attack, or any annexation …

(b) Bombardment …

(c) The blockade of the ports or coasts …

(d) An attack by the armed forces of a State …

(e) The use of armed forces

(f) The action of a State in allowing its territory … to be used by that other State for perpetrating an act of aggression against a third State

The sending by or on behalf of a State of armed bands, groups, irregulars or mercenaries.”

\(^{78}\) Cf. Cassese, cit. fn. 2, p. 996-997: “practically all States … have come to assimilate a terrorist attack by a terrorist organisation to an armed aggression by a State… Thus, aiding and abetting international terrorism is equated with an “armed attack” for the purpose of legitimizing the use of force in self-defence”. Contra, Bothe, “Terrorism…”, cit, fn. 2.
Position on the application of specific measures to combat terrorism\textsuperscript{79} defines a “terrorist act” as “an intentional act which... may seriously damage a country... as defined as an offence under national law where committed with the aim of ...(iii) seriously destabilising or destroying the fundamental, political, constitutional, economic or social structures of a country...”\textsuperscript{80}.

The second interesting question is who is responsible for evaluating the existence of a sufficiently serious threat. Advocate General Jacobs has clarified\textsuperscript{81} that it is for the Member State concerned to evaluate whether international tensions can be qualified as a threat of war; “the scope and the intensity of the review that can be exercised by the Court is severely limited ... by the absence of any appropriate legal criteria capable of judicial application”\textsuperscript{82}. Therefore, it can be argued that it is for the concerned State to decide whether significant and destabilising terrorist acts are to be considered as a threat of war.

3 – Obligations accepted for the purpose of maintaining peace and international security

Even in the case of this specific condition, it could be argued that Article 297 is anachronistic. The international obligations which could have an impact on the common market are mostly military obligations. With the development of the CFSP, and given that all Member States are members of the UN and most are members of NATO, a joint reaction and joint obligations are much more probable than individual ones. In any event, it is difficult to imagine that these international obligations might be so different among Member States as to impose the creation of barriers between them, given the fact that they are under an obligation to coordinate their actions on these issues.

4 – Is “preventive” legislation allowed?

Even if one of the three objective above-mentioned conditions were to be satisfied, another question to be raised in the case of the Finnish Act is whether a Member State can invoke Article 297 to enact legislation to deal with a future potential emergency situation.

The wording of Article 297 does not support an interpretation including such a preventive element, as it uses the expression “in the event of”. The exceptional nature of Article 297 therefore excludes the possibility of adopting


\textsuperscript{80} Even if terrorism is not considered to be an act of war, it appears from this definition that, in some extreme situations, it could constitute a case of serious internal disturbances affecting the maintenance of law and order.

\textsuperscript{81} Agreeing with the decision of the German courts, as referred by Advocate General Jacobs, cit. fn. 67, I-1527, point 51.

\textsuperscript{82} Cf. Opinion of Advocate General Jacobs, case C-120/94, cit. fn. 67, para. 50-51. When evaluating public security, the Court has always granted a certain discretion to the Member States: "depending on the circumstances, national authorities have a certain degree of discretion when adopting measures which they consider to be necessary in order to guarantee public security in a Member State”, case C-273/97, cit., fn. 50, para. 27; Case C-83/94, cit., fn. 73, para. 35; Case C-285/98, cit., fn. 50, para. 24. Also regarding the exercise of derogation powers pursuant to Article 120 of the Treaty, the Court has held that "in the event of urgency and when a decision of the Council is not forthcoming immediately, Article [120] allows, as a precaution, unilateral action by a Member State and leaves this latter to decide the circumstances which render such action necessary", Joined Cases 6 and 11/69, cit., fn. 57, para. 28.
“precautionary” or “preventive” legislation in the absence of the necessary conditions.

It could be argued that the Finnish Act did not imply the adoption of preventive legislation but only of an enabling clause, on the basis of which, if and when the necessary conditions came into existence, emergency legislation could be adopted. However, the ECJ has clearly stated that Member States have a duty to eliminate from their legal system any legislation which is in conflict with the Treaty even when it is not applied, to foster transparency and certainty of law.

In this case, either the limits and conditions (including procedural) of the enabling law would coincide with what is foreseen in Article 297, and its only function would be to determine which organ is competent according to national law to issue the emergency legislation, or the limits and conditions would differ (and be broader), in which case the national provision would violate the Treaty since, as mentioned above, Article 297 must be interpreted in a restrictive way. In this latter case, the Finnish government would be under an obligation to eliminate the inconsistency with the Treaty even though no concrete emergency measure violating the Treaty has yet been adopted.

V CONCLUSION

The analysis has shown that, according to the Treaty, Member States can only adopt provisions which conflict with those of the Treaty and create obstacles to the four freedoms when specifically allowed by a Treaty provision, strictly within its limits and following the required procedure. It has also been demonstrated that Member States cannot take back competences transferred to the Community, particularly in the case of the competences related to the Community monetary policy, where the Treaty explicitly states that the move is irrevocable, unless Member States withdraw from the Community as a whole (and even in this case they have to negotiate their exit and cannot withdraw unilaterally). Finally, the analysis of Article 297 has shown that the objective of the Article is not to maintain a reserve of sovereignty for the Member States, but rather to establish conditions and specific procedures for the individual reactions of Member States to such extremely exceptional situations.

If one of the events listed in Article 297 occurs, the Member State concerned is allowed, after consultation with the other Member States, to take the measures within its competence that least affect the common market, if Community
institutions are unable to act. It is not possible on this basis to “repatriate” exclusive Community competences instead. The Finnish government hence cannot invoke Article 297 of the Treaty for the amendment of its Emergency Powers Act, as the Act suffers from both procedural and substantive defects.

It can be concluded therefore that there is no fissure in the Treaty through which the competences transferred to the Community can flow back to the Member States. If the Treaty is respected, in particular in fields of exclusive Community competence, the States do not have any residual power to adopt provisions that conflict with the Treaty.
INSIDE EU, OUTSIDE EMU: INSTITUTIONAL AND LEGAL ASPECTS OF THE EXCHANGE RATE MECHANISM II

Kirsten Rohde Jensen

ABSTRACT

I nuovi Stati membri hanno espresso la propria intenzione di adottare l’euro il prima possibile, probabilmente prima della fine del decennio. La partecipazione ai nuovi accordi europei di cambio (ERM II) è uno dei criteri che dovranno essere soddisfatti prima che sia possibile considerare il passaggio all’euro. Lo studio intende fornire un esame generale del contesto giuridico e istituzionale dell’ERM II. Al fine di inserire l’analisi dell’ERM II in una prospettiva più generale vengono anche ripercorsi gli sviluppi storici e i negoziati che hanno condotto a tale accordo. Viene infine trattato il ruolo dell’ERM II nel criterio di convergenza relativo al tasso di cambio.

1 The author is grateful to Jens Anton Kjaergaard Larsen for contributions and suggestions to the paper.
1 INTRODUCTION

Since 1 January 1999, the EU Member States have been divided in terms of participation in Economic and Monetary Union (EMU). Currently, 12 out of the 25 Member States in total have moved to the third stage of EMU and have adopted the euro (the “euro area Member States”). The remaining 13 EU Member States have not introduced the euro; two of these, Denmark and UK, both have a Treaty-bound special right not to participate in the euro.

As long as not all Member States have adopted the euro, Articles 121 and 124 of the Treaty establishing the European Community (“the Treaty”) stipulate the existence of an exchange rate mechanism. The present Exchange Rate Mechanism II (ERM II) links the currencies of the Member States participating in ERM II to the euro. This provides incentives among the participating Member States to pursue stability-oriented economic and monetary policies, which helps to create convergence and to foster exchange rate stability. This stability supports the functioning of the single market and facilitates later full integration into the euro area. In this paper we take a closer look at the legal and institutional framework of ERM II. This analysis is placed into a more general perspective that includes the historical developments and negotiations leading up to ERM II. In addition, the role of ERM II in the exchange rate convergence criterion is also briefly discussed.

2 THIRTY YEARS OF MONETARY COOPERATION

In 1972, following the launch of the Werner Plan for Economic and Monetary Union, the Governors of the national central banks (NCBs) of the then six Member States and of the three countries that would join the European Community (EC) on 1 January 1973, established through the Basel Agreement a fixed exchange rate system with fluctuation bands of ±2.25%, known as the “Snake”. During its existence from 1972 to 1978, the Snake was characterised by frequent exchange rate adjustments as well as the coming – and especially going – of participating Member States. The lack of success of the Snake, coupled with the dismal economic situation at the beginning of the 1970s, caused the Werner Plan to suffer a major setback.

The idea of monetary stability in Europe was revived with the creation of the European Monetary System (EMS) in December 1978. The aim of the EMS, which started operations in March 1979, was to promote monetary stability and closer economic cooperation. At its core was the Exchange Rate Mechanism. A central parity against the European Currency Unit (ECU) was fixed for each participating currency. Based on these rates, bilateral “central rates” were established against all other member currencies of the ERM, constituting the so-called parity grid. The fluctuation bands around the bilateral central rates were ±2.25%. The first few years of the EMS were characterised by frequent exchange

2 Except for the Italian lira, for which it was set at ±6%. On 8 January 1990 the fluctuation band for Italy was narrowed to ±2.25%. 
rate realignments, which closely resembled a continuation of the Snake, with no more substantial change than that of a broader group of participating countries. However, from 1983 onwards the economic policies of a number of countries became stability-oriented to a degree that made it possible to maintain a stable exchange rate against the Deutsche Mark, which had the status of anchor currency. Regular realignments of central rates still occurred, however, until 12 January 1987, when the system changed in nature as the participating countries shifted towards avoiding such realignments. From January 1987 to September 1992 there were no realignments in the system. The system was supported by improved convergence of prices and costs. Positive, albeit declining, inflation differentials accumulated over time, however, and, coupled with fixed nominal exchange rates, resulted in a deterioration in competitiveness, especially in Italy and Spain. The increasing fundamental divergences and the full capital liberalisation adopted from 1 July 1990 by most Member States, as well as speculative attacks, led to crises in September 1992 when the UK and Italy left the ERM. The Spanish peseta and the Portuguese escudo were devalued in November 1992 and again in May 1993, while the Irish pound was devalued in January 1993. In August 1993 the EMS was partly suspended when its fluctuation limits were extended to ±15% to remove potential “one-way” speculative bets and to restore stability. After ratification by all Member States, the Maastricht Treaty, which established among other things the political and institutional framework for the process of convergence towards EMU, came into force on 1 November 1993. The EMU project of the Maastricht Treaty, with its well-determined objectives, institutions and deadlines, turned out to be a catalyst for the path towards Monetary Union. The establishment of the European Monetary Institute (EMI) at the beginning of 1994 also provided new momentum. The EMI helped in preparing the subsequent stages of the EMU process which led to the introduction of the euro in 1999.

3 NEGOTIATIONS ON ERM II

Deliberations on the establishment of a new exchange rate mechanism in the third stage of EMU commenced in autumn 1995. The blueprint of the mechanism developed gradually through discussions in EMI and in the EC Monetary Committee, as well as in the informal ECOFIN meetings between central bank governors and finance ministers in Verona, Dublin and Noordwijk from spring 1996 to spring 1997.

The natural starting point for these discussions was the existing exchange rate arrangement, the ERM. Given the lack of Treaty provisions specifying institutional arrangements regarding internal exchange rate regimes, there was an absence of clear authority and a lack of clear legal basis in the Treaty on how to regulate the new ERM, labelled ERM II. Some countries, as well as the

4 In Spain a nominal appreciation took place during part of the period.
Commission, argued that in monetary and exchange rate matters the exclusive competence, at least for the “ins”, should belong to the Community. The majority of countries, however, found it appropriate to retain from ERM I the structure of two parallel agreements among governments and among central banks, given the respective competences and responsibilities. Another issue raised in the discussions was whether participation in the new system should be made compulsory, or remain voluntary as in ERM I. The Commission argued that Member States with a derogation (the “pre-ins”) would be expected to join the new mechanism. Those existing countries with a special status constituted a unique case in the view of the Commission. If the convergence situation were favourable, they should have the same opportunity to join as Member States with a derogation. Most Member States, with a few exceptions, favoured some degree of voluntariness, with the UK insisting on this.

A central parameter of the discussions on the design of the new system was of course the new economic and institutional environment that the move to the third stage of EMU would create. Clearly, the euro was expected to play a central role in the mechanism, given the expected stability and size of the euro area, as well as the fact that the non-participating Member States would be expected to participate in the euro at a later stage. Two options regarding the fundamental arrangement of the system were put forward. The first was a continuation along the lines of ERM I, with the fixing of central parities and fluctuation bands between all participating currencies, thereby creating a parity grid. In such a system, the fluctuations of each currency against the other currencies would be limited. The second option – supported by the EMI and the Commission – was purely to define central parities for the non-euro currencies vis-à-vis the euro. Under this option, there would only be limitations to the fluctuations relative to the euro. The euro would thus be the hub of the system, while the non-euro currencies would constitute the spokes. This solution resembled that of the Bretton Woods system, in which the dollar acted as the hub. Under a hub-and-spoke system there are no bilateral central exchange rate parities or fluctuation margins between the spokes. Hence, fluctuations among the spokes could in principle be up to twice the size of the currency fluctuations against the euro. Depending on the size of the permitted fluctuations against the euro, the fluctuations between the participating non-euro currencies could potentially be of a size detrimental to the efficient working of the single market. It turned out during the discussions that there was almost unanimity among the countries in favour of the hub-and-spoke model, assuming that the decision on the central parities were to be multilateral. Since the currencies would no longer be on an equal footing, it was not possible to copy all the rules directly from the previous exchange rate agreements into the new agreement (although naturally a large number of new rules have their roots in the previous agreements, as further elaborated below).

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6 This view is supported, for example, by R. Smits in *The European Central Bank – Institutional Aspects*, (The Hague: Kluwer Law International, 1997).
7 See De Grauwe, op. cit.
8 In ERM I the Deutsche Mark was normally considered to play the role of an informal anchor, but the role was not formalised and was occasionally challenged.
The question concerning the size of the standard fluctuation band, and whether to allow narrower bands, proved to be the most contentious issue during the negotiations. The majority of countries found that the latest period in ERM I, with relatively broad bands of ±15% around the central parities, had worked quite well and had secured a certain degree of stability. A few others, however, argued that a system with such broad bands was tantamount to a “non-system”. While central parities could still play a role as exchange rate objectives, interventions at the margins of the fluctuation bands would, according to this view, be highly unlikely. Rather, such interventions would be preceded by a realignment of the central parities. The experience in the period 1993-1996 showed that the currencies in ERM I had not moved to the margins of the fluctuation bands, and hence mandatory intervention had not been needed. Regarding the possibilities for formal or informal narrower bands, the discussion again revealed differences in opinion. Some felt that narrower bands could invite speculators to test these bands, creating the risk of losses for the NCBs involved, as happened during the crisis of 1992-93. Furthermore, some feared that the possibility of narrower bands might influence the interpretation of the exchange rate criterion in the Treaty and hence potentially discriminate against later entrants to EMU. Others argued for narrower bands, based on the convergence position of the Member State in question. Some countries also argued that arrangements on narrower bands should be decided on an ad hoc basis, while others expressed a preference for a standard arrangement for narrower bands, to avoid a proliferation of all kinds of arrangements. A compromise was reached, namely that the agreement should explicitly state that narrower bands do not influence the interpretation of the exchange rate criterion. The agreement on an escape clause from mandatory intervention if this conflicted with the primary objective of price stability also helped quell fears of losses from speculative attacks.

4 ERM II LEGAL DOCUMENTS

ERM II is an intergovernmental arrangement based on the following two legal documents:


The main features of the mechanism are described in the Resolution and include the following:

– Voluntary participation in the mechanism for all non-euro area Member States (Article 1.6);
– A central rate against the euro (Article 2.1), which explicitly makes the euro the anchor currency;
– A standard fluctuation band of ±15% around the central rate (Article 2.1);
– Automatic and unlimited interventions at the margin, in principle. However, the Resolution explicitly states that participating NCBs can suspend intervention if this were to conflict with their primary objective, i.e. the maintenance of price stability (Articles 1.5 and 2.1);
– The right of all parties to the agreement to initiate a confidential procedure aimed at reconsidering central rates (Article 2.3), which has to be done in a timely fashion (Article 1.5);
– The possibility of formal narrower fluctuation bands than the standard one, backed up in principle by automatic intervention and financing (Article 2.4), as is the case with the standard band;
– The availability of very short-term financing, with the details determined in the central bank agreement (Article 2.6).

While participation in the mechanism is voluntary for all non-euro area Member States, Member States with a derogation are nevertheless expected to join the mechanism at some stage. The Resolution makes no mention of entry conditions and provides no reasons for a refusal of an application. The only provision in this regard in the Resolution is the demand for common agreement on the central rates and standard fluctuation band by the ministers of the euro area Member States, the ECB and the ministers and central bank governors of the non-euro area Member States participating in ERM II, following a common procedure involving the European Commission and after consultation of the Economic and Financial Committee (EFC). Ministers and NCB governors of the non-euro area Member States not participating in ERM II will take part in the procedure but will not have voting rights (Article 2.3).

Compared with the EMS Resolution from 1978, the ERM II Resolution is less detailed and at the same time more flexible in a number of areas.9 The size of the standard fluctuation band allows for a significant degree of flexibility in exchange rate movements. At the same time, the ERM II Resolution makes it possible to take Member States’ different degrees of convergence into consideration. If economic performance has converged very closely to that of the euro area, a Member State can request a formal narrower band. The ministers of the euro area Member States, the ECB and the minister and NCB governor of the non-euro area Member State in question take a decision after a request following a common procedure involving the European Commission and after consultation of the EFC. Ministers and NCB governors of other Member States will take part in the procedure, but will not have voting rights (Article 2.4). The central bank agreement makes it possible to conclude informal bilateral agreements between the ECB and the participating non-euro area NCBs on closer exchange rate arrangements (Article 15.3). Furthermore, the participating non-euro area NCBs naturally still have the option to unilaterally stabilise their exchange rates within the band.

The possibility of suspending intervention, as well the possibility of reconsidering central rates, makes maintaining price stability a priority. However, any decision to suspend compulsory intervention would have to take all relevant factors into account, including the credible functioning of the ERM (Article 2.1). In ERM I, NCBs were subject to the obligation to intervene when the exchange rate reached the limit of the band. This difference is also found in the ERM I and ERM II central bank agreements. The latter explicitly mentions in Article 3 the possibility of suspending intervention if this conflicts with the primary objective of price stability. The ERM I agreement, on the other hand, does not mention any suspension of intervention. However, the difference between ERM I and ERM II has been questioned. The Bundesbank thus had an informal agreement with the German government to ensure that the Bundesbank could suspend intervention if the Bundesbank considered Germany’s monetary stability to be at risk. Conversely, Padoa-Schioppa (2003) concludes that the safeguards granted to the Eurosystem in ERM II are much stronger than those granted to the Bundesbank in ERM I.

5 OPERATIONAL FEATURES OF ERM II

The central bank agreement lays down the operating procedures of the mechanism. The agreement covers interventions, very short-term financing and monitoring.

At the margins of the fluctuation band, the NCBs involved shall intervene by buying the weak currency or selling the strong one to market participants. To avoid settlement risk, a “payment after payment” procedure is employed. According to this procedure (in Annex I of the agreement), in interventions at the margins, the NCB concerned shall release its payment only after receiving confirmation that the amount due has been credited to its account. The participating non-euro area NCBs act as correspondent banks of the ECB and of the “in” NCBs. So-called intramarginal interventions between margins of exchange rate fluctuation, either unilaterally or coordinated, can also be conducted (Article 4). Depending on the intervention currency, such non-compulsory interventions may be subject to prior approval. If the intervention currency is different from the euro and exceeds the agreed limits, prior agreement must be obtained from the issuing non-euro area Member State (Article 5.1). If the intervention currency is the euro, a non-euro area NCB shall immediately notify the ECB if it has used euro in amounts exceeding the agreed limits (Article 5.2). The distinction between non-euro intervention currencies and the euro is a result of the increased international role of the euro.

For the purpose of intervention, the ECB and the participating non-euro area NCBs have established “very short-term financing facilities”. This ensures that

all participants have access to sufficiently large amounts of partner currencies and enhances the credibility of intervention commitments. For interventions at the margin, the financing is in principle available automatically and is unlimited in amount (Article 7.1), but can be suspended if it conflicts with the primary objective of maintaining price stability (Article 7.3). The financing has an initial maturity of three months (Article 6.1), but can be renewed subject to restrictions on duration and size (Articles 10 and 11). The very short-term financing facility can also be used for intramarginal intervention, subject to the agreement of the NCB issuing the intervention currency. The ceilings of the ECB and of the NCBs of the “ins” are set at zero, which indicates that these banks will not engage in intramarginal intervention.\(^\text{12}\) NCBs wanting to draw on the facility, whether for interventions at the margin or intramarginally, should first make appropriate use of their foreign reserves (Articles 7.2 and 8b).

A direct comparison of the two central bank agreements under ERM I and ERM II also reveals a number of differences regarding operational issues. Most of the differences, although not all, follow from the introduction of the euro and the change of the mechanism from a parity grid into a hub-and-spoke system.

From an economic point of view, the most important difference relates to the methods for settling financing operations. Under the ERM I agreement, a creditor central bank was obliged to accept settlement by means of ECUs of an amount equal up to 50% of its claim, unless the creditor central bank’s assets in ECU were smaller than its forward sales of ECUs to the European Monetary Cooperation Fund (Article 16.1). This represented a compromise between the NCBs that wanted an upper limit on the amount of ECUs they were obliged to accept, and those NCBs that wanted an unlimited use of ECUs for settlement.\(^\text{13}\) The ECU was a standard basket of all currencies in the European Community, so in case a currency after a period of intervention were to devalue, it would also result in a lower value of the ECU vis-à-vis the rest of the participating currencies. Hence, a creditor central bank ran the risk of facing a loss on its credits due to settlement in ECUs if there were any changes in the central parities. In ERM II, settlement in principle shall be carried out by means of holdings in the creditor’s currency (Article 14). This removes the risk of losses to the creditor central bank. In both agreements the methods of settlement are without prejudice to other forms of settlement agreed by creditor and debtor central banks.

Second, the ERM II agreement leaves intramarginal intervention to the discretion of the participating NCBs. In ERM I, intramarginal intervention was also a tool for NCBs according to Article 2.2 in the Agreement. However, according to Article 3.1 in the ERM I Agreement, rates for the currencies in terms of ECUs that constituted “thresholds of divergence”\(^\text{14}\) were established with the help of a divergence indicator. If a currency crossed the divergence threshold, it was

\(^{12}\) See “Operational Features of the New European Exchange-rate Mechanism”, op. cit.

\(^{13}\) See J. Thomsen, *Det europæiske monetære samarbejde* (Copenhagen: Handelshøjskolens forlag. 1990). Informally, the Basel-Nyborg agreement suspended the 50% rule without changing Article 16.1.

\(^{14}\) According to Article 3.2 of the Resolution and to Article 3.1 of the Agreement, the threshold of divergence was fixed at 75% of the maximum spread of divergence for each currency.
presumed that the authorities concerned would correct the situation by taking adequate measures as set out in Article 3.6 of the ERM I/EMS Resolution. The measures listed in Article 3.6 of the Resolution are a mixture of intervention, domestic monetary policy measures, changes in central rates, and other measures of economic policy. The proponents of the divergence indicator saw it as an objective indicator to trigger consultations in case of divergence and as a tool to oblige participating Member States with stronger currencies to shoulder part of the necessary adjustments instead of leaving the Member States with the weaker currencies to shoulder the burden. However, there was no obligation to conduct policy measures when a Member State had crossed the divergence threshold, so in practice the divergence indicator did not have any appreciable impact on the functioning of the ERM I system.

The General Council of the ECB, comprising the President and Vice President of the ECB’s Executive Board, as well as the governors of the NCBs of all EU Member States, monitors the functioning of ERM II. The General Council also serves as a forum for monetary and exchange rate policy coordination as well as the administration of the intervention and financing mechanism specified in the agreement.

6 ERM II AS A CONVERGENCE CRITERION

While the main feature of ERM II is to help participating Member States to secure a stable economic environment, participation in ERM II is also one of the convergence criteria to be fulfilled in order to join the euro. Article 121 of the EC Treaty and Article 3 of the Protocol (on the convergence criteria referred to in Article 121 of the Treaty) state that the national currency in question must remain within the normal fluctuation margins provided for by the ERM of the EMS without displaying any severe tensions for at least two years prior to the date of examination. In particular, each Member State must not have devalued its currency’s bilateral central rate against any other Member State’s currency on its own initiative during the same period.

Regarding the duration of ERM participation, historical experience shows that the criterion has been interpreted somewhat more freely. When Italy and Finland were approved for euro participation in May 1998, both respective currencies had only been participating in ERM I for around 18 months. However, at the onset of the euro on 1 January 1999, both Member States had been participating for more than two years. At the time of the EMI and the Commission’s assessment of the state of convergence of the Member States in the convergence reports of March 1998, the EMI chose to consider the reference period to be the time spent by the two countries in the ERM up to the assessment, while the Commission chose to analyse the preceding 24 months up to the assessment, even though not all of this time was spent in the ERM.

15 The other convergence criteria relate to inflation, the interest rate, sustainable public finances and compatibility of national legislation with the Treaty.
The extension of the fluctuation bands from ±2.25% to ±15% after the ERM crisis in August 1993 and thus preceding the entry into force of the Maastricht Treaty on 1 November 1993 has since given rise to alternative, though not necessarily conflicting, views and practices when interpreting the criterion. It is evident that exchange rate fluctuations of 30% are too wide to be interpreted as exchange rate stability in an economically meaningful way. Therefore it is interesting to study how the convergence reports have interpreted the criterion. It turns out that the EMI/ECB and the Commission used somewhat different measures regarding the assessment of currency stability. The EMI/ECB convergence reports emphasised exchange rates measured by ten-day moving averages that were close to the ECU/euro central rates without explicitly defining the “close to” criterion. Up to the introduction of the euro, the Commission used the concept of the median ERM currency to take partial account of the wider band. The median currency is defined as the currency with the “median” deviation from its ECU central parity among the participating currencies. This currency was chosen on a daily basis. For a currency to fulfil the exchange rate criterion, its bilateral exchange rate against the median currency’s official bilateral parity should be kept within a fluctuation band of ±2.25%. The use of the median currency allowed a higher degree of flexibility, as bilateral exchange rates between two participating currencies using this approach could deviate by up to ±4.5%, instead of the original ±2.25% in ERM I. The Commission explicitly mentioned that this assessment was not mechanical. Whether larger fluctuations constitute severe tensions depends on their size and duration, and on whether they occur on the weaker or stronger sides of the fluctuation band. As Egert and Kierzenkowski have shown, regardless of the method chosen there have been occasions when currencies which would later be irrevocably fixed traded outside a range close to their central rates. This shows that the final judgement on the fulfilment of the criterion involves a degree of flexibility and discretion. The deviations, however, tended to be limited and temporary and were mainly found at the beginning of the reference period. The primary exceptions to this are Ireland and Greece, whose currencies traded on the stronger side of the central rates. Furthermore, both countries revalued their currencies. This illustrates the asymmetric nature of the exchange rate criterion, which is more lenient towards revaluation (on which the criterion remains silent) and appreciation than towards devaluation or depreciation. The underlying economic rationale for this differentiation is that revaluations or appreciations are not viewed as dangerous for price stability and do not adversely affect the competitiveness of other Member States.

In accordance with the principle of equal treatment, future assessments of the exchange rate criterion will follow the same approach. The Informal ECOFIN Meeting in Athens stated that the assessment of exchange rate stability against
the euro for the new Member States will focus on their exchange rates being close to the central rate, while also taking into account factors that may have led to an appreciation, in line with past policy.  

7 THE NEW EU MEMBER STATES

Ten countries joined the EU on 1 May 2004, namely the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia. Upon entering the EU, the new Member States also became members of EMU as “Member States with a derogation”. The new Member States have all expressed their intention to adopt the euro as soon as possible, probably before the end of the decade. The next step in this monetary integration is participation in ERM II. With effect from 28 June 2004, Estonia, Lithuania and Slovenia joined ERM II, joining Denmark, which had been a member of ERM II since it began on 1 January 1999 (and the sole participant in ERM II between 1 January 2001, when Greece joined the euro area, and 28 June 2004). Subsequently, Cyprus, Latvia and Malta joined ERM II with effect from 2 May 2005, bringing the number of participating countries to seven.

All new countries were smoothly admitted into ERM II with the standard fluctuation band of ±15%. It was mutually agreed that Estonia and Lithuania would join the mechanism with an unchanged central parity against the euro as the central ERM II parity. The two countries would also continue their currency board arrangements as unilateral commitments, thus placing no additional obligations on the ECB. In the case of Slovenia, it was agreed that the market exchange rate of the Slovenian tolar against the euro on Friday 25 June 2004 would be chosen as the central rate. Cyprus and Latvia joined with an unchanged central parity against the euro as the central ERM II parity. The Latvian authorities have declared that they will unilaterally maintain the exchange rate of the Latvia lats against euro at the central rate with a fluctuation band of ±1%. Upon entry to ERM II the Maltese lira was re-pegged to the euro from a basket of currencies including the euro, the pound sterling and the US dollar. The market rate of the Maltese lira against euro on Friday 29 April 2005 was chosen as the central rate. The Maltese authorities have declared that they will unilaterally maintain the exchange rate of the lira at the central rate. When the new countries joined ERM II, all six of them took upon themselves policy commitments regarding fiscal policies and structural reforms as detailed in the communiqués on ERM II participation. This represents something new compared to the communiqué on the entry of Denmark and Greece to ERM II.

In the period of less than a year that Estonia, Lithuania and Slovenia have been members of ERM II, the fluctuations of the nominal exchange rates inside the

19 Informal ECOFIN document on “Accession Countries and the ERM II” of 5 April 2003.
21 Denmark has entered into an agreement with a narrower fluctuation band of ±2.25%.
fluctuation bands have been very limited in Slovenia, while the nominal exchange rates of Estonia and Lithuania have not diverged from their respective central rates due to these countries’ unilateral commitment to a currency board arrangement. The period of time that Cyprus, Latvia and Malta have been members of ERM II is too short to make conclusions regarding the exchange rate behaviour.

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CONFIDENTIALITY OF CENTRAL BANK DOCUMENTATION: LEGAL PROFESSIONAL PRIVILEGE IN THE UK

John Heath

ABSTRACT

Issues surrounding confidentiality are part of the daily fare of a central bank lawyer. Central banks handle vast amounts of sensitive information. Duties of confidentiality derive from a myriad of national, Community and foreign law sources, many of which may overlap. There is an equally impressive array of countervailing provisions which may require or permit disclosure. Add to that an increasingly diverse range of provisions, covering such matters as data protection, copyright and human rights, which may also impact on the legal status of information. The legal environment itself is forever changing, triggered in part by developments in information technology and calls for greater transparency within the public sector and for more extensive information-sharing regimes.

This article examines one particular aspect of confidentiality – legal advice provided to central banks – in the light of recent UK and EC developments. It focuses on the House of Lords *Three Rivers* judgment of November 2004 on legal advice privilege, which considered the circumstances in which legal advice provided to the Bank of England was protected from disclosure in litigation and what actually constituted legal advice for this purpose. It also considers how the UK Freedom of Information Act 2000 (FOIA), which came into force in January 2005 and provides a general right of access to information held by public authorities, deals specifically with legal advice. The article goes on to explore, somewhat more tentatively, whether the judgment and the FOIA may be instructive in the ESCB framework more generally, particularly in the light of legal risk management, litigation and public access issues. It considers the ECB Decision of March 2004 (2004/3) on public access to ECB documents and the judgment of the Court of First Instance of November 2004 in *Turco v Council of the European Union*, focusing on the legal advice exceptions. The article is a short excursion into one small corner of a complex landscape, rather than an encyclopaedic review of the law of confidentiality or the law relating to legal professional privilege.

**THREE RIVERS DISTRICT COUNCIL VERSUS BANK OF ENGLAND – HOUSE OF LORDS JUDGMENT – NOVEMBER 2004**

Following the collapse of the Bank of Credit and Commerce International (BCCI) in 1991 an independent inquiry into the supervision of BCCI was conducted under the chairmanship of Lord Justice Bingham. The Inquiry reported in October 1992. The Bank of England was assisted by external lawyers in the preparation and presentation of the Bank’s evidence and submissions to the Inquiry.

In subsequent litigation between the liquidators of BCCI and the Bank of England, the liquidators sought disclosure by the Bank of a large number of documents relating to the Inquiry, which the Bank claimed were covered by legal advice privilege and did not therefore need to be disclosed.¹ The matter came

¹ Under English law there are two main types of legal professional privilege: litigation privilege covers communications that come into being after litigation is in reasonable prospect or is pending (including communications between the lawyer and his client and the lawyer or client and third parties eg an expert witness); and legal advice privilege which is considered below.
before the Court of Appeal, twice, which held in 2003 and 2004 that legal advice privilege only covered material constituting or recording communications between clients and lawyers seeking or giving advice about the clients’ legal rights and obligations and that legal advice sought or given for presentational purposes (even to an inquiry) was not protected from disclosure.2

The Bank of England appealed to the House of Lords. In its judgment of 11 November 2004, all five Law Lords (Lords Scott, Brown, Rodger, Carswell and Baroness Hale) unanimously rejected the Court of Appeal’s approach and re-established the fundamental position of legal advice privilege in English law and the right to obtain legal advice in confidence.3 The judgment confirmed that legal advice necessarily goes wider than just advising on rights and obligations and could include advice on presentational matters provided in a relevant legal context.

In addressing the issue, the Lords considered the basic policy underlying legal advice privilege. They acknowledged that there are many relationships, where the common law recognises the confidentiality of communications (eg doctor/patient, accountant/client), but where nevertheless there may be strong public interest or administration of justice reasons why such material may need to be disclosed when relevant to issues in subsequent litigation. In contrast, once a communication or document between a lawyer and the client qualifies for legal advice privilege, the privilege can be waived by the client and it can be overridden by statute, but it is otherwise absolute.

The Lords accepted that there was a long series of authorities which supported this special protection for communications between lawyers and their clients. For example, in R v Derby Magistrates, ex parte B [1996] AC 487 Lord Nicholls at 510 said: “The law has been established for at least 150 years, since the time of Lord Brougham LC in 1833 in Greenough v Gaskell 1 M & K 98: subject to recognised exceptions, communications seeking professional legal advice, whether or not in connection with pending court proceedings, are absolutely and permanently privileged from disclosure even though, in consequence, the communications will not be available in court proceedings in which they might be important evidence.” In the same case Lord Taylor CJ at 507 et seq said: “In Balabel v Air India [1988] Ch. 317 the basic principle justifying legal professional privilege was again said to be that a client should be able to obtain legal advice in confidence. The principle which runs through all these cases … is that a man must be able to consult his lawyer in confidence, since otherwise he might hold back half the truth. The client must be sure that what he tells his lawyer in confidence will never be revealed without his consent” and that “… once any exception to the general rule is allowed, the client’s confidence is necessarily lost” (pp 507 and 508). In R (Morgan Grenfell Ltd) v Special Commissioner of Income Tax [2003] 1 AC 563 Lord Hoffmann described legal professional privilege as “a fundamental human right” and continued (p.607) that “such advice cannot be

effectively obtained unless the client is able to put all the facts before the adviser without fear that they may afterwards be disclosed and used to his prejudice.”

The Lords accepted that there was well established jurisprudence supporting legal professional privilege in foreign jurisdictions and at an EC level. The judgment records the comments of Advocate-General Slyn (as he then was), who considered the justification for legal professional privilege in *A M & S Europe Ltd v European Commission* [1983] QB 878 at 913: “[The privilege] springs essentially from the basic need of a man in a civilised society to be able to turn to his lawyer for advice and help, and if proceedings begin, for representation; it springs no less from the advantages to a society which evolves complex law reaching into all the business affairs of persons, real and legal, that they should be able to know what they can do under the law, what is forbidden, where they must tread circumspectly, where they run risks.”

Lord Scott observed that the cases had in common the idea that, in a society in which the restraining and controlling framework is built upon a belief in the rule of law, communications between clients and lawyers should be secure against the possibility of scrutiny from others. Baroness Hale added that it was in the interests of the whole community that lawyers give their clients sound advice, accurate as to the law and sensible as to their conduct and that there was little or no chance of the client taking the right or sensible course if the lawyer’s advice was inaccurate or unsound because the lawyer had been given an incomplete or inaccurate picture of the client’s position. In similar vein Lord Rodger noted that the public interest justification for legal professional privilege was the same today as it was 350 years ago: if the advice given by lawyers is to be sound, their clients must make them aware of all the relevant circumstances of the problem. Clients would be reluctant to do so unless they could be sure that what they said about any potentially damaging or embarrassing circumstances would not be revealed later.

The Lords went on to consider the kind of communications and documents covered by legal advice privilege and referred approvingly to the Court of Appeal decision in *Balabel v Air India* [1988] 1 Ch 317, where Taylor LJ said said at page 330: “Privilege obviously attaches to a document conveying legal advice from solicitor to client and to a specific request from the client for such advice. But it does not follow that all other communications between them lack privilege. In most solicitor and client relationships, especially where a transaction involves

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4 Although not cited expressly by the House of Lords, the European Court of Human Rights has upheld the principle that a “person who wishes to consult a lawyer should be free to do so under conditions which favour full and uninhibited discussion” is protected by Art 6 where litigation is contemplated and Art 8 where it is not – see *Campbell v United Kingdom* 15 EHRR 137, 160-1 (1992) paras 46,48.

5 For example in *Upjohn Co. v United States* (1981) 449 US 383, a decision of the US Supreme Court, Justice Rehnquist said, at p.389, that the purpose of legal professional privilege was “… to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice…The privilege recognises that sound legal advice or advocacy serves public ends and that such advice or advocacy depends upon the lawyer being fully informed by the client.” Similarly, in *Jones v Smith* [1999] 1 SCR 455, a decision of the Supreme Court of Canada, privilege was justified on the ground that “Clients seeking advice must be able to speak freely to their lawyers secure in the knowledge that what they say will not be divulged without their consent. …. The privilege is essential if sound legal advice is to be given … Without this privilege clients could never be candid and furnish all the relevant information that must be provided to lawyers if they are to properly advise their clients*.
protracted dealings, advice may be required or appropriate on matters great or
small at various stages. There will be a continuum of communication and
meetings between the solicitor and client. ... Moreover, legal advice is not
confined to telling the client the law; it must include advice as to what should
prudently and sensibly be done in the relevant legal context.”

The concept of the relevant legal context is key to understanding legal advice
privilege. In the case in question the “relevant legal context” was the Bingham
Inquiry and whether the Bank had properly discharged its public law duties under
the Banking Acts. The Lords saw no reason why presentational advice sought
from lawyers to parties in such an Inquiry should not also be privileged. When
the Bank of England consulted external lawyers about the presentation of their
evidence to the Bingham Inquiry Unit, Lord Rodger considered it was asking
them to put on legal spectacles when reading, considering and commenting on
the drafts. It was seeking their comments and assistance as lawyers, how the
Bank’s evidence could be most effectively presented to the Inquiry. Legal advice
privilege applied therefore to those communications. The Lords considered a
wide range of other scenarios (ie besides inquiries) where lawyers provide advice
and assistance, which would qualify for legal advice privilege, even where the
lawyer’s role is essentially presentational in character.

The judgment re-established the fundamental position of legal advice privilege
in English law and the right to obtain legal advice in confidence. Will it be the
last word on the subject? Probably not. The Lords recognised that there may
occasionally be marginal cases where it is not always clear whether legal advice
privilege covers all documents passing between clients and their lawyers. In such
cases the courts may from time to time have to decide whether the seeking of
advice from lawyers has a relevant legal context and whether it was reasonable
for the client to consult the special professional knowledge and skills of a lawyer.
Furthermore, the judgment only concerned legal advice privilege (not litigation
privilege) and left open the question who precisely is the client (in the case of
a company, partnership or public body) for legal advice privilege purposes.

**FREEDOM OF INFORMATION ACT 2000**

Legal professional privilege is first and foremost a rule of evidence in litigation.
However, the concept surfaces in other contexts, notably legislation, which need
to be interpreted consistently with the House of Lords judgment. One particular
example is the Freedom of Information Act 2000 (the “FOIA”) which came into
force in the UK on 1 January 2005.6

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6 In Scotland the Freedom of Information (Scotland) Act 2002 applies, which also came fully into force on
1 January 2005.
The FOIA provides a general right of access to information held by public authorities in the UK. Information for this purpose means recorded information held by the public authority (it is not a right to documents as such). The general right of access is subject to certain procedural requirements, cost-compliance limits and various exemptions in sections 21 to 44 of the FOIA. Some of the exemptions (including legal professional privilege and law enforcement) are “qualified” in that the public authority must first decide whether the exemption applies to all or part of the information requested. If so, it must then consider whether the public interest in maintaining the exemption outweighs the public interest in disclosing the information. The other exemptions (including information provided in confidence to the authority and court records) are “absolute” in that there is no supplementary public interest test. In practice, many of the exemptions in the FOIA are likely to overlap. The Information Commissioner (IC) and the Department for Constitutional Affairs (DCA) have both issued detailed guidance on the scope of the exemptions and the related public interest test.

The legal professional privilege exemption in section 42(1) FOIA covers “information, in respect of which a claim to legal professional privilege…could be maintained in legal proceedings”. Accordingly, issues of legal advice privilege (being one type of legal professional privilege) would need to be assessed against prevailing case law (including the House of Lords judgment of last November). In an FOIA context, there is then a separate public interest assessment. The DCA guidance on legal professional privilege is particularly interesting as to the kind of factors that may be relevant when balancing the public interest considerations:

- The public interest arguments that may weigh in favour of disclosure might include: circumstances where the Government would waive its privilege if litigation were afoot; the public interest in public authorities being accountable for the quality of their decision making; ensuring that decisions have been made on the basis of good quality legal advice as part of that process. The weight to be attached to these public interest factors will differ according to the case in question. Given the very substantial public interest in maintaining the confidentiality of material protected by legal professional privilege, the guidance concludes that the public interest is only likely to come down in favour of disclosure in “exceptional circumstances”.

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7 There are over 100,000 such authorities in the UK, including for example Government Departments, schools and many general medical practitioners. The Bank of England is one such authority but is in a special position since information held by the Bank with respect to certain of its functions (monetary policy, lender of last resort and its private banking and related business) is not subject to the FOIA at all.

8 “Qualified” exemptions include in summary: (s 22) information intended for future publication; (s 24) certain matters relating to national security; (s 26) defence; (s 27) international relations; (s 28) relations within the United Kingdom; (s 29) the economy; (s 30) investigations and proceedings conducted by a public authority; (s 31) law enforcement; (s 33) audit functions; (s 35) formulation of government policy; (s 36) prejudice to the effective conduct of public affairs; (s 37) health and safety; (s 38) environmental information; (s 40) some personal information; (s 42) legal professional privilege; and (s 43) commercial interests.

9 “Absolute” exemptions include in summary: (s 21) information accessible to the applicant by other means; (s 23) information supplied by or relating to the security services; (s 32) information relating to court records; (s 40) certain personal information; (s 41) information provided in confidence to the public authority; and (s 44) information prohibited from disclosure (e.g. by statute or Community law obligations).

10 The Information Commissioner is responsible for promoting observance by public authorities of the requirements of the FOIA. The Commissioner has various review and enforcement powers under the FOIA. The Department for Constitutional Affairs is the lead Government Department responsible for freedom of information.
The public interest arguments which may argue against disclosure might include: the need to ensure that a client can obtain legal advice in confidence and the adverse consequences of less than adequate disclosure by the client; the need to ensure that decisions taken by Government are taken in a fully informed legal context with a full appreciation of the facts; the importance of the lawyer being able to present the full picture to his/her client, including arguments for and against (and perceived weaknesses of) his/her final conclusions; a recognition that disclosure of legal advice may unfairly exposing the authority’s legal position to challenge; the risk that lawyers and clients will avoid making a permanent record of the legal advice that is given (or make only a partial record) and the associated risk, as policy develops or litigation decisions are made, of being unable to refer back to advice given along the way. There may even be a reluctance to seek advice at all, resulting in decisions that are legally flawed and attracting successful legal challenges which could otherwise have been avoided; and a recognition that legal advice given in one context may be helpful or relevant to subsequent issues. Disclosure by reference to particular facts might thus prejudice future legal interests in other contexts.

The DCA guidance also considers the situation where parties to actual or prospective litigation might argue for disclosure of the legal advice provided to Government departments concerning the interpretation of legislation on the grounds that there is a public interest in knowing the perceived strength of the case against the department and the legal basis on which the department had decided to defend the case. The guidance notes the countervailing public interest arguments (eg the department’s right to consult its lawyers on a confidential basis, the importance of the department having access to thorough and candid legal advice and in not being considerably disadvantaged in the conduct of its litigation) and concludes that, unless there are exceptional circumstances, such advice would not normally be disclosed.

POSSIBLE IMPLICATIONS AND LESSONS FOR THE ESCB?

Are the House of Lords judgment and the FOIA and related guidance instructive in the ESCB context more generally? The judgment concerns procedural matters of English law and the FOIA applies to public authorities in the UK, so they may not at first sight score very highly on the search engine “relevance” indicator. But, if the uniquely English law aspects of the judgment and the FOIA are put to one side, there may be rather more common ground. Three particular areas come to mind – legal risk management, litigation/investigations and public access legislation – where it is tentatively suggested that they may serve as useful sources of comparative approach in their own right and may highlight considerations which may be relevant in other jurisdictions.

LEGAL RISK

Central banks need sound legal advice and assistance. This goes to the heart of how central banks manage legal risk. In order to provide such advice and
assistance, central banks need to be able to discuss matters freely and frankly with their lawyers (in-house or external), who in turn need to be aware of all relevant circumstances and need to be able to convey the full picture to the client, including any weaknesses. The House of Lords judgment highlights the importance in this respect (in the UK context at least) of clients being able to obtain legal advice on a confidential basis and lays down some parameters as to what may constitute legal advice for this purpose.

Are these relevant considerations for central banks in other jurisdictions? Principles of confidentiality and professional secrecy are of course well-embedded at a national and EC level. At an ESCB/Eurosystem level, for example, various confidentiality provisions may be relevant (eg Art 38 of the ESCB Statute and the ECB Rules of Procedure of February 2004 and the General Council Rules of Procedure of June 04).\(^\text{11}\) It might nevertheless be worth considering whether national law, EC law, other provisions (eg European Convention on Human Rights) and/or local professional rules provide adequate safeguards regarding lawyer/client communications, whether there are any limitations to such safeguards (eg depending on who holds the material) and whether it is clear to whom advice and assistance is being provided.

**LITIGATION/INVESTIGATIONS**

The status of legal advice provided to central banks might also be relevant in litigation involving central banks (directly or as third parties) or investigations (eg by the European Anti-Fraud Office – OLAF). Various factors may be relevant in this respect. For example, in contrast to the position in many Civil law jurisdictions, in the UK there is a general and wide duty on a party involved in litigation to disclose to the other party documents and material relevant to the dispute, including any documents which may adversely affect his case. On the other hand, *in-house lawyers* under English law have the same status as external lawyers on matters of legal professional privilege, whereas this would not appear to be the case in all EU jurisdictions.

The position of *in-house lawyers* under EC law is still developing. The general principle of privileged lawyer/client communications was recognised in 1982 in *AM&S Europe Ltd v European Commission*, when the ECJ held that such communications in EC competition proceedings would be protected, but only if the communication was for the client’s “right of defence” and the lawyer was in private practice (ie not an in-house lawyer).\(^\text{12}\) That position may perhaps change. In an interim decision of the Court of First Instance in October 2003 in *Akzo Nobel Chemicals v Commission* (another competition-related case), the President of the CFI acknowledged that the question whether communications involving *in-house lawyers* should also benefit from legal professional privilege now merited “very special attention”, particularly since the *AM&S* decision was “based...on an interpretation of the principles common to the

11 ECB Decision of 19 February 2004 (ECB/2004/2) and ECB Decision of 17 June 2004 (ECB/2004/12) respectively.
12 Case 155/79. 1982 ECR 1575.
Member States dating from 1982’. The President went on to say that the evidence “tends to show that increasingly in the legal orders of the Member States and possibly, as a consequence, in the Community legal order, there is no presumption that the link of employment between a lawyer and an undertaking will always, and as a matter of principle, affect the independence necessary for the effective exercise of the role of collaborating in the administration of justice by the courts if, in addition, the lawyer is bound by strict rules of professional conduct, which where necessary require that he observe the particular duties commensurate with his status”. Although a subsequent ECJ ruling of 27 September 2004 overruled the CFI’s interim order, a ruling from the CFI on the main case is still awaited.

The importance of legal privilege in relation to investigations is reflected in the ECB’s Decision of 3 June 2004 (ECB/2004/11) concerning the terms and conditions for European Anti-Fraud investigations of the ECB. Recital (4) of the Decision notes that internal investigations by OLAF are subject, inter alia, to “Article 6(2) of the Treaty on European Union [this refers to the European Convention on Human Rights] and to other principles and fundamental rights common to the Member States and recognised by the Court of Justice, such as, for instance, the confidentiality of legal advice (legal privilege).”

PUBLIC ACCESS LEGISLATION

Public access legislation exists, or is currently under consideration, in a number of EU Member States. Such legislation (as with the FOIA) typically provides a general right of access to information or documents subject to certain procedural requirements and exemptions/exceptions. The ECB has itself recently adopted a Decision on public access to ECB documents. Where such acts are qualified in relation to legal advice or legal professional privilege, the kind of issues raised in the House of Lords judgment and the FOIA guidance may be of interest.

The ECB Decision confers a general right of access to ECB documents. It is aimed primarily (though not exclusively) at documents held by the ECB. The right of access is subject to certain procedural requirements and exceptions.

13 Joined cases T-125/03 and T-253/03 of 30 October 2003.
14 C-7/04 P (R).
16 ECB/2004/3 of 4 March 2004 on public access to ECB documents. The Decision was adopted pursuant to Art 12.3 of the ESCB/ECB Statute and the ECB Rules of Procedure of 19 February 2004 (ECB/2004/2) and repealed the earlier ECB Decision on public access to ECB documents of 3 November 1998 (ECB/1998/12). The Decision was adopted in line with the Joint Declaration of the European Parliament, the Council and the Commission of 30 May 2001 calling on the other institutions and bodies of the Union to adopt internal rules on public access to documents which take account of the principles and limits set out in Regulation (EC) 1049/2001 regarding public access to European Parliament, Council and Commission documents.
17 An ‘ECB document’ means any content whatever its medium drawn up or held by the ECB (thus including documents received by the ECB from third parties) and relating to its policies, activities or decisions, as well as documents originating from the European Monetary Institute and from the Committee of Governors of the central banks of the Member States of the European Economic Community.
18 Art 5 provides that national central banks may only disclose documents drawn up by the ECB (or documents from the European Monetary Institute or Committee of Governors) following prior consultation with the ECB (unless it is clear that the document shall/shall not be disclosed).
listed in Art 4 of the Decision. One of the exceptions covers court proceedings and legal advice (Art 4(2): “where disclosure would undermine the protection of … court proceedings and legal advice,… unless there is an overriding public interest in disclosure”). As with the FOIA legal professional privilege exemption, the Art 4(2) exception is subject to a public interest override and may overlap with one or more of the other exceptions. The ECB Decision is largely modelled on Regulation (EC) 1049/2001 of the European Parliament and of the Council of 30 May 2001 regarding public access to European Parliament, Council and Commission documents (OJ L 145, 31.5.2001, p 43). The court proceedings and legal advice exception in Art 4(2) of the ECB Decision is effectively the same as that in Art 4(2) of Regulation 1049/2001.

This latter provision was recently assessed by the Court of First Instance in Turco v Council of the European Union (Case T-84/03 of 23 November 2004). The case concerned a public access request to the Council for a Council Legal Service opinion on a proposed Council Directive, to which the Council had refused access on the grounds of the Art 4(2) legal advice exception. The Court rejected the applicant’s submission that the court proceedings and legal advice exception in Art 4(2) only covered legal advice drawn up in the context of actual or prospective legal proceedings and did not cover legal advice relating to legislative proposals (paras 53-67). The Court noted that legal advice drawn up in the context of court proceedings is already covered by the court proceedings exception (see eg Interporc v Commission, Case T-92/98 [1999] ECR II-3521) and that the express reference to “legal advice” in Art 4(2) therefore has a distinct meaning from the court proceedings exception. The Court acknowledged that the Council had to consider specifically whether “disclosure of the legal opinion would undermine the protection to which that type of document may be entitled” (ie simply because the document was a legal opinion was not enough in itself to justify application of the exception), but nevertheless concluded that the legal opinion was indeed “legal advice” and that it was entirely compatible with the Regulation for the Council to withhold the whole of the opinion (paras 69-74). The Court also accepted that the independence of legal opinions of the Council Legal Service constitutes an interest to be protected and that the applicant failed to explain how disclosure

19 Art 4(1) provide that the ECB shall refuse access to a document where disclosure would undermine the protection of: (a) the public interest as regards: the confidentiality of the proceedings of the ECB’s decision-making bodies; the financial, monetary or economic policy of the Community or a Member State; the internal finances of the ECB or of the NCBs; protecting the integrity of euro banknotes; public security; international financial, monetary or economic relations; (b) the privacy and the integrity of the individual…; and (c) the confidentiality of information that is protected as such under Community law. In addition to the court proceedings and legal advice exception (commented on in the main text), Art 4(2) provides that the ECB shall refuse access where disclosure would undermine the protection of the commercial interests of a natural or legal person (including intellectual property) or the purpose of inspections, investigations and audits unless there is an overriding public interest in disclosure.


21 The Court, drawing on the Interporc judgment, noted (para 63) that the term court proceedings within the meaning of Decision 94/90 covered not only pleadings and other documents lodged and internal documents concerning the investigation of the case before the Court, but also correspondence concerning the case between the directorate-general concerned and the legal service or a lawyer’s practice. NB the Interporc judgment goes on to make clear (para 45) that the court proceedings exception would not cover “documents drawn up in connection with a purely administrative matter”.

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of the legal opinion in question would help to protect the Council’s Legal Service from improper external influences (para 79).

As regards the public interest override in Art 4(2), the Court also rejected the applicant’s arguments that the Council had not examined whether there was such an interest and that the principles of transparency, openness and of democracy or of the participation of citizens in the decision-making process, are overriding public interests which warrant the disclosure of the legal opinion (paras 81–85). In the Court’s view these principles were implemented by Regulation No 1049/2001 as a whole; the overriding public interest in Art 4(2) was, as a rule, distinct from the general principles underlying the Regulation. Moreover, although the institution may itself identify an overriding public interest, it was for the applicant to invoke such an interest in his application so as to invite the institution to give a decision on that point. Since the Council did not make an error of assessment in its finding on the overriding public interests invoked by the applicant, the Court concluded that the Council could not be criticised for not having identified other overriding public interests.

The *Turco* case provides an interesting and up-to-date insight into the Court’s approach to Community public access legislation. It may prove to be equally relevant when applying the parallel legal advice exception and the related public interest assessment in the ECB Decision 2004/3.\(^{22}\)

**CONCLUSION**

This article has focused on legal advice provided to central banks in the light of recent UK and EC developments. The *Three Rivers* case – published two weeks before *Turco* – highlights the importance of clients being able to obtain legal advice on a confidential basis and provides some parameters as to what may constitute legal advice for this purpose. This raises a broad range of associated issues, including the manner in which central banks manage legal risk. The UK FOIA and the ECB Decision 2004/3 both provide mechanisms for protecting legal advice provided to central banks; the related FOIA guidance and the *Turco* case suggest a broad similarity in the range of considerations that may need to be taken into account in applying the legal advice exception/exemption. In turn, this draws on Community and national jurisprudence on legal professional privilege. Looking ahead, it might reasonably be expected: first, that there will be further developments in the legal environment at a national and Community level concerning matters in the field of legal professional privilege, confidentiality and information issues more generally (driven by various legal, political and technological considerations); second, that there will be increasing overlap and convergence between Community and national instruments, laws and jurisprudence in this field; and third that central bank lawyers will remain busy in this field in the coming months and years.

\(^{22}\) The applicant has since filed an appeal against the judgement of 23 November 2004 (Case C-52/05 P-OS C 106, 30.04.2005, p.14).
THE EUROSYSTEM
ABSTRACT

L’Eurosistema è composto dalla Banca Centrale Europea (BCE) e dalle Banche Centrali Nazionali (BCN) degli Stati membri la cui valuta è l’euro. Dall’introduzione dell’euro nel 1999, il termine “Eurosistema” è stato diffusamente utilizzato, soprattutto nelle pubblicazioni delle banche centrali. Il Trattato di Maastricht ha introdotto il concetto del tutto innovativo del Sistema Europeo di Banche Centrali (SEBC), concetto che però rimane ambiguo perché non fa distinzione tra il SEBC nella sua composizione più ampia, che comprende le BCN di tutti gli Stati membri, e il SEBC nella sua composizione di Eurosistema, che agisce come vera e propria banca centrale per l’euro. La Costituzione firmata nell’ottobre 2004, pur mantenendo il SEBC, introduce e definisce il concetto di Eurosistema. Nel contributo, l’Eurosistema viene presentato come un organismo pubblico europeo unico, organizzato conformemente a due principi generali: il suo carattere federale e la sua indipendenza. Nella seconda parte dello studio, sono riportati alcuni sviluppi giuridici relativamente alle attività dell’Eurosistema negli ultimi sei anni. Il contributo si concentra sulla descrizione della realtà giuridica dell’Eurosistema nei suoi aspetti sia istituzionali sia operativi.
INTRODUCTION

The creation of the European System of Central Banks (ESCB) represents a remarkable institutional innovation of the Maastricht Treaty. However, in contrast to the ESCB, the concept of the Eurosystem is not defined by either the Treaty establishing the European Community (“the Treaty”) or the Statute of the European System of Central Banks and of the European Central Bank (“the Statute”).

The Eurosystem has only existed since January 1999, when the euro was introduced in the new euro area (composed at that time of 11 Member States). The ESCB was created in the previous year (on 1 June 1998), and comprised the European Central Bank (ECB) and one new national central bank1 created on that same day, together with the 14 existing national central banks (NCBs) of the European Union (EU) Member States.

The underlying raison d’être of these two new concepts is derived from the coexistence within the EU of Member States whose currency is the euro, and Member States with a derogation or an exemption, in which the new currency of the Union was not introduced. This imbalance is corrected by the fact that for most purposes in the Statute, the term “national central banks” means the central banks of the euro area Member States; the NCBs of the Member States with a derogation are in principle excluded from Eurosystem operations.

The term “Eurosystem” has been used from the beginning of the third stage of Economic and Monetary Union (EMU) not only in communication documents, but also in many legal acts of the ECB, including its Opinions concerning European and national legal acts.2 The paradox is that the Eurosystem is systematically referred to in official European, especially central banking, publications without a precise legal basis.

The new Constitution for Europe3 formally defines the term Eurosystem as follows:

“The Eurosystem, which comprises the European Central Bank and the national central banks of the Member States whose currency is the euro, is the monetary authority of the euro area.”4

This contribution aims to provide some answers to a number of simple questions. The first general question is to establish whether a system may have a life of

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2 The term was first introduced in the January 1999 ECB Monthly Bulletin.


4 Also defined in the “Eurosystem Mission Statement” of 5 January 2005 adopted by the Governing Council, see the websites of the ECB and the NCBs of the Eurosystem.
its own: is such a system a legal reality, or does it purely exist through its components? If the former is true, what are the specific differences between the Eurosystem and the ESCB in the European monetary legal order, and if the latter is the case, is this new formula merely of a symbolic or cosmetic nature, rather than representing an addition of substance? The goal of this contribution is to present the Eurosystem as an institutional and operational reality.

1 THE EUROSYSTEM AS AN INSTITUTIONAL CONCEPT

1.1 THE EUROSYSTEM AS AN EU BODY

The Treaty\(^5\) defines the ESCB by its tasks, objectives and components, but not by its nature. The ESCB is not formally recognised as an EU institution.\(^6\) As it was established on the basis of Article 108, it is an EU constitutional body.\(^7\) The ESCB has no legal personality; as a public body, a quasi-institution, it has to perform the tasks imposed on it by the Treaty.

An equivalent status should apply to the Eurosystem, which comprises a substantial part of the ESCB.

1.1.1 THE ESCB AND THE EUROSYSTEM

The ESCB concept was agreed during the Intergovernmental Conference (IGC) negotiating the Treaty, but without a clear definition. The desire to introduce some kind of federal dimension to the new monetary power seems to have been the driving force behind this spectacular but mysterious institutional innovation. The ESCB was conceived to avoid the abrupt setting up of a new centralised European bureaucracy, to prevent the devastating social effects of an imposed merger of central banks, and to ensure the decentralisation principle.\(^8\) The ESCB is designed to achieve the “checks and balances”\(^9\) which characterise the institutional framework of the EU.

Both the ESCB and the Eurosystem are systems which, until now, did not correspond to a formal definition in public law. The concept of a “system” may

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5 Article 107 of the Treaty and Article 1.2 of the Statute.
6 Under the new Constitution Article 1-30, the ECB will be ranked among the “other institutions”; the same quality may apply to the Eurosystem itself as far as the ECB together with the NCBs are an integral part of it; the Eurosystem, as the encompassing entity, is considered to be “over” its components.
8 This in itself is not unusual; none of the EU institutions has its own legal personality. It can be assumed that the Eurosystem may engage the EU when acting in its own field of competence. As it has a similar statute to that of the EU institutions, it may engage the legal personality of the Community when acting in the international field; for its operational tasks, the Eurosystem will rely on the legal personality of its components, namely the ECB and the NCBs.
9 The larger NCBs are currently engaged in restructuring plans affecting thousands of jobs. So far the social conditions of the staff of the Eurosystem’s central banks have not been harmonised.
10 See C. C. A. van den Berg’s recently published thesis, The Making of the Statute of the European Central Banks – An Application of Checks and Balances (Amsterdam: Vrije Universiteit Amsterdam, 2004). The concept of a system had previously been proposed by influential authors, see in particular J. V. Louis et al., Vers un système européen de Banques centrales (Brussels: Université de Bruxelles, 1989), but their proposals were more focused on the ECB as the core element of the proposed system; the Committee of Governors and subsequently the IGC preferred to replace the ECB by the ESCB in various provisions. Interestingly, Smits presents the ESCB extensively but under the title The European Central Bank: Institutional Aspects, op. cit.
have been commonplace for a long time in academic discussions on cybernetics or political science, but it has only recently made its appearance in legal texts.\textsuperscript{11} In central banking terminology, this concept is mainly used by economists, as in for instance the notion of a “financial system” as mentioned in various central bank publications; this phrase is used as a broad concept, which includes markets, institutions and infrastructure.

In Community financial law, a system has in the field of payment and securities settlement been defined as “a formal arrangement […] governed by the law […]”\textsuperscript{12}. Such arrangements not only cover technical operating systems, but also include regulatory provisions.

The political intention to set up a system was clear, but the legal clarification remained ambiguous.\textsuperscript{13} Legal experts of the former Committee of Governors noted in 1991 that: “the term ‘system’ should thus be understood to describe the existence of the ECB and the national central banks as integral parts of the system, governed by a common set of rules and committed to the objectives of and tasks assigned to it.”

The system cannot be limited to the sum of its components. It has its own existence and its own functioning which have enabled it to assume its role and set up its organisation. The system not only ensures the coexistence and coordination of the different entities which are part of it; it is also a system of action with common rules, rights and duties for its members, which have legal personality.

\textbf{1.1.2 THE EUROSYSTEM IN THE CONSTITUTION}

Article I-30 of the Treaty establishing a Constitution for Europe\textsuperscript{14} defines the Eurosystem in the following terms:

“The European Central Bank, together with the national central banks of the Member States whose currency is the euro, which constitute the Eurosystem, shall conduct the monetary policy”.

This is one of the few drafting changes in the monetary provisions of the Treaty. It was introduced by the IGC at the initiative of the ECB in its formal Opinion.\textsuperscript{15} The Opinion states that:

\begin{enumerate}
\item The success of the European Monetary System (EMS) since 1979 may have contributed to the positive acceptance of the concept. It would be misleading to consider that the US Federal Reserve System was the envisaged model; the drafters of the Statute focused their attention on a basic uniform model provided in Europe by what appeared at the time to be the most successful central banks. Paradoxically, the central bank is a centralised institution in all the EU Member States.
\item The Delors Report states that “Considering the political structure of the Community and the advantages of making existing central banks part of a new system, the […] monetary policy-making of the Community should be organised in a federal form in (the) ESCB. This new System would have to be given the full status of an autonomous Community institution” (“Report on Economic and Monetary Union in the European Community”, presented by the Committee for the study of economic and monetary union, under the direction of Jacques Delors, President of the European Commission, approved by the European Council in June 1989).
\end{enumerate}
“Under the acronym ‘ESCB’ two realities coexist. On the one hand, ESCB refers to the ECB and the NCBs of all the EU Member States. On the other hand, and by the effect of other provisions, ‘ESCB’ also refers to the ECB and the central banks of only those EU Member States which have adopted the euro. This second concept is different from the first, since it embodies the exclusive competence for defining and conducting monetary policy, including the issue and the overall management of the euro, the management of the official foreign reserves of the Member States that have adopted the euro, and promoting the smooth operation of payment systems. The actions required to implement this competence require a high degree of harmonisation of procedures, instruments and infrastructure, and a single decision-making body with regulatory capacity.

The EU Treaty has created these two realities by introducing in the EC Treaty and in the Statute a single concept without distinguishing which provisions apply to one composition or to the other. This legislative technique does not serve the aim of clarity and comprehension of the EC Treaty. In order to distinguish the second concept of “ESCB”, the Governing Council adopted and has been using since 1998 the term “Eurosystem” in its communications with the public. With a view to simplifying and making the Constitution more accessible for European citizens and, in so doing, to bringing the Union’s institutional framework closer to the general public, the ECB suggested that the historic reform that the draft Constitution represents would represent a suitable opportunity to introduce the term “Eurosystem” into the Constitution”.

The Constitution will also formally introduce the euro into primary law, definitively replacing the former denomination of the European Currency Unit, or ECU. It qualifies the euro as the “currency of the Union” (Article I-8), and provides that “European laws or framework laws shall lay down the measures necessary for the use of the euro as the single currency” (Article III-191).

Beyond its symbolic value (Article I-8), the euro is the key element of the EU monetary policy, and is listed as an exclusive Union competence for those Member States whose currency is the euro (Article I-13); it is established as the anchor of EMU (Article III-194). The concept of the “euro area” is only informally introduced in the Constitution via the expressions “the Member States whose currency is the euro” and the “participating Member States” (Articles I-13 and III-194). In so doing, the Constitution consecrates the already widely used concept of the Eurosystem.

However, the ambiguity of the Maastricht Treaty will not disappear with the entry into force of the Constitution, which does not clarify the status of the ESCB. If it recognises the Eurosystem as a distinct body, it does not make clear its concrete content vis-à-vis the ESCB, the ECB or the NCBs. No clarification is to be found in the ESCB/ECB Statute. The IGC has considered it inappropriate
to adapt systematically the provisions of the Statute to indicate where the ESCB has to be read as the Eurosystem. In so doing, it follows the Opinion of the ECB.  

In Protocol No 4, annexed to the Constitution, Article 1 (1) has been redrafted in order to define the ESCB in the first sentence and the Eurosystem in the second, in accordance with Article I-30 of the Constitution. The Constitution will also confer a constitutional value on the Eurogroup. The Eurosystem shall be associated with the Eurogroup, but the relationship between the Eurogroup and the EU Council of Ministers of Economic Affairs and Finance (ECOFIN) is different from that between the Eurosystem and the ESCB. The Eurogroup remains basically an informal meeting that does not interfere in the competence of the formal Council, ECOFIN, while the Eurosystem is the core of the ESCB. The General Council only contributes to the tasks of the Governing Council, which is the supreme decision-making body of the whole ESCB.

1.2 THE CHARACTERISTICS OF THE EUROSYSTEM

The Eurosystem combines the two basic characteristics of the monetary authority of the European Union; by its nature, its composition and its functions, it is federal and independent in a specific way, as this paper will later demonstrate.

1.2.1 THE FEDERAL PRINCIPLE

Monetary policy is an exclusive competence of the Union. It is not however administered according to the classical model for most European policies, the well-known principle of indirect administration. Instead, it is operated directly throughout the entire euro area, with the participation of the NCBs forming an integral part of the Eurosystem.

The relationship within the ESCB/Eurosystem between the ECB and the NCBs should in no way be compared to the situation of the other EU institutions vis-à-vis corresponding national bodies. The relationship between the European Parliament and the national parliaments, the Council of the EU and the national governments or the European Court of Auditors and the national courts of auditors are very different from the relations between Eurosystem members.

Furthermore, it would be wrong to consider that on the one hand EU institutions are only subject to EU law, whereas on the other hand NCBs are only subject to national law. The legal order of the EU is unique. It combines European rules, which are directly applicable and enjoy primacy, with national regulations. Both

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18 Paragraph 14 of the ECB Opinion of 19 September 2003, last sentence, reads: “This terminological change will require a general provision indicating that ‘ESCB’ is to be read as ‘Eurosystem’ in those provisions of the Constitution that refer to tasks or functions related to the euro or to the Member States that have adopted the euro.”

19 Article 1 “The European System of Central Banks” (title unchanged) states: “1. In accordance with Article I-30 (1) of the Constitution, the European Central Bank and the national central banks of those Member States whose currency is the euro shall constitute the Eurosystem.”

20 In anticipation of the Constitution, a chairman for the Eurogroup has already been appointed for two years from 1 January 2005; the President of the ECB is invited to Eurogroup meetings, where it may be assumed that he then acts on behalf of the whole Eurosystem.
the ECB and the NCBs have to comply with a mixed set of rules, at both European and national level.\textsuperscript{21}

The coexistence of 13 legal personalities inside the system is an element of heterogeneity together with the autonomy of management and action that is left to the discretion of each central bank, either at the centre or on the periphery. Basically the Eurosystem, governed by centralised decision-making bodies and acting as a single entity, assumes public tasks of general interest. The Eurosystem was not conceived as a group of commercial undertakings subject to competition law.\textsuperscript{22} The rules of company law find no specific application. The ECB’s shareholders’ rights are not to be compared with those of shareholders in limited companies: there is no right of appointment to the Executive Board, no right to withdraw or to change the Statute. The Eurosystem is basically a concept of public law, but it can be adapted to private obligations through legal mechanisms such as co-ownership or solidarity.

The Eurosystem is unique, a sui generis institution created by the Treaty, but leaving a considerable degree of latitude for internal organisation and regulation to its decision-making bodies. In accordance with Article 107 (3), it “shall be governed by the decision-making bodies of the ECB which shall be the Governing Council and the Executive Board.” In consequence, these decision-making bodies have a dual role, acting for the ECB as a legal entity but also competent vis-à-vis the whole Eurosystem (and the ESCB).

The Eurosystem has one supreme authority, the ECB Governing Council\textsuperscript{23}; the latter has the remarkable power\textsuperscript{24} to make regulations of general application similar to the regulations issued by the Parliament, Council or Commission, which are directly applicable in the euro area. The Eurosystem contains elements of heterogeneity but also, in many ways, of unity. It conducts and applies a single policy; it has a single decision-making process; it has a single voice\textsuperscript{25}; and it has a single working language.\textsuperscript{26}

The NCBs are subject to the guidelines and the decisions adopted by the Governing Council as well as to the instructions of the Executive Board with a view to implementing them. It is generally agreed on the basis of Articles 12.1 and 14.3 of the Statute that the guidelines adopted by the Governing Council

\textsuperscript{21} Indeed, even the ECB must, in some respects, comply with national regulations.

\textsuperscript{22} As a public service it does not appear as a commercial undertaking subject to competition law; the author considers that it would be inappropriate to compare the Eurosystem to a group of undertakings, and that the exclusion of its public tasks from competition law is not derived from the “single group doctrine”.


\textsuperscript{24} This power is used less in practice; only a few ECB Regulations have been formulated in the field of minimum reserves statistics and the balance sheet of monetary financial institutions and sanctions.

\textsuperscript{25} See the various presentations of the Eurosystem communication policy in the ECB Monthly Bulletin, on the ECB website and in other ECB publications.

\textsuperscript{26} Which is English; certain facilities are provided for French, German and Italian; according to Article 17.8 of the Rules of Procedure of 19.2.2004 (referring to the principles of a Council Regulation determining the language to be used by the EEC of 15 April 1958, the ECB legal acts generally published in the Official Journal of the European Union, as well as the ECB official publications, are to be made available in the various national languages of the EU; the NCBs provide translation services to this end.
are binding only on Eurosystem members: usually the NCBs in the framework of the decentralisation principle, but also the ECB.27

According to Article 34.2 of the Statute, the opinions and recommendations of the Governing Council shall have no binding force. Nevertheless, they are legal acts to be respected by all Eurosystem central banks. It can even be argued that to the extent that the Governing Council, with the contribution of the General Council, adopts Opinions, these may not be circumvented, even by the central banks of non-participating Member States.28

The Governing Council shall remain the supreme ECB decision-making body of the enlarged European Union. The modification of its voting rules in accordance with the new Article 10.2 of the Statute29 will ensure its proper functioning in respect of the fundamental voting principle of “one member, one vote”.

The Statutes of the NCBs have been only partly harmonised31, and the Statute purely contains basic common rules ensuring the smooth functioning of the decision-making process in the system.

Article 38 imposes a single regime of professional secrecy for “members of the governing bodies and the staff of the ECB and the national central banks”. This regime allows for the exchange of confidential information inside the Eurosystem. It may impose “Chinese walls” between the ESCB and the Eurosystem, so that, for example, the documents of Eurosystem/ESCB Committees meeting in standard composition may not be circulated to the other members of these committees meeting in extended composition. On the basis of this Article, common rules for confidentiality, classification and management of documents are adopted.32 The committees “shall assist in the work of the decision-making

27 A good example is provided in the area of payment systems, one of the basic tasks of the Eurosystem. The TARGET 1 payment system, and the future TARGET 2, which should become operational in 2007, are both organised by a Guideline containing obligations for the ECB, which has a certain operational capacity in this area, as well as for the NCBs. An Agreement is concluded between all the ESCB central banks for the participation of the central banks of the Member States with a derogation or exemption. Nevertheless, this Agreement imposes on these central banks the responsibility to respect the same provisions as those of the Guideline; it is a mere “contrat d’adhésion” that is not individually negotiable.

28 The Governing Council is the supreme decision-making body not only of the Eurosystem but also, by virtue of Article 107.3 of the Treaty, of the ESCB as a whole. The General Council is only a decision-making body to a very limited extent.


30 The new Article 10.2 can be seen as a remarkable success for the Eurosystem, taking into account the particularly rigid framework given by Article 10.6; ECB President Duisenberg said during the Press Conference of 6 February 2003, presenting the Recommendation agreed unanimously by the Governing Council: “And I challenge anyone to come up with a model that is as transparent, as equitable and as simple as the one we have come up with.” According to a well-informed commentator: “Mêlant raison et audace, le nouveau mode de fonctionnement du conseil des gouverneurs concilie la nature fédérale de la BCE avec la préservation des équilibres existant entre les gouverneurs des BCN”, in F. Allemand, “L’audace raisonnée de la réforme de la Banque centrale européenne”, Revue du Marché commun et de l’Union européenne, No 469 (2003), pp. 391-98.

31 See the Convergence Reports adopted originally by the European Monetary Institute (EMI) in 1998, then by the ECB in 2000, 2002 and 2004; these Reports imposed by Article 222 of the Treaty contain an assessment of the requirements and progress of legal convergence on the part of the Member States adopting the euro.

32 Confidential information may only be used for the performance of a public task at the origin of its collection; this speciality principle restricts the circulation of information inside the ESCB or the Eurosystem or even inside each central bank; so for instance, individual pieces of statistical information may not be used without specific legal provision for the performance of supervisory tasks. ECB documents are subject to confidentiality rules contained in Administrative circulars.
bodies of the ECB and shall report to the Governing Council via the Executive Board.” Basically, these committees belong to the Eurosystem; they are composed of up to two members from each of the Eurosystem NCBs and the ECB, appointed by each Governor and the Executive Board respectively [...]”. Additionally, “whenever it deals with matters falling within the field of competence of the General Council”, a committee will also include up to two staff members appointed by the non-participating NCBs (i.e. non-Eurosystem NCBs). They also may be invited “whenever the chairperson of a committee and the Executive Board deems this appropriate”. The same rule applies for “representatives of other Community institutions and bodies and any other third party”.

The documents of the committees are subject to the confidentiality rules of the ECB. Normally they may only circulate within the Eurosystem, as they are preparatory documents for the ECB decision-making bodies. After these bodies have taken their decision, they can be released by the ECB, in particular to the General Council members, by the President in accordance with Article 47.4 of the Statute and Article 6 of the Rules of Procedure of the General Council.

It is also the President’s responsibility to organise the way in which the General Council shall contribute to the tasks of the ECB in accordance with the Statute. Basically, the draft measures for these specific tasks are submitted to the General Council for observation.

**1.2.2 THE INDEPENDENCE OF THE EUROSYSTEM**

The ECB and the NCBs respectively are independent by virtue of the Treaty (Article 108) and in accordance with the Statute (Article 7) and the national legislation organising each NCB.

The ECB insisted on the recognition of the ESCB and Eurosystem in the institutional framework of Part I of the Constitution, and suggested a reference in the Constitution to the independence of the NCBs. There are indeed good reasons to consider that the independence regime affects the system as a whole, not only its entities that have legal personality. The independence of central banks contributes to the smooth functioning of the Eurosystem; the NCBs’ independence is therefore limited by their participation in the Eurosystem. The independence of the other central banks of the ESCB is also guaranteed, but has a very different meaning in the absence of their participation in the Eurosystem.

The institutional, personal and functional aspects of independence have been extensively analysed and explained by the ECB. The Convergence Reports

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34 Article 9 of the RoP.
35 Ibid.
37 See Article 6, ibid.
39 The subject of the independence regime of the “out” central banks lies outside the focus of this paper.
40 The types of independence are summarised in the legal chapters of the Convergence Reports of the ECB, following the first Convergence Report drawn up in 1998 by the EMI in accordance with Article 121 of the EC Treaty.
addressed these issues before the entry of the new NCBs into the Eurosystem. However, the financial independence requirements after their entry, with the concept of the financial independence of the Eurosystem, still need to be defined concretely, although some aspects of this question have been addressed in recent ECB Opinions.

Article I-30 (3) of the Constitution provides that the ECB “shall be independent in the exercise of its powers and in the management of its finances”. The financial independence of the NCBs and the Eurosystem is to be clarified on the basis of the Statute in conjunction with their organic national provisions.

Each NCB has its own funds, resources and expenses expressed in its annual accounts established on the basis of national provisions and the standardising accounting and reporting rules established by the Governing Council on the basis of Article 26.4 of the Statute. No national contribution is imposed; the NCBs have to finance the subscription of the capital of the ECB – the initial subscription as well as the capital increases as determined by the Governing Council – as well as the coverage of any eventual losses and the transfer of foreign reserve assets to the ECB.

By setting up the Eurosystem, the Treaty nevertheless imposes on each Member State the duty of ensuring that its NCB fully performs its tasks in that system.

The Statute provides for the annual distribution among NCBs of the monetary income accruing to them from their performance of the Eurosystem’s monetary policy. In turn, according to national law, their own benefits may be distributed to the respective Member States. The rule according to which “the national central banks are an integral part of the ESCB” (Article 14.3 of the Statute) also covers the financial assets of each NCB. If this were not so, the Eurosystem would be one of the weakest central banks in the world; this was surely not the vision of the founders of EMU.

The following aspects may be clarified concerning, respectively, budgetary autonomy, the protection of own funds, the distribution of profits and the protection of reserve assets with central banks. The accounting and reporting rules have to be harmonised in view of the financial statements, among other reasons.

A. Budgetary autonomy
Each central bank preserves its budgetary autonomy: it decides its expenditures and allocates adequate funds to its provisions and reserves in order to ensure

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41 Nevertheless, the resources and expenditures of the ECB are part of the “financial interests of the Community” mentioned in Article 280 of the EC Treaty, CIEC, Case C-11/00 Commission v European Central Bank (2003) ECR I-7147, point 95.
42 The Governing Council has clarified elements of these aspects in some recent Opinions, in particular the ECB Opinion of 20 January 2004 at the request of the Economic Committee of the Finnish Parliament on the governmental proposal to amend the Suomen Pankki Act and other related acts (see the ECB’s website, www.ecb.int, for more details).
43 Article 28.1 of the Statute.
44 Article 32.
45 See Articles 15 (Reporting requirements) and 26 (Financial accounts).
that its financial stability is secured and that its Eurosystem tasks are not endangered.

This is also the case with the ECB. Its yearly budget is adopted by the Governing Council, according to the normal voting procedure of one member, one vote. For obvious reasons of independence, the Statute does not include the approval of the budget among those financial provisions to be adopted by the shareholders by weighted voting.

On the other hand, the ECB may not impose charges in the budgets adopted by the NCBs in accordance with their national legislation and in excess of the revenues they receive from the ECB. The Statute organises the pooling of revenues and their redistribution to the NCBs. For the ECB, specific arrangements are decided by the Governing Council, acting unanimously. Eurosyste...
may be called on in the future to finance any capital increases of the ECB. The principle of stable capital for the ECB, with the possibility of increase – and the prohibition of reimbursement or decrease – is logically correlated with the same dynamics at the level of the participating NCB. Any other approach might imply the renationalisation of a Community body.

The assets and liabilities of each entity are affected by the rules of the system. The financial independence of each central bank is aimed at protecting the independence of the Eurosystem as such, in view of the performance of its tasks.

Each entity of the Eurosystem must be self-supporting; there is no reverse guarantee from the ECB to the NCBs.

In creating the Eurosystem and the ECB, the Treaty did not discharge the Member States of their obligation to create and maintain their own effective, stable and independent central bank. On the contrary, Article 1.2 of the Statute clearly states this commitment, in explicitly imposing on the only Member State without a central bank the obligation to create one. In this sense “NCBs should be in a position to avail themselves of the appropriate means to ensure that their ESCB-related tasks can be properly fulfilled.” This is why the Treaty does not authorise Member States to reduce unilaterally the financial means of their NCB; it can be argued that these means, even if they belong to the NCBs, are also part of the Eurosystem.

It should be noted that, for the national Treasuries, the right to receive NCB profits does not include the right to treat a reimbursement of capital as ordinary fiscal revenue for the year, i.e. a reimbursement of capital. The reduction of capital is not the attribution of a profit. It is equivalent to an element in the liquidation of the NCB. Such partial liquidation of an entity of the Eurosystem is contrary to the Treaty if it entails the risk that the NCB could be unable to fulfil its tasks; it is in any case subject to the opinion of the ECB, which may consider either that such a reduction requires its approval, or that it should invite the Commission to bring the case before the European Court of Justice. If the Member State in question is not allowed to receive credit from its central bank, it could be argued that a fortiori it may not take over its central bank’s own funds.

The general line of argument whereby the risks of the NCBs have been assumed or dramatically diminished since the setting up of the Eurosystem may be contested. The Treaty does not guarantee any minimum profit for the NCBs. Situations of very low interest rates, decrease in the demand for banknotes or increased financial stability may not be considered as purely hypothetical. NCBs have to be prepared to act in the case of an emergency.

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49 The Article states that “The Institut monétaire luxembourgeois will be the central bank of Luxembourg”. As this provision was implemented after 1998, it will be deleted according to the new version of the Statute annexed to the Treaty on the Constitution.

50 EMI Convergence Report 1998; this may also apply to the “out” NCBs, but in a different context.
C. The protection of foreign reserve assets

The ECB considers that a law forcing an NCB to sell foreign reserve assets in order to pay its Member State shall be subject to its previous approval in accordance with Article 31.2 of the Statute. Such approval has to be justified by reference to the exchange rate and monetary policies of the Community. In any event, the NCB must be able to transfer additional reserves according to Article 30 of the Statute.

It can be argued that with the introduction of the Eurosystem, several risks have diminished for the national monetary authorities. However, it would be wrong to consider that Member States are totally free to continue to determine the level of their foreign reserves. More fundamentally, the question of whether a Member State has the right to impose the sale of foreign reserve assets has to be answered in view of the basic Eurosystem task “to hold and manage the official foreign reserves of the Member States”. Article 31.2 refers to the management of these reserves. The “holding”, for its part, implies that these reserves should be maintained by the NCBs; it can be argued that any reimbursement to the respective Member States implies the need for authorisation by the Governing Council, which is the supreme decision-making body of the Eurosystem. One could consider that even if the Treaty mentions the “reserves of the Member States”, that is simply by reference to their origin or possibly to their beneficiaries in case of liquidation. Since the creation of the Eurosystem, these national reserves are also to be considered as “Eurosystem reserves”.

2 THE EUROSYSTEM AS AN OPERATIONAL CONCEPT

The Eurosystem started with an already defined monetary policy framework before the introduction of the euro in 1999; since then, other Eurosystem operations have been developed. An exhaustive overview implies a detailed analysis that would exceed by far the scope of this paper; however, some general considerations regarding the decentralisation principle and the organisation of activities may be helpful in presenting the Eurosystem.

2.1 THE DECENTRALISATION PRINCIPLE

According to various Statute provisions, Eurosystem activities are carried out by “the ECB and national central banks.” As a rule, each central bank has to be able to conduct all the basic Eurosystem operations, even if it may decide not to perform certain functions or to cooperate with other Eurosystem entities in the execution of specific tasks. At the same time, the Eurosystem does not allow competition among its members for services of general interest.

The general organisational principle of the Eurosystem is a preference for the decentralisation of activities inside the system. The Treaty’s preference for

52 Articles 16, 17, 21, 22, 23 and 24.
decentralisation is expressed in various provisions, but most clearly in Article 12.1 of the Statute. It is finally for the Governing Council to determine how, in practice, the operations shall be carried out. In most cases, centrally adopted decisions are implemented through the action of the NCBs.

The Governing Council has the general competence to define the modalities of decentralisation “to the extent deemed possible and appropriate”. The Treaty itself allows for a certain flexibility in the organisation of the Eurosystem and the division of labour between the ECB and the NCBs. One should of course not exaggerate the tensions present in any federal structure between the centre and the periphery. Some very pragmatic solutions exist, and the decentralisation model has proven to be flexible. The centralisation of some activities and even specialisation may be decided in respect of the general principle of equal treatment. All the NCBs within the Eurosystem are to be treated without discrimination or preference. Derogations to this principle are only possible on a voluntary basis. The application of internal rules such as guidelines and instructions taken on the basis of Articles 12.1 and 14.3 of the Statute may not be left to the discretion of the addressee. No permanent opt-out may be allowed to NCBs for basic Eurosystem tasks. An NCB may not be authorised to apply national solutions forever, in derogation from the Eurosystem’s operational organisation, as this would introduce discrimination among NCBs and distort the uniform application of ECB decisions. Formal differentiation requirements need support in primary law (which appears very restrictive in that regard) or unanimous support at the level of the Governing Council.

It does not appear compatible with this rule to fix minimum quotas restricting a priori the number of participating NCBs. Similarly, it may be argued that a distribution of work inside the Eurosystem, for certain activities, making use of the capital key formula, is not in line with the rule of equal treatment. The capital key is confined by the Statute to the financial rights and obligations of the shareholders, and is not intended to provide a measure for the effective contribution of the NCBs to the Eurosystem. It should furthermore be remembered that other criteria are also used in the Treaty to differentiate some NCBs from the others – in particular, the three criteria for the new voting modalities in the Governing Council, as mentioned in the amended Article 10.2. Any fixed division of activities requires the unanimous agreement of the governors in so far as it implies an exceptional measure unforeseen in the Treaty, to be justified and accepted by all as specific circumstances.

The decentralisation principle should not be seen as a cost factor, but mainly as an efficient way of conducting operations with full respect for equal treatment and a level playing-field.

Flexibility is realised by the systematic use by the Governing Council of “guidelines”. These are obligatory for the NCBs so long as the latter are not

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53 The President of the ECB has already had to write to one national government in view of entrusting its NCB with the adequate legal and administrative resources to comply with statistical requirements.
entrusted with the adequate legal and financial means; they appear more as "obligations de moyens" than as "obligations de résultat".\textsuperscript{53} They may not contain direct obligations for third parties; in such cases, the NCBs are only allowed to use their national instruments. The same applies in the case of sanctions imposed on operators: if these fall outside the scope of the EC Regulations for which the ECB is basically competent, the NCB in question acts purely on its own behalf.

Outside the scope of its exclusive European competence, the Eurosystem may provide a forum for the coordination of central bank activities. This is the case for the function of oversight of payment and securities settlement systems, which is currently carried out by the NCBs, mainly on the basis of national law; this is also the case for the contribution to prudential supervision and financial stability.

For the participation of the NCBs of countries with a derogation or exemption, in the absence of the possibility of relying on ECB guidelines, contractual arrangements may be concluded; however, these will be subject to possible amendments of the guidelines that are binding for the Eurosystem.

Whereas the Statute organises the redistribution of ECB profits, the financing of Eurosystem operations is not specified. Article 32.4 provides for possible indemnification of NCBs against costs in connection with the issue of banknotes or, in exceptional circumstances, for specific losses arising from monetary policy operations undertaken for the ESCB. This rule is applicable in the field of monetary operations, for which the NCBs are globally remunerated by the Eurosystem. For other Eurosystem tasks, it is for the Governing Council, in its capacity of budgetary authority, to decide by which modalities the participating central banks shall be compensated, either by the operators or by the Eurosystem itself, in respect of its financial provisions. When, as is often the case, cost recovery is made through fees imposed on the external counterparties, then a single tariff shall apply. The same prices are applied to Eurosystem services throughout the euro area.\textsuperscript{54} Whereas services of general interest are provided by the Eurosystem as a public good, the costs shall be assumed by the Eurosystem itself in respect of the financial provisions of the Statute.

As far as the NCBs’ activities remain national, their financing is exclusively subject to national regulations, in conformity with Article 14 of the Statute and in respect of competition law.

\textbf{2.2 \textsc{The Organisation of Eurosystem Activities}}

Monetary policy operations offer the most visible application of the decentralisation principle.

For other operations, specific rules shall be applied. In the field of payment systems, three NCBs will develop a common platform to be used by all the

\textsuperscript{54} This will be the case, for instance, with the new payment system TARGET 2, starting in 2007.
central banks of the ESCB for TARGET 2, which is a Eurosystem service replacing the existing interlinking mechanism between national systems.

In the field of management of foreign reserve assets, six central banks have agreed to offer standardised services decided by the Governing Council.

For banknote production, it is foreseen, in the medium term, to rely on one single Eurosystem tender procedure.

In the field of statistics, the legal framework governing Eurosystem activities, based on Article 5 of the Statute, is composed of a large number of European and national regulations. EU regulations55 and ECB regulations allow the transfer of data from NCBs to the ECB. Considering the functional use of these data for the performance of either ESCB or Eurosystem activities, such data are exchanged between the central banks concerned under the protection provided by the common confidentiality regime on the basis of Article 38 of the Statute.

In the field of contribution to prudential supervision and financial stability, each NCB has to act on its own in a system of mutual cooperation, as long as the ECB has neither activated its competences under Article 22 of the Statute nor has been entrusted by the Council with specific tasks in accordance with Article 105 (6). Even in this area, the Eurosystem has a role to play.56 The oversight of payment and securities settlement systems is a core competence of the Eurosystem. As long as the ECB has not adopted regulatory measures, each NCB must act on its own. For such Eurosystem activities, the NCBs’ competences are not confined to the implementation of operations, but also imply the exercise of decision-making power. This is a sector in which the existence of regulatory power for NCBs remains of particular importance.

A detailed examination of the field of external relations is not the aim of this paper, although a few general comments can be made in this regard.

The role of the Eurosystem in the international field is basically founded on Articles 6 and 23 of the Statute, and is essentially of an operational nature. The Eurosystem has to contribute in its area of competence to the implementation of international agreements binding on the EU or its Member States. The problems may be exemplified by the situation with the International Monetary Fund (IMF). The NCBs are the fiscal agents of their respective Member States in their capacity as IMF members. In the IMF, there is no common position systematically expressed by the ESCB57, the Eurosystem or the Eurogroup. The

57 It is so far mainly within the International Relations Committee (IRC) that coordination among ESCB central banks is sought, notably for issues related to the IMF.
EU does not have a single chair and does not speak with one voice: although EU Member States represent 32% of the total votes in the IMF (compared with 17% for the United States), they take part in ten constituencies, in a number of which they are in a minority position.

This is basically not in line with the transfer of exclusive competence, which would imply that both the internal and external aspects of the single currency are dealt with exclusively by the competent European bodies.

The Constitution provides that “in order to secure the euro’s place in the international monetary system, the Council, on a proposal of the Commission, shall adopt a European decision establishing common positions on matters of particular interest for economic and monetary union within the competent international financial institutions and conferences” (Article III-196). This Article goes on to state that “The Council, on a proposal from the Commission, may adopt appropriate measures to ensure unified representation within the international financial institutions”. In both cases, “The Council shall act after consulting the European Central Bank” and decide in its Eurogroup composition.58 This procedure may contribute to the clarification of responsibilities and support various pragmatic solutions adopted by the EU and national authorities for their external relations.

CONCLUSION

The Maastricht Treaty was particularly innovative in establishing the ESCB together with the ECB. The definition of the ESCB was however limited to its tasks and composition.

There is no ex ante definition of the ESCB’s reality as a “system”. An assessment requires more of an inductive than a deductive approach. A system is an original and evolving concept; it possesses flexible rules designed to accommodate the evolution of both its organisation and its activities.

The situation created in 1999 by the decision of some Member States not to introduce the euro resulted in the transformation of most of the ESCB into a new system, the Eurosystem. Six years after the introduction of the euro, this paper examines the reality of the Eurosystem. It concludes that the Eurosystem works; indeed, its reality is assessed by its effectiveness and its successes.

Some confusion will nevertheless remain. The distinction between the ESCB and the Eurosystem is not clear-cut. The Eurosystem is not only derived from legal texts but also, to a significant extent, from practice.

From a communication point of view, replacing the acronym “ESCB” with the term “Eurosystem” was almost certainly a positive step. The Constitution, which

58 Paragraphs 1 and 2.
it is hoped will enter into force in 2006, following the completion of the cumbersome approval procedure in the Member States, will transform the Eurosystem into a permanent concept within the EU institutional framework. At the moment, the ESCB and the Eurosystem are very different; the one mainly a collection of entities with legal personalities, while the other functioning as an operational body in charge of the performance of the tasks transferred from the EU Member States to the Union with the introduction of the single currency.

When, hopefully, the euro becomes the currency in all the Member States that presently have a derogation or exemption, the ESCB will then come to an end and will simply be replaced by the Eurosystem. Such a progressive approach is not unusual in European constitutional law. Indeed, the whole history of the EU is marked by progressive evolutions whereby institutional experiments are later sanctified by law.

By recognising the Eurosystem, the Constitution provides welcome elements of cohesion and clarification. The way forward will be through the transformation of the ESCB into the Eurosystem.
THE ISSUE OF THE DEMOCRATIC LEGITIMACY OF THE EUROSYSTEM – A SKETCH

Phoebus Christodoulou

ABSTRACT

I poteri della indipendente Banca Centrale Europea previsti dal Trattato hanno legittimazione costituzionale e democratica sostanziale (I). Il contributo valuta la possibilità di un’applicazione dello slogan sul “deficit democratico” delle istituzioni e degli organismi della UE agli atti giuridici della BCE, oltre ad analizzare se i regolamenti, le decisioni, le direttive o i pareri della BCE non siano solo misure amministrative o misure tese, in definitiva, a regolamentare la condotta delle persone. In quest’ultimo caso, la domanda è rilevante: tali misure sono coerenti con il requisito della accountability a livello politico (II).

In vista dei meccanismi di controllo politico previsti nel Trattato al riguardo (III), si sostiene che la pratica della trasparenza adottata dalla BCE comporta una responsabilità che genera credibilità e fiducia, diventando così di per sé un elemento di legittimazione democratica. Si sostiene inoltre che la responsabilità potrebbe sostanzialmente compensare l’eliminazione dello scrutinio parlamentare dei provvedimenti giuridici dell’Eurosistema - eliminazione intenzionalmente adottata dal Trattato (IV).
THE ISSUE OF THE LEGITIMACY OF THE INDEPENDENT CENTRAL BANK

The Maastricht Treaty (1992) contains three fundamental provisions on monetary policy. First, the Treaty explicitly enshrines price stability as a guiding principle of the European Community.1 Second, it separates monetary policy from other economic policies and establishes the European System of Central Banks (ESCB), to which it entrusts the responsibility for the single monetary policy in the European Community, whereby the primary objective of the ESCB is to maintain price stability.2 Third, the ESCB, the European Central Bank (ECB) and the national central banks (NCBs) enjoy independence when exercising the powers and carrying out the tasks and duties conferred upon them by the Treaty.3

Such provisions were subsequently included, without any changes in substance, in the Treaty establishing a Constitution for Europe, which was adopted by European governments on 18 June 2004.

As long as there are Member States that have not yet adopted the euro, it is necessary to make a distinction between the ESCB and the Eurosystem. The term “Eurosystem” denotes the ECB and the NCBs of those Member States that have adopted the euro. The term “euro area” refers to the area comprising those EU Member States that have adopted the euro.4

The principle of central bank independence as provided in the Treaties has given rise to the issue of the legitimacy of central bank actions. One particular slogan, the so-called democratic deficit, has become something of a catchphrase in the relevant discussions.5 This issue is usually raised more generally with respect to EU institutions and bodies, most notably the Council of Ministers and the European Commission. The case of the Eurosystem has, however, some specific features as far as political legitimacy is concerned which warrant a more nuanced approach.6

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1 Article 4 (3) of the Treaty establishing the European Community.
2 Article 105 (1) and (2).
2 THE MODERN THEORETICAL FOUNDATION OF CENTRAL BANK INDEPENDENCE

Painful past experiences with monetary instability and inflation as well as developments in economic and political thinking have prompted a radical change in how inflation and its consequences are generally perceived. Price stability has come to be widely regarded as highly desirable, which in turn made it possible to establish price stability as a guiding principle of the European Community and its Member States.

Economic analysis has shown that inflation is not only an impediment to economic growth, but also unfair, because it ultimately hits those who are entirely dependent on their wages and pensions. The economic literature as well as first-hand negative experiences have supported the perception that inflation is very undesirable, as opposed to monetary stability, as reflected in price stability, which is highly desirable.

Experience has also shown that inflation can only be dealt with by making a long-term effort. Initially, this effort will involve some sacrifices, but will eventually yield good results. Petty politics driven by short-term considerations are unlikely to result in the implementation of far-reaching measures and are thus doomed to failure. Related developments in political thinking have, therefore, led to the broadly accepted view that combating inflation is also a matter of overcoming the shortcomings of the parliamentary system, which in the current era represents democracy in the political field.

At the same time, there is a growing awareness that the design of a proper anti-inflationary policy requires expertise and access to timely and reliable information as well as efficient compilation and evaluation of data. This therefore requires the advice of experts who are capable of addressing the problem objectively, as professionals unaffected by either external pressures or petty political considerations.

3 FORMAL AND SUBSTANTIVE LEGITIMACY OF THE POWERS OF THE INDEPENDENT CENTRAL BANK

As a result of such developments and discussions, a broad consensus was reached that is reflected in the Treaty establishing the European Community. The Treaty


9 Articles 2, 4 (2) and (3), 98 and 105 (1) and (2).
enshrines price stability as a guiding principle of the European Community, and entrusts once and for all the definition and implementation of monetary policy to a supranational body, the ESCB. It endows this body not only with administrative and financial self-sufficiency, but also with functional independence, by insulating the ESCB and its decision-making bodies against any interference from political bodies that could exert political, financial or any other influence. Above all, it insulates the ESCB against political pressure from parliamentary majorities. In so doing, the Treaty effectively elevates the ESCB to the status of a quasi-fourth power independent from the other powers of the state.

The endorsement and enactment of all the aforementioned provisions was thus a political decision made by the competent Community bodies and ratified by the respective national bodies in accordance with their respective constitutional requirements. Such a decision has, therefore, full constitutional legitimacy deriving from the Member States, and this will continue under the Treaty establishing a Constitution for Europe. It is the Member States that confer competences (powers) on the Union and its respective institutions and bodies.  

However, the decision also has substantive democratic legitimacy, since it is in line with the principle of the separation of powers. Matters relating to distributive justice, that is to say distributional fairness and wealth-sharing, as well as matters defining which national or, by extension, supranational body will exercise a given function or responsibility, must, according to the principle of the separation of powers, be dealt with and decided upon by the legislative branch.  

This indeed is what happened in the case under discussion.

4 THE DEMOCRATIC LEGITIMACY OF THE LEGAL ACTS OF THE INDEPENDENT CENTRAL BANK

Any alleged “democratic deficit” can therefore only refer to the democratic legitimacy of the ECB’s actions regarding monetary policy.

Monetary policy measures are actions taken by the executive branch. They are aimed at defining and implementing on each occasion the binding political platform of price stability which has been constitutionally established as a guiding principle of the European Union by the decision taken by the competent legislative bodies.

Admittedly, legislative and executive functions often intersect in modern democratic states; indeed, they even tend to be confused in the practice of rulemaking by the executive branch. However, the Maastricht Treaty has removed any confusion between the legislative and the executive functions as far as monetary policy is concerned by elevating the task of defining and implementing...
monetary policy to a separate, autonomous and independent function which it
delegated to the ESCB, governed by the decision-making bodies of the ECB.\textsuperscript{14} Therefore, the legal acts of the ECB – whether regulations, decisions, recommendations or opinions\textsuperscript{15} – are measures of the executive branch\textsuperscript{16} as far as the requirement of separation of powers in its original sense is concerned.\textsuperscript{17}

In principle, administrative measures are generally not subject to the prior approval of parliament or – much less – the electorate. Nevertheless, public administration in general is currently considered to be indirectly legitimised by being subjected to parliamentary scrutiny and, thus, is ultimately accountable to the people.\textsuperscript{18}

It is in this context that a key question has been raised, namely whether or not the ECB’s acts, which are rules that aim at regulating the conduct of people, should, in one way or another, accommodate the requirement for political accountability or not.

5 \hspace{1em} MECHANISMS OF POLITICAL CONTROL UNDER THE TREATY

In terms of pure reason, there is in principle a conflict between independence and accountability, whereas practical reason would endeavour to reconcile independence and democratic control by making a synthesis of the two. Such a synthesis would call for a conceptual clarification of the nature of central bank independence.

In the first place, central bank independence is not an end in itself. Under the Treaty, it is only an instrument for attaining and ensuring the goal of monetary stability. The principle of independence requires that the Eurosystem and its members are not subject to any governmental or administrative hierarchy, neither seeking nor receiving any instructions whatsoever regarding the performance of their duties. More importantly, it requires them to be legally independent from both the European Parliament and the national parliaments.

Nevertheless, mechanisms are in place for monitoring and controlling the operation of the Eurosystem as well as the acts of the ECB. Six types of control mechanisms can be identified according to the Treaty and the Statute, and are listed below.

First, the ECB’s actions are subject to a substantive restraint, namely the Eurosystem’s mandate. The principle of independence is binding insofar as it is used for the purpose of monetary stability. The Treaty states that the primary objective of the ESCB shall be to maintain price stability. Without prejudice to

\begin{itemize}
\item \textsuperscript{14} Article 8 of the Statute of the ESCB and the ECB.
\item \textsuperscript{15} Ibid., Article 34.
\item \textsuperscript{17} F. A. Hayek, op. cit., p. 26.
\item \textsuperscript{18} A. Bleckmann, „Das europäische Demokratieprinzip“, \textit{Juristenzeitung} (2001), pp. 53-58 (58).
\end{itemize}
the objective of price stability, the ESCB shall support the general economic policies of the Community. 19

Second, in the exercise of its responsibilities, the Eurosystem is subject to the general restraint of rule of law. The decision-making bodies of the Eurosystem operate on the basis of official rules of procedure, and the acts and omissions of the ECB are open to review or interpretation by the Court of Justice of the European Communities. 20

Third, the President, the Vice-President and the other members of the ECB’s Executive Board are appointed from a pool of persons of recognised standing and professional experience in monetary or banking matters by the common accord of the governments of the Member States at the level of the Heads of State or Government, on a recommendation from the Council of Ministers after it has consulted the European Parliament and the Governing Council of the ECB. 21 The latter comprises the members of the Executive Board and the governors of the NCBs, who are appointed in accordance with the provisions of national law, and in any case by a decision of the respective government.

Fourth, the members of the ECB’s governing bodies may be removed from office before the end of their term if there are serious grounds for so doing (e.g. serious misconduct). 22

Fifth, the Treaty regulates the relations of the ECB with other Community institutions and bodies, in particular the Council of Ministers, the European Commission and the European Parliament. 23

Sixth, the ECB is required to produce an annual report on the activities of the ESCB and on the monetary policy of both the previous and the current year for the European Parliament, the Council, and the Commission, as well as for the European Council. Moreover, this report is presented by the President of the ECB to the European Parliament and the Council of Ministers, which may hold a general debate on that basis. 24

Thus, the European Parliament takes note of the ECB’s annual report, and the Council of Ministers may each time hold a general debate on this report. However, neither of these bodies has the power (competence) either to approve or to reject the ECB’s report on monetary policy.

Article 113 (3) of the Treaty clearly illustrates the idea of the Eurosystem’s independence from the representative bodies. However, it may just as easily be

19 Article 105.
20 Article 35 of the Statute of the ESCB and the ECB.
21 Ibid., Article 11.2.
22 Ibid., Article 11.4, regarding the members of the Executive Board; national provisions regulate, according to Article 14.2 of the Statute, the removal from office of each of the other members of the Governing Council.
23 Article 113.
24 Article 113 (3).
perceived, as some have indeed done, as proof of a “democratic deficit” with regard to the functioning of the Eurosystem. This is an important issue which is addressed in detail in Section 6 below.

6 THE ECB’S PRACTICE OF TRANSPARENCY

This paper submits that such reasoning is unfounded for three main reasons. In the first place, the assertion of a democratic deficit is based on sophistry. In view of the shortcomings of the parliamentary system, what the drafters of the Treaty had in mind was to safeguard the central bank’s administrative and political independence in defining and implementing monetary policy, mainly as a counterweight to the preponderance of parliamentary power in general. Secondly, this argument conveniently disregards the control mechanisms that are in place as described above. Finally, and more importantly, it also fails to consider the fact that, apart from and beyond any statutory requirements, the independent central bank declares itself legally and politically obligated to explain properly and justify each time its decisions to the citizens of the euro area and their elected representatives, thereby making itself responsible for fulfilling its objectives under the Treaty.

Moreover, the ECB has since its inception practised a policy of dialogue with the general public, based on the ideals of transparency, accountability and credibility.

The ECB defines central bank transparency as an environment in which the central bank provides the general public and the markets with all relevant information on its strategy, assessments and policy decisions as well as its procedures, and does so in an open, clear and timely manner. The ECB considers that transparency constitutes a crucial component of its monetary policy framework, thereby emphasising the importance of effective communication and proper interaction with the public.

Transparency entails accountability, which is in turn essential for democracy as far as the latter encapsulates the idea of freedom in public affairs. Accountability is consistently applied by the ECB, and is as a result gradually developing into standard central bank practice. It remains somewhat premature to decide whether such practice and understanding of the concept already qualify for customary law. However, accountability itself is certainly an element of democratic legitimacy. The ECB in this regard legitimises itself as a democratic body by consistently acting like one, which is to say, by offering greater transparency and accountability as a matter of political obligation.

All efforts to enhance transparency (and through this, accountability) aim at ensuring that monetary policy is better understood by the public and is as a result more credible and effective.

Modern economic theory confirms that if monetary policy is to be credible, the targets set must be consistently pursued. As Robert Lucas argues in his well-known critique as well as in his paper about rational expectations, monetary policymakers should avoid surprises, and only a credible policy can be considered to be “optimal monetary policy”. Market participants have no confidence in a particular policy when policy measures are inconsistently implemented. Credibility, as modern economic theory teaches us, is built on consistency.28

Advances in information technology corroborate these findings. In the high-tech era, financial markets can support or disapprove of and ultimately counteract monetary policy measures on a daily basis, depending on whether such measures are consistent with the announced targets and the proclaimed principles which their respective rational expectations have been based upon. In this specific sense, it can be said that the financial markets “vote”. Strange though it may sound in today’s increasingly globalised world, this statement recalls the idea of direct and participatory democracy.29 However, this topic lies outside the scope of this paper.

Jürgen Habermas, the noted German social philosopher, has remarked that, apart from any formal concept of legitimacy, the main problem with democracy in the European Union is how to prevent a non-transparent, arbitrary and authoritarian bureaucracy from growing to a menacing size. To prevent this, new life should be breathed into the Treaties through dialogue. This would, according to Habermas, promote understanding and lead to the building of a European collective consciousness.30

In other words, the legal framework alone cannot build trust: instead, a synergy of many other aspects is needed. The European Union and each of its bodies need to connect with the way people think and feel, yearn and aspire.

The building of trust is, after all, primarily a matter of character and moral commitment. The latter is implicitly attributed to the policymaker by the general

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public. However, this parameter, no matter how cardinal it may be, is also beyond the scope of this paper.

To cut a long story short, these preliminary thoughts can be summed up by rephrasing the well-known distinction between law in action and law in the books. It can be reasonably affirmed that only committed accountability in action can establish credibility and trust and, despite any slogans to the contrary, materially compensate for the planned and justified elimination of formal parliamentary scrutiny of the day-to-day measures of monetary policy.

THE ROLE OF THE DECENTRALISATION PRINCIPLE IN
THE LEGAL CONSTRUCTION OF THE EUROPEAN SYSTEM
OF CENTRAL BANKS

Francisco Javier Priego and
Fernando Conlledo

ABSTRACT

L’obiettivo dello studio è di sottolineare gli aspetti principali che devono essere valutati quando ci si riferisce al “principio di decentramento”, considerato una delle caratteristiche chiave alla base della struttura del Sistema Europeo di Banche Centrali.

Il sistema SEBC/BCE delinea un’unica struttura organizzativa che condivide elementi propri della decentramento e della delega, senza essere identificabile con nessuno dei due. Le competenze per l’esecuzione dei compiti da parte delle Banche Centrali Nazionali sono assegnate direttamente dallo Statuto e dalle rispettive legislazioni nazionali, mentre la competenza per la gestione del Sistema (dal punto di vista degli aspetti di decisione e controllo) è accentrata presso la BCE.

Nell’ultimo paragrafo dell’Articolo 12.1, lo Statuto stabilisce il principio del decentramento esecutivo, a condizione che esso sia “possibile ed adeguato”. Pertanto, solo nel caso in cui tali requisiti non siano rispettati, la BCE può optare per la centralizzazione delle funzioni del Sistema che essa è in grado di svolgere da sola. Sia tale decisione, sia la possibile applicazione di un modello di “decentramento selettivo” comportano rilevanti problematiche legali, in considerazione delle caratteristiche istituzionali del sistema e dell’ambigua stesura dell’Articolo 12.1.
I INTRODUCTION

The legal configuration of the European System of Central Banks (ESCB) is an original construction given shape in the Treaty on European Union, passed in the Dutch city of Maastricht on 7 February 1992. The ESCB, which comprises the European Central Bank (ECB) and the national central banks (NCBs)\(^1\) of the euro area, is charged with the implementation of the functions and activities envisaged in the Treaty establishing the European Community (“the Treaty”) and its Statute.\(^2\) With regard to the management of the ESCB, it is stated that “The ESCB shall be governed by the decision-making bodies of the ECB”.\(^3\) One of the principles that the ECB needs to take into account when determining how the ESCB is to operate is the so-called principle of decentralisation, which basically derives from Articles 9.2 and 12.1, in the third paragraph of the Statute.\(^4\) In this paper we aim to analyse this principle, and to highlight how it represents one of the essential principles in the definition of the legal construction of the ESCB. The paper is organised as follows. In Section 2 we study the concept of decentralisation and how it differs from other similar concepts; in Section 3 we consider the treatment of the principle of decentralisation in the legal framework of the ESCB; in Section 4 we examine the issue of the different levels of decentralisation; and in Section 5 we offer some reflections on the ideas of selective centralisation and decentralisation. Finally, we end in Section 6, which provides some conclusions.

2 DECENTRALISATION: THE CONCEPT AND DISTINGUISHING FEATURES

THE CONCEPT OF DECENTRALISATION

As mentioned in the preceding section, there is no doubt that the principle of decentralisation is one of the essential defining features of the ESCB’s legal framework. Nevertheless, its definition, which belongs at national level to the realm of constitutional law and administrative law, has not received the treatment it deserves in either the Treaties or the secondary law of the European Union.\(^5\)

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\(^1\) Article 107, first paragraph of the Treaty, Article 1.2 of the Statute of the European System of Central Banks and of the European Central Bank (“the Statute”).

\(^2\) Article 8 of the Treaty, Article 1.1 of the Statute.

\(^3\) Article 107, third paragraph of the Treaty, Article 8 of the Statute.

\(^4\) Article 9.2 states that “The ECB shall ensure that the tasks conferred upon the ESCB under Article 105 (2), (3) and (5) of this Treaty are implemented either by its own activities pursuant to this Statute or through the national central banks pursuant to Articles 12.1 and 14.” Paragraph three of Article 12.1 states that “To the extent deemed possible and appropriate and without prejudice to the provisions of this Article, the ECB shall have recourse to the national central banks to carry out operations which form part of the tasks of the ESCB”.

\(^5\) M. P. Chiti, Derecho Administrativo Europeo (Madrid: Civitas, 2002), p. 179, considers that there are basically two reasons for the scant attention paid to administrative organisation in Community law: “firstly, the original configuration of the Community as a variant of international organisations, which normally lack a structure of their own, and secondly, the emphasis placed on the production of regulations in the service of the development of Community policies and as the main instrument of integration. These are diverse reasons, to which must be added the fact that the tasks of the Community were limited and, at least initially, could not be interpreted in a broad sense, meaning that no particularly complex administrative apparatus was needed for their implementation” (text translated by authors). In addition, J. Schwarze, European Administrative Law (London: Sweet and Maxwell, 1992), p. 24, notes that “Taking into account also the many mixed forms of administration and the types of action which have developed within administrative practice, in particular in intra-administrative relations, a comprehensive and complete explication of the concept of European Administration hardly seems attainable”. This author outlines the massive recourse by the Community to the so-called Indirect Administration, that is to say, by means of the activities of the Member States.
To define the concept of decentralisation, it is therefore necessary to have recourse to doctrine and comparative law. As Giannini points out, decentralisation “has been the subject of discussion more among politicians and political sociologists than among lawyers, resulting in an uncommon degree of confusion”\(^6\). No sooner does one try to tackle the issue, than one confronts the fact that there is no single unambiguous definition of it. As the World Bank says, “Decentralization – the transfer of authority and responsibility for public functions from the central government to subordinate or quasi-independent government organizations and/or the private sector – is a complex multifaceted concept. Different types of decentralization should be distinguished because they have different characteristics, policy implications, and conditions for success”.\(^7\)

In this regard, an initial distinction is usually made, due to their differing scope, between political decentralisation and administrative decentralisation.\(^8\) Even though the dividing line between these two concepts is not clear-cut, it would seem to be the case that the former finds a natural place in constitutional texts, and customarily refers to the question of the form of the state, whereas the latter is generally found in the norms governing the principles of organisation of a government or public administration.

It is undoubtedly the legal/administrative doctrine that has made the most decisive contribution to the definition of the concept of decentralisation and other related concepts, such as that of delegation. Thus the most common feature of decentralisation is the transfer of a competence to another organisation. (This possibility must be envisaged by the relevant legislation.) This transfer takes place through a general provision; a resolution or administrative act by the body responsible would not sufficiently allow for such a transfer. This transfer of competence, which will be exercised in the name of the new holder of the competence, will nevertheless be under the supervision, oversight or control of the administration transferring its competence.\(^9\)

**DELEGATION**

Delegation consists of the transfer of the mere exercise of a competence from one body or organisation to another. The distinctive features of the delegated competence are that it is exercised in the name and under the responsibility of

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\(^8\) In a similar way, the doctrine distinguishes between territorial decentralisation and functional decentralisation, or decentralisation according to services.

\(^9\) According to G. Ariño Ortiz (1988), “Principios de descentralización y desconcentración”, *Documentación Administrativa*, No 214, April/June, pp. 28-30, these powers of control “may have as their cause and purpose the upholding of the legal order (control of legality… or they can be determined by reasons of a political or economic order, or for reasons of moral character or technical criteria (opportunity control…))” (text translated by authors).
the delegating body. The legal commission to exercise this competence is made through a simple administrative act or resolution. 10

From the point of view of Community law, it should be pointed out here that Community precedent has tended to look unfavourably upon delegation to bodies other than Community institutions, following the precedent set by the Meroni case. However, the specific features of the legal structure of the ESCB, as expressly envisaged in the Treaty, means that it lies outside the scope of the aforementioned doctrine. 11

OUTSOURCING

The difference between decentralisation and outsourcing would seem to be clear-cut. The latter consists fundamentally of the external performance of a particular task, i.e. one that is entrusted to a third party, normally a private company, through a contract for the provision of services. In the case of outsourcing, the outsourced tasks are “instrumental” and in no way suppose the exercise of public functions or powers by the company receiving the commission.

SUBSIDIARITY

Lastly, regarding the relationship between the principle of decentralisation and subsidiarity, which is envisaged in the Treaty (Article 5, second paragraph), it should be noted that on occasions the two may share the same purpose, i.e. achieving greater efficiency, bringing decision-making by Community or national bodies closer to those they affect. However, subsidiarity is only applicable in the case of competences that are shared by the Community and the Member States, and not when the issue concerned is the sole competence of the European Community. There is no question that the functions of the ESCB are the sole competence of the Community, ruling out the application of subsidiarity. Nor should it be confused with decentralisation. 12

10 See A. Gallego Anabitarte (2000), “Conceptos y principios fundamentales del Derecho de Organización”, in Lecciones de Derecho Administrativo, 1 (Madrid: Marcial Pons, 2000), pp. 79-80. Nevertheless, there is also a great deal of confusion surrounding the concept of delegation. Part of the doctrine conceives it as a legal agreement through which there is a “deconcentration” or bureaucratic decentralisation, which implies “the permanent transfer of competences from a higher to a lower body. Its essential characteristic is that it takes place between bodies within the same legal person. It therefore does not involve two different legislations, as in the case of territorial decentralisation, nor two different legal persons as in the case of functional or service decentralisation.” (Garrido, op. cit.) (text translated by authors).


3 DECENTRALISATION IN THE LEGAL FRAMEWORK OF THE ESCB

In the previous section we sought to approach the theoretical concept of decentralisation. We now need to assess the specific legal framework defined by the Statute. This is not the place to analyse the different conceptualisations of the system that have been put forward, which range from seeing it as a federal or quasi-federal structure, to regarding it as a system that is basically characterised by a hierarchy in which the NCBs are reduced to the role of mere operating arms of the ECB, without making a significant contribution to it.13 Moreover, it should be noted that there is also a degree of debate about the suitability of decentralisation, with positions ranging from those who see it as a weakness in the way the ESCB is constructed14, to those who consider it to be one of the elements giving it strength and credibility.15 In this paper we will limit our analysis to questions of lege data, as otherwise we would need to enter into a discussion of how the Maastricht Treaty should have defined matters.

What is clear is that the Articles of the Statute that deal with this issue (9.2, 12.1 and 14.3) are not reducible, prima facie, to any of the classic types of decentralisation or delegation.16 We can state already that they have elements of both, which in the end leads us to conclude that the legal structure is atypical. In our view, in order to analyse it, it is necessary to break down the different elements involved in realising the tasks of the ESCB by the NCBs.

1. From the point of view of the authorities involved in the process, we have on the one hand the ECB, a body created by primary Community law, whose governing bodies govern the ESCB17; and, on the other hand, the NCBs, which have their roots in the national legislation of their respective countries but form an integral part of the ESCB under Community law.18 Moreover, the legal framework applicable to the NCBs, as set out in their statutes, fully empowers them to contribute to the exercise of the functions of the ESCB. This gives them the legitimacy to carry out tasks not only by virtue of a legal instrument of the ECB, but from their status as national central banks within the legal framework of the ESCB.

13 Zilioli and Selmayr, op. cit., pp. 53-81.
14 Thus, for example L. Bini Smaghi & D. Gros, in Open Issues in European Central Banking (London: MacMillan Press, 2000), pp. 5-26, hold that “the main reason for decentralization is the desire to protect the employment of specialized staff in the NCBs”, envisaging a progressive de facto centralisation among the NCBs that has an increasing impact on operations over time.
15 M. Goodfriend (1999), “The Role of a Regional Bank in a System of Central Banks”, Federal Reserve Bank of Richmond Working Paper, No 99-4 (July), pp. 18-28, holds that “A regional presence facilitates the acquisition of specialized information on the economy and positions the staff to reach out to the public with an explanation of the central bank’s policy objectives and practices. Presidents (Governors) of regional central banks bring analytical diversity to the monetary policy committee. Above all, a system of central banks promotes a healthy competition that stimulates innovative thinking on operational, regulatory, research, and policy questions. Federal Reserve experience teaches that a decentralized system needs a strong center”.
16 Zilioli and Selmayr, op. cit., p. 66, appear to uphold the thesis of delegation. Nevertheless, the Statute uses the term delegation, but only to refer to the transfer of the tasks of the Governing Council to the Executive Board (Article 12.1, second paragraph).
17 According to Article 8 of the Statute, “The ESCB shall be governed by the decision-making bodies of the ECB”.
18 According to the Statute, the statutes of the national central banks must be compatible with the Treaty and the Statute (Article 14.1), and “the national central banks are an integral part of the ESCB and shall act in accordance with the guidelines and instructions of the ECB. The Governing Council shall take the necessary steps to ensure compliance with the guidelines and instructions of the ECB, and shall require that any necessary information be given to it” (Article 14.3).
2. From the point of view of the tasks transferred to the NCBs by the ECB, the following points should be made. The exercise of tasks is most commonly transferred by means of Guidelines. These instruments are legal acts under Community law, which are typical of the ESCB. The NCBs are obliged to translate the content of these Guidelines into their own national law and have sufficient powers to do so, not by virtue of the ECB Act transferring the task, but out of the national legal framework regulating the NCBs. Lastly, the ECB reserves powers of verification not only over the translation of the Guidelines into national legislation, but also in the execution of the transferred task, and it can appeal to the Court of Justice to demand compliance (Articles 14.3 and 35.6 of the Statute).

The tasks (contracts concerning monetary policy, operations in the payments system, etc.) are performed by the NCBs in their own right and in their own name, in accordance with national law, charged against their own balance sheet, and with responsibility for their actions out of their assets, without prejudice to the fact that in certain matters the provisions of the Statute allowing the sharing of the losses between the members of the ESCB may come into effect. This legal structure is not entirely compatible with the view of the NCBs as agents, which has no explicit support in any legal text.

4 THE DIFFERENT LEVELS OF DECENTRALISATION

Having reached this point, it makes sense to examine to what extent the Statute allows different levels of decentralisation.

Unfortunately, this is not a subject to which the various authors who have attempted to analyse the structure of the ESCB have devoted much attention, despite its being crucial to any evaluation of the ESCB’s real (and not merely conceptual) functioning.

As noted earlier, the answer to this question can be found in Article 12.1, last paragraph of the Statute, which states that the ECB “to the extent deemed possible and appropriate […] shall have recourse to the national central banks to carry out operations which form part of the tasks of the ESCB”.

At first reading, this wording offers little scope for doubt as to its imperative nature, which imposes the obligation that the System’s tasks be executed in a decentralised way, unless, in the judgement of the Governing Council of the ECB, this is impossible or inappropriate.

19 Article 32.4 states that “The Governing Council may decide that national central banks shall be indemnified against costs incurred in connection with the issue of banknotes or in exceptional circumstances for specific losses arising from monetary policy operations undertaken for the ESCB. Indemnification shall be in a form deemed appropriate in the judgment of the Governing Council; these amounts may be offset against the national central banks’ monetary income”.

20 See Zilioli and Selmayr, op. cit., p. 78.

21 According to Smits, op. cit., p. 112, “Article 12.1, last sentence, ESCB Statute, is evidence of a presumption that the operations and activities of the System should, where ‘possible and appropriate’, take place at a decentralized level rather than be centralized at the ECB”. The same reasoning is followed by Zilioli and Selmayr, op. cit., p. 116: “By this, the discretion enjoyed by the ECB under Article 9.2 of the Statute is directed in such a way that it makes a legal requirement (‘shall’) to choose indirect implementation of the ECB’s monetary policy decisions”.

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Even though this interpretation does seem fairly clear, recourse to the use of ill-defined legal terms raises inherent difficulties in weighing up the degree of discretion open to the Governing Council when modulating the level of decentralisation of the System.

Obviously, the wording of the Article is clear in so far as the Governing Council’s decision is not free, but must be justified by the degree to which the decentralised execution of a given task is impossible or inappropriate.

We shall not dwell upon the first of these requirements (i.e. regarding “possibility”), as its analysis is relatively free of shades of meaning. Indeed, it seems reasonable to take the view that the “possibility” requisite is related to the operating capacity of a particular NCB, which probably refers us to episodes of temporary centralisation linked to exceptional cases of force majeure. More doubts, however, are raised by the analysis of whether the decentralised execution of a given task is “appropriate” or not. In principle, the subjection of the ECB to the rule of law obliges it to decide on objective grounds in accordance with the principles underlying the System. In the event of a disagreement over the compliance of the decision with the Treaty, the last word obviously lies with the Court of Justice.22

Independently from the above, however, it is undoubtedly the case that the use of a term in the Statute so closely linked to subjective considerations greatly widens the room for discretion by the Governing Council when delimiting its scope.23 As we have already pointed out, “the two essential characteristics defining the institutional design of the ESCB are its uniqueness with respect to the traditional scheme in the Treaty and its open character, which places in the hands of the system, to a large extent, a noteworthy capacity for self-definition”.24

Although Article 12.1 is part of an instrument whose legal force is beyond doubt (the Statute), its deliberately ambiguous wording tends to empty it of concrete legal content, which approximates it de facto to what is known generically as “soft law”.25 This fact will determine in the final instance its real imperative scope, although, as has already been noted, “[o]ur binary law is well capable of handling all kinds of subtleties and sensitivities; within the binary mode, law can be more or less specific, more or less exact, more or less determinate, more or less wide in scope, more or less pressing, more or less serious, more or less far-reaching; the only thing it cannot be is more or less binding”.26

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22 See Articles 230 of the Treaty and 35 of the Statute.
23 In fact, the term “appropriate” is the same as that used generically in Recommendation No R (80) 2 adopted by the Committee of Ministers of the Council of Europe on the exercise of discretionary powers by administrative authorities, which defines “discretionary power” as that “which leaves an administrative authority some degree of latitude as regards the decision to be taken, enabling it to choose from among several legally admissible decisions the one which it finds to be the most appropriate”.
5 CENTRALISATION VERSUS SELECTIVE DECENTRALISATION?

Without prejudice to the answer to the question concerning the ECB’s degree of discretion in determining the level of decentralisation of the System, the final paragraph of Article 12.1 of the Statute raises a number of further questions regarding the possible scope of the decision. It seems clear that, having observed the impossibility or inappropriateness of a task being carried out by the NCBs, the natural decision for the Governing Council to adopt would be to assign its execution to the ECB itself, in accordance with the provisions of Article 9.2 of the Statute.

However, could the ECB decide to centralise all ESCB tasks? In our view, the answer has to be negative. Not all the ESCB tasks may potentially be centralised. One task which is particularly significant in this regard is related to the holding and managing of the official foreign reserves of the Member States. Given that these foreign reserves have not been transferred to the ECB and undoubtedly remain assets of the Member States, it is the NCBs’ responsibility, as national authorities, to implement this function.27 Identical considerations would be applicable to the function of “conducting foreign exchange operations”, in so far as these are executed using the national reserves held by the NCBs, and without prejudice to the fact that this management is subject to the decision-making powers of the ECB, “in order to ensure consistency with the exchange rate and monetary policies of the Community”.28

Concerning the remainder of the functions listed in Article 3 of the Statute (“to define and implement the monetary policy of the Community” and “to promote the smooth operation of payment systems”), the Statute shows careful neutrality with respect to the question of the possible attribution of its execution to the ECB or to the NCBs, with the exception of the decision-making power (which, as we have seen, always lies with the ECB). In this regard, it suffices to say that all Articles of Chapter IV of the Statute (‘Monetary functions and operations of the ESCB’)29 systematically mention the ECB and the NCBs when defining the regulations for the executive functions in the framework of both ESCB tasks.30

This technique is also the same as the one used in the Statute regarding the issuance of euro banknotes, a function jointly assigned to the ECB and the NCBs in Article 106, first paragraph of the Treaty and Article 16. In this case, however, the logistical requirements of the circulation of banknotes (which are intimately linked to the power of issuance) make it difficult to imagine this power being taken over solely by the ECB.

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27 With regard to the foreign reserve assets transferred by the NCBs to the ECB pursuant to Article 30.1 of the Statute, and the relevant transactions conducted with them, the same considerations made in the following paragraphs related to the functions listed in Article 3 apply.
28 Article 31.1 of the Statute.
29 Apart from Article 20, which relates to a typical regulatory capacity.
30 Both the ECB and the NCBs can open accounts and accept assets as collateral (Article 17), perform open market and credit operations (Article 18), hold minimum reserve accounts (Article 19), enter into transactions with public entities (Article 21), and provide facilities to ensure efficient and sound clearing and payment systems (Article 22).
Now that we have tried to outline the potential decision-making scope under the last paragraph of Article 12.1 of the Statute, its application raises an additional question: is it possible that this decision might only affect certain NCBs?

Apart from exceptional and transitional cases of force majeure, “selective decentralisation” raises huge questions, even though future expansions of the Eurosystem make it legitimate to speculate about the possible advantages and drawbacks of the System in a scenario in which the ESCB comprises the ECB and 25 NCBs or more.

From a legal perspective, the first difficulty we face when considering selective decentralisation is that the Statute does not contain any clause enabling discrimination among NCBs. All the NCBs enjoy, as members of the System (Article 1.2 of the Statute), an identical legal position. It would certainly be difficult to question this statement by referring to the differing weight of the vote of the governors on patrimonial issues (Article 10.3 of the Statute). The same conclusion may be drawn regarding the voting differences that apply when the Eurosystem has 15 NCBs or more (Article 10.2 of the Statute in the version amended by Council Decision 2003/223/EC of 21 March 2003 on an amendment to Article 10.2 of the Statute – OJ L 83, 1.4.2003, p. 66), although the recitals of Decision 2003/223/EC seems to suggest a kind of ranking between NCBs.31

In view of the above, it is hard to imagine that the ECB would, when weighing up the requirements established in the final paragraph of Article 12.1 of the Statute, be able to decide that decentralisation was only “possible or appropriate” with respect to some NCBs, and not others. For these purposes, particular attention is merited by one of the basic principles (“Equality before the law”) in Recommendation No R (80) 2 adopted by the Committee of Ministers of the Council of Europe on the exercise of discretionary powers by administrative authorities. The Explanatory Memorandum of this Recommendation states: “(22) The purpose of this principle is to prevent unfair discrimination by ensuring that persons in the same ‘de facto’ or ‘de jure’ situations enjoy similar treatment where the exercise of a given discretionary power is concerned”; “(23) If a distinction in treatment is based on reasonable grounds whereby it can be objectively justified having regard to the purpose to be pursued, there is no infringement of the principle of equality before the law. There is unfair discrimination only where the distinctive treatment has no reasonable justification having regard to the purpose and consequences of the measure envisaged”.

31 Recital 5 of the above-mentioned Decision reads as follows: “The allocation of governors to groups is thus dependent on a ranking of their NCB’s Member State based on an indicator with two components: the size of the share of their NCB’s Member State (i) in the aggregate gross domestic product at market prices (hereinafter GDP mp) of the Member States which have adopted the euro; and (ii) in the total aggregated balance sheet of the monetary financial institutions (hereinafter TABS-MFIs) of the Member States which have adopted the euro. The economic weight of a Member State as reflected in its GDP mp is an appropriate component as the impact of central bank decisions is greater in Member States with larger economies than in those with smaller economies. At the same time, the size of a Member State’s financial sector also has a particular relevance for central bank decisions, since the counterparties of central bank operations belong to this sector. A 5/6 weight is attributed to GDP mp and a 1/6 weight to TABS-MFIs. This choice of weights is suitable, as this will mean that the financial sector is sufficiently and meaningfully represented”.

The above points refer exclusively to the capacity of the ECB in order to impose a specific selective decentralisation structure. Other possibilities, such as the establishment of different levels of execution to which NCBs could adhere on a voluntary basis, will not be subject to such legal constraints.

6 CONCLUSIONS

1. From a theoretical point of view, decentralisation entails the transfer of a competence to another organisation. Delegation, on the other hand, consists of the transfer of the mere exercise of a competence, but not the competence itself, which remains that of the delegating body. Both decentralisation and delegation should be distinguished from outsourcing, in that the latter does not have an effect upon public powers or functions and takes the form of the provision of an auxiliary service by a third party.

2. On the Community level, decentralisation should not be confused with the subsidiarity principle, to which Community institutions are subject in the case of non-exclusive competences.

3. The ESCB/ECB system is a unique organisational structure which shares elements proper to decentralisation and delegation, without being identifiably either. The competences for the execution of tasks by NCBs are assigned to them directly by the Statute and their respective national legislations, while the competence for the management of the System (in terms of its decision and control aspects) is centralised with the ECB.

4. In the last paragraph of Article 12.1, the Statute lays down a principle of executive decentralisation, provided that this execution by NCBs is “possible and appropriate”. Therefore, only in the case that these requirements are not met can the ECB decide to centralise those functions of the System that it is able to perform itself. Both this decision and the possible application of a selective decentralisation model raise difficult legal questions, given the institutional characteristics of the System and the ambiguous drafting of Article 12.1.
Il contributo esamina l'interpretazione da dare alle previsioni in materia di vigilanza prudenziale relative al SEBC, alla luce del dato storico della loro inclusione nel Trattato CE e nello Statuto del SEBC. Si osserva che tali previsioni implicano un campo di competenza più ampio di quanto talora ritenuto. Si descrivono alcuni dei contributi offerti dalla BCE, in funzione consultiva, nel campo dell'evoluzione degli standards prudenziali e della vigilanza sul rispetto dei medesimi. Il testo, in linea con l'opinione della BCE, suggerisce un maggiore ricorso allo strumento dei Regolamenti al fine di stabilire standards a livello europeo per l'industria dei servizi finanziari e argomenta in favore di un intenso coinvolgimento del SEBC nell'ambito di un processo evolutivo orientato verso una più accentuata allocazione a livello europeo delle responsabilità per la vigilanza su banche, assicurazioni e imprese finanziarie. Tale maggiore accentramento delle responsabilità non dovrebbe peraltro portare ad un ulteriore livello di burocrazia, bensì basarsi sulle autorità nazionali aventi funzioni di vigilanza, in un contesto di stretta cooperazione e condivisione di informazioni - che le entità commerciali operanti sul mercato interno potrebbero così preferibilmente fornire ad un'autorità soltanto - e svolgendo tale attività sotto l'egida di un'Autorità dotata di un mandato esteso all'intero mercato in Europa.
Memories of Paolo Zamboni

As a member of the Legal Committee (LEGCO) of the European System of Central Banks (ESCB) until September 2001, I witnessed many interventions by the head of the Banca d’Italia delegation, Paolo Zamboni. Paolo did not ask the floor on every subject we discussed, but, when he spoke, it was with conviction and clarity. Indeed, his interventions were made even more eloquent by his use of the Italian language, interspersed with English terms from the European Central Bank (ECB) documents that formed the basis for our discussions. Paolo was forthright in proposing solutions which the non-legal audience that LEGCO worked for (i.e. the Governing Council and Executive Board of the ECB) would accept. I will never forget his staunch support for my personal project, the writing of a thesis on the ECB’s institutional aspects – of which he kept saying that an Italian version had to be made – and his welcome every time I visited Rome for lectures on Economic and Monetary Union at LUISS University, when he had a vegetarian lunch prepared for me at the Banca d’Italia. His early departure from life was a loss for the central banking legal world and, for many, a personal one too.

1 INTRODUCTION

In this paper, I will sketch the provisions on the involvement of the European System of Central Banks (ESCB) in the prudential supervision of the banking industry, evoke the origins of these provisions, and offer my own interpretation of what they mean. I will also try to elaborate how they can best be put to use in an integrating European financial market.

2 HISTORY AND FUTURE OF THE RELEVANT PROVISIONS

A FIRST PROPOSAL

Since central banks have traditionally always been involved in the prudential supervision of banks or, in the wording of the legal acts of the European Community (EC) on this matter, “credit institutions”, a role for the ESCB in this area would seem a logical extension of the history of the national central banks (NCBs) that form the majority of the legal entities in the ESCB. In the preparations for Economic and Monetary Union (EMU), a role in banking supervision was, indeed, envisaged. An academic proposal for legal provisions to be inserted into the European Economic Community (EEC) Treaty envisaged

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giving the European Central Bank (ECB) a basic task to contribute to the proper functioning of the financial markets. The study further proposed to entrust the ECB with the task of coordinating the supervision of credit institutions with their seat or a branch within the Community, as well as similar undertakings placed on the same footing under EC law. The ECB was to ensure a coordinated interpretation and implementation of Community legislation in this area by the national supervisory authorities, as well as making sure that credit institutions and similar undertakings respect these norms. The ECB should be given the right to intervene in individual cases. The national supervisory authorities were to be placed under the ECB’s authority for the application of this provision. A further role that this study proposed to give to the ECB concerned the adoption of general decisions in the implementation of Community legislation in this area. Finally, in the proposals put forward by the “Groupe Louis”, the ECB should be entrusted with its own direct role as a supervisor of credit institutions if an organic law were adopted to this effect. Furthermore, it should have the capacity to enter into agreements with authorities of third countries or international organisations to facilitate its supervisory function and, by regulation, could be given tasks concerning credit institutions in difficulty or undergoing restructuring, whereas further tasks could also be given to the ECB.

THE DELORS COMMITTEE

Similarly, the Delors Committee Report (1988) had proposed that, in line with traditional central bank tasks in the area of the stability of the financial system, the ESCB should be entrusted with a “macro-prudential” role and should “participate in the coordination of banking supervision polices of the supervisory authorities”.

THE INTERGOVERNMENTAL CONFERENCE LEADING TO MAASTRICHT

The Intergovernmental Conference (IGC) which led to the adoption of the 1992 Maastricht Treaty on European Union (EU), the legal instrument which, inter alia, amended the EEC Treaty by inserting the provisions on EMU, had worked on the basis of a draft text for the Statute of the ESCB (“the Statute”) proposed by the Committee of Governors of the Central Banks of the EEC (the “Committee of Governors”). In their proposal, the Governors had envisaged that the ESCB should participate in the formulation, coordination and execution of
banking supervisory policies. After much discussion, the IGC adopted less far-reaching texts. Reluctant to attribute to the ECB more than an auxiliary role, the authors of the EMU provisions of the EC Treaty (“the Treaty”) and of the Statute refrained from explicitly mentioning those coordinating tasks proposed by the Study Group headed by Professor Louis, the Delors Committee and the Committee of Governors.

**THE TEXTS AS ADOPTED**

Without going further into the details of the legislative history, the texts that were adopted mention as tasks of the ESCB (note: not of the ECB alone) that it

“shall 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.”

To that end, Article 25.1 of the ESCB Statute, the sole provision in Chapter V headed “Prudential supervision”, entrusts the ECB (alone) with the following advisory functions:

“The ECB may offer advice to and be consulted by the Council, the Commission and the competent authorities of the Member States on the scope and implementation of Community legislation relating to the prudential supervision of credit institutions and to the stability of the financial system.”

In line with Article 105 (6) of the Treaty, Article 25.2 of the Statute provides that the Council may entrust the ECB (again: the ECB alone) with the task of performing

“specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings”.

**APPLICABILITY**

These provisions entered into force on 1 November 1993, the date on which the Maastricht Treaty became effective. Nevertheless, their actual application would have to wait until the date that the ESCB was to assume full powers. In the interim period (1994-1999), the so-called Stage Two of EMU, the European Monetary Institute (EMI) prepared the ground for Europe’s new monetary

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7 In Article 105 (5). Note that the Maastricht Treaty renamed the EEC Treaty as “The Treaty establishing the European Community”, leaving out the adjective “Economic” from the Community’s name. Hence, after 1993, all references are to the EC Treaty (henceforth “the Treaty”).
8 In Article 3.3.
authority. The EMI had itself been entrusted with a supervisory task among its 
six main functions of a coordinating and preparatory character. It was to:

“hold consultations concerning issues falling within the competence of the 
national central banks and affecting the stability of financial institutions and 
markets”.

This was a function that its predecessor, the Committee of Governors, had also 
performed.

With the establishment of the ESCB and the ECB on 1 July 1998, the EMI’s 
powers were taken over by these new EC bodies. They only assumed the “full 
exercise of their powers” on the first day of Stage Three, i.e. on 1 January 1999.
In view of the monetary split of the EU, with the (then) majority of Member 
States adopting the single currency with a few remaining, for the time being, 
outside monetary union, these powers were limited in respect of the non-
participating or “out” Member States. As Article 122 (3) of the Treaty and 
Article 43.1 of the Statute make clear, the task-setting provisions concerning 
prudential supervision, i.e. Article 105 (5) of the Treaty and Article 3.3 of the 
Statute, do not apply to Member States with a derogation. Nevertheless, the 
provision which was considered to implement this task-setting provision, i.e. 
Article 25 of the Statute, does apply to the “out” Member States, as does the 
provision containing a potential own supervisory function for the ECB (Article 
105 (6) of the Treaty, reflected in Article 25.2 of the Statute).

Although the ESCB, when performing tasks for those Member States that have 
attempted the single currency, is known as the “Eurosystem” in order to 
distinguish it from the ESCB in its overarching functions for the EU as a whole – 
a term that comprises the ECB and the NCBs of the “in” Member States only –, this contribution will mainly use the term employed in the Treaty and 
the Statute. This is based on the fact that, whereas Article 105 (5) applies only 
to the “in” Member States, Article 25.1 applies to all States within the Union, 
as does the enabling clause.

9 See Article 117 (2) of the (EC) Treaty (numbering following the Amsterdam Treaty’s renumbering of EC Treaty 
provisions) and Article 4.1 of the Statute of the EMI.
10 Article 117 (2), fourth indent of the Treaty, and Article 4.1, fourth indent of the EMI Statute.
11 Pursuant to Article 3 of Decision 64/300/EEC on cooperation between the central banks of the Member States 
of the European Economic Community (OJ No 77, 21.5.1964) establishing the Committee of Governors, as 
amended by Decision 90/142/EEC (OJ L 78, 24.3.1990, p. 25), the decision which inserted new language into 
the original basic charter of the Committee of Governors with a view to enhanced cooperation during Stage 
One of EMU (1 July 1990-31 December 1993).
12 Article 123 (2) of the Treaty.
13 Article 123 (1), in fine, of the Treaty.
14 Since then, the members of the euro area have numerically become in a minority, as the ten States that acceded 
on 1 May 2004 have the status of Member States with a derogation pursuant to Article 4 of the 2003 Act of 
15 Officially, Member States with a derogation (Article 122 (1), in fine, of the Treaty), or States with an opt-
out (i.e. Denmark and the United Kingdom (UK); see, respectively, Protocol Nos 25 and 26 (current numbering) 
to the Treaty).
16 For the UK, see paragraphs 5 and 8 of its Opt-out Protocol. The Danish Opt-out Protocol makes it clear that 
Denmark is to be treated as a Member State with a derogation.
17 Note, however, that the general consultative function of the ECB in respect of draft legislation in its fields 
of competence (Article 105 (4) of the Treaty and Article 4 of the Statute) does not apply to the UK.
18 The European Constitution – on which more below – mentions, in Article III-30 (1), the Eurosystem.
The European Convention was called upon to reframe the EU’s founding Treaties into a single constitutional text, while enhancing the transparency, democratic legitimacy and efficiency of the Union. The Convention did not come forward with amendments to the texts adopted in Maastricht.19 The IGC that adopted the Treaty establishing a Constitution for Europe (“the European Constitution”)20 likewise largely refrained from altering the provisions, except in consequence of general amendments. Thus, the European Constitution requires a “European law” to make use of the enabling clause on specific supervisory tasks for the ECB (Article III-185 (6)). However, the text of the enabling provision has been changed in that, whereas the Council, acting unanimously, nowadays needs the assent of the European Parliament, the European Constitution still requires it to act unanimously but only to consult (rather than seek the assent of) the European Parliament, as well as the ECB itself.21 Just as a Commission proposal is required under Article 105 (6) of the Treaty, the European Constitution requires an initiative from the European executive to make use of the enabling clause. This follows from the general provisions on law-making.22 Furthermore, the Statute, as amended, will refer to the provisions of the European Constitution rather than to the Treaty. As is the case at present, the Member States with a derogation will not be bound under the Constitution to the objectives of the ESCB, meaning that the general supervisory objective of Article III-185 (5) does not apply to them.23 The enabling clause will still apply to the “out” Member States.

3 INTERPRETATION

A narrowly historic view of Article 105 (5) of the Treaty and Article 25.1 of the Statute might imply that the supervisory task of the ESCB exhausts itself in the mere possibility for the ECB to give advice. As set out before24, my reading of the provisions, both on textual and contextual grounds, suggests a wider interpretation. The discrepancies between Article 105 (5), entrusting the ESCB to contribute to the smooth conduct of supervisory policies, and Article 25.1, allowing the ECB alone to offer and to be sought advice from on Community legislation relating to prudential supervision and to the stability of the financial system, are too great to accept that the two provisions fully overlap.25 It cannot be assumed that the Treaty authors intended the ESCB to perform a task without

22 Article I-34 of the European Constitution on legislative acts.
23 See Article III-197 (2) (c) of the European Constitution and Article 42.1 of the Statute in the version of Protocol No 4 attached to the Constitution. For the UK, see Articles 4 and 7 of Protocol No 13 to the Constitution; for Denmark, see Protocol No 14. In the area under consideration, both provide for the same applicability of prudential provisions as the Treaty and the relevant Protocols thereto. For the ten new Member States since 1 May 2004, see Article 4 of Protocol No 9 to the Constitution.
25 In addition, the divergent field of applicability (euro area versus EU) argues in favour of a teleological reading.
equipping it with the necessary powers. Therefore, I read Article 105 (5) as making the ESCB competent to use more instruments to perform its prudential task. Not only will the NCBs, as well, have to ensure that Article 105 (5) is implemented, but the ECB will also have to make use of more instruments than just its consultative role under Article 25.1. For the ESCB to pursue its prudential task, various methods may be put to use, such as its required advice in draft legislation at the Community and national levels, its statistical function, the largely market-oriented operations which the ECB and the NCBs are competent to perform under Chapter IV of the Statute, the possibility for the ECB to take part in international monetary institutions, as well as other, more informal methods. The close connection of prudential and financial stability concerns with the fourth basic task, i.e. to promote the smooth operation of payment systems, forms an additional argument in favour of reading more into Article 105 (5) than purely what is stated in Article 25.1.

One element that may be considered to be implicit in the financial stability-related task set out in Article 25.1, i.e. operation in crisis management, including the function of lender of last resort, is not further explored here, for two main reasons. First, I consider providing lender-of-last-resort assistance a core central banking function that also pertains directly to its monetary functions, as it may both concern general liquidity supervision to the financial system and assistance to individual financial institutions experiencing liquidity problems. Second, the debate on the proper system of supervision is not focused on the crisis element – which, moreover, has been covered by specific measures. Rather, the issue is how to organise the prudential supervision of the EU’s financial sector.

Broadly in line with the ECB’s memorandum on “The Role of Central Banks in Prudential Supervision”, a distinction can be made between:

– investor protection activities, focusing on conduct-of-business rules and disclosure of information;

Moreover, Article 109 of the Treaty requires that national legislation is made compatible with the (EMU provisions of) the Treaty and the Statute before the establishment of the ESCB. Note that Article III-189 of the European Constitution states this requirement without reference to the date of 1 July 1998.


Article 5 of the Statute.

Articles 17-24 of the Statute.

Article 6 ESCB of the. As set out in my thesis, the term “monetary” needs to be read as encompassing all central banking tasks of the ESCB. See The European Central Bank – Institutional Aspects, op. cit. (footnote 24), pp. 426-427.

Article 105 (2), fourth indent of the Treaty (Article III-185 (2) (d) European Constitution) and Article 3.1, fourth indent of the Statute.


It should be acknowledged that any assistance beyond the granting of lender-of-last-resort facilities may exceed the competence of the ESCB, as it might imply that public funds should be channelled to financial institutions. In addition, the European Commission may have to play a role in any lending that would amount to public aid, which is prohibited in principle pursuant to Article 87 of the Treaty. Collateralised lending is certainly permitted under the Statute. These wider issues, however, cannot be discussed in the context of this contribution.

micro-prudential supervision, geared towards the safety and soundness of individual financial services providers in the interest of depositors and other creditors;

macro-prudential supervision, geared towards the avoidance and containment of systemic risk, and therefore concerned with macroeconomic and financial market developments and market infrastructures.

4 PRACTICE AND TRENDS

BANKING SUPERVISION COMMITTEE

The ESCB has been an active contributor to developments in the area of prudential supervision. Among the committees which have been established to assist the decision-making bodies of the ECB, a special committee representing all NCBs and the ECB, as well as supervisory agencies in those States where these are not the respective NCB, has been created, following a similar committee that previously existed under the Committee of Governors and the EMI. The Banking Supervision Committee (BSC), which combines central bankers and outside supervisory agencies from across the EU, is one of the main fora for the coordination of supervisory policies. In addition, the ECB has issued many opinions on draft legislation in the area of supervision. It actively promoted the role of central banks in the ongoing debate about the proper place of prudential supervision.

THE DEBATE ON THE PROPER PLACE OF PRUDENTIAL SUPERVISION

The current debate on the proper place of supervision, whereby the third area of concern mentioned above is almost invariably that of the central bank, but the first hardly ever so, roughly began with the entry into force of the new arrangements for monetary policy. It seemed to have purely a national dimension. In many Member States, the proper organisation of supervision was the subject of study and debate, with departments of finance often taking a stance against the (continuation of) attribution of (micro-)prudential tasks to the now independent NCBs. Developments in Belgium, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal and the UK over the past seven years all involved a restructuring of the supervisory landscape and, in some instances, a hiving-off of prudential tasks from the central bank. In most of these States, central banks are in either still in charge of or are involved in banking

37 See most notably the paper mentioned in footnote 35.
38 Of course, many central banks had enjoyed independence to a greater or lesser degree before 1998, but by that time their independence had become established as guaranteed in the Treaty and defined in Convergence Reports. (The Commission and the ECB [previously, the EMI] investigate the measure of legal convergence pursuant to the Treaty requirement of a two-yearly study into the progress towards meeting the convergence criteria for adopting the single currency. See Articles 121 (1) and 122 (2) of the Treaty, and Article III-198 of the European Constitution.)
supervision. A European dimension is only slowly entering the debate. Especially in the field of securities regulation and supervision, the search for greater consistency and the desire to alleviate the regulatory burden on players points in the direction of a further strengthening of cooperation mechanisms. Calls for a Europe-wide supervisor have even been voiced. The euro area represents a special case in the debate as the single currency is helpful in the integration of payments systems and has stimulated the formation of large banking groups, although a single market and monetary union do not necessarily require a single regulatory framework, as the US example proves. However, the integration of payments systems and the creation of financial conglomerates make it more likely than before that disturbances will affect other markets, and not only that of the State in which a difficulty arises. The EU-wide mandate for monetary policy that the NCBs of the “in” States have may help in seeking a coordinated solution to any risk-related problems that may arise.

THE LAMFALUSSY APPROACH

In the field of securities regulation, a new approach to regulation and supervision was adopted, the Lamfalussy approach, named after the Chairman of the Committee of Wise Men which had been asked to investigate the possibilities of speedier adaptation of European rules to market change. The Lamfalussy approach practically coincided with the adoption of the Financial Services Action Plan (FSAP), a set of proposed (and, by now, almost entirely adopted) legislative measures to supplement the 1992 internal market programme and to achieve integrated, efficient and stable financial markets in the EU.

The Lamfalussy approach entails the following:
1) Framework principles are adopted in basic EU legislation, for which the Council and the European Parliament are responsible according to the so-called co-decision procedure; 2) Implementing legislation setting out the technical details is to be adopted by the Commission after consultation of a regulatory committee, composed of representatives of the ministries of finance and the national supervisory agencies;

41 This reasoning is derived from the ECB’s paper of 30 March 2001 mentioned above.
44 Article 251 of the Treaty (Article III-396 of the European Constitution).
45 Based on Articles 202, third indent and 211, fourth indent of the Treaty and the Comitology Decision of the Council (Council Decision 1999/468/EC laying down the procedures for the exercise of implementing powers conferred on the Commission, OJ L 184, 17.7.1999, p. 26, as amended). In the European Constitution, see Article I-36 and the Declaration on Article I-36, which notes the Commission’s intention to continue to consult national experts in the preparation of draft delegated European regulations in the area of financial services.
3) Enhanced cooperation and networking of supervisory authorities should ensure a uniform approach in all Member States to the rules thus adopted;
4) Strengthened enforcement of implementation with a central role for the Commission in overseeing the implementation.46

Although the Lamfalussy approach is widely seen as a success47, allowing the Union to provide a regulatory response to market change with greater speed and efficiency, and in a more transparent fashion48, it should not be forgotten that it still entails a five-level system of preparation of rules, as follows:
1) Global agreement on the norms and standards at G10 level, in the International Organization of Securities Commissions (IOSCO), the Basel Committee, the FATF49, etc.;
2) EU directives, adopted in co-decision by the Council and the European Parliament (Lamfalussy level 1);
3) EU implementing legislation, adopted by the Commission in cooperation with regulatory committees (Lamfalussy level 2);
4) National legislation (national Acts of Parliament);
5) National regulatory implementation, i.e. rules and standards adopted by regulators and supervisors, with this implementation overseen by the Commission (Lamfalussy levels 3 and 4).

The Lamfalussy approach has meanwhile been expanded to the other segments of the financial services industry, leading to the establishment of a new European Banking Committee, in which the ECB has observer status50, and the Committee of European Banking Supervisors (CEBS)51, in which the ECB sits.52 Very recently, a Directive amending the supervisory directives with the aim of creating “a new organisational structure for financial services committees” has been adopted and has entered into force.53

As the above steps indicate, the preceding five-step approach usually has to be followed before any change in market practice can be reflected in new rules applying to those same markets. Not only is the Lamfalussy approach still time-consuming, but it does not guarantee uniform trading rules either, since the

46 Based on the Commission’s “guardian of the Treaty” function (Article 226 of the Treaty; Article III-360 of the European Constitution).
48 This is because of the required consultation mechanisms, which are modelled in such a way that the industry and other interested parties can make their voices heard in the preparation of both framework rules and detailed standards.
49 Financial Action Task Force (Groupe d’action financière sur le blanchiment de capitaux) is an independent forum for cooperation on measures to combat money laundering. It was initiated by the G7, and has its secretariat at the OECD in Paris. See http://www.fatf-gafi.org/.
51 See the Commission’s Decision of 5 November 2003 establishing the Committee of European Banking Supervisors, OJ L 3, 7.1.2004, p. 28. For a graphic depiction of the role of the London-based CEBS, see its website at file:///D:/Documenten%20en%20Settings/Re%E9%20Smits/Local%20Settings/Temporary%20Internet%20Files/Content.IE5/UHOZUHU5/594,8,CEBS.
52 As one of “the central banks which are not directly involved in the supervision of individual credit institutions, including the European Central Bank”; see Article 3 sub c of the Decision establishing the CEBS.
The possibility remains of different interpretation of the EU-wide framework standards, the addition of State-specific rules, or of the divergent application of the standards by national enforcement agencies. For this reason, new ideas have developed to counter the extent of regulatory divergence and to ensure a true level playing-field for financial services providers and clients alike.

**RECENT IDEAS DEVELOPING IN THE SUPERVISION OF THE SECURITIES INDUSTRY**

After tracking the progress of the FSAP\(^\text{54}\), and in the midst of the implementation phase, the focus now is on new methods of ensuring uniform rule-making and their consistent application. In this context, I intend to sound out a few voices among the many tones that can be heard in the current concert accompanying the supervisory landscaping.

The Committee of European Securities Regulators (CESR)\(^\text{55}\) has published a report that sets out which supervisory tools may be useful in the coming years. The consultation report\(^\text{56}\) is firmly wedded to the Lamfalussy approach, yet includes proposals such as a database of supervisory decisions to ensure consistency, the use of joint teams of supervisors, the possible future attribution of “one-stop shop” decision-making powers in certain fields where, nowadays, 25 agencies decide matters\(^\text{57}\), sometimes without EU rules to base themselves on.\(^\text{58}\) Although a different tune can be heard from across the Channel\(^\text{59}\), with the Financial Services Authority (FSA) and the Bank of England advocating no new supervisory arrangements\(^\text{60}\), it is clear that a discussion of how best to organise the supervisory landscape is developing in an EU-wide setting.\(^\text{61}\)

The ECB itself, in its contribution to the public consultation on the application of the Lamfalussy process to securities market legislation\(^\text{62}\), has made several proposals that would enhance supervisory consistency and introduce a single set of Europe-wide standards. Specifically, the ECB welcomes alterations to the Lamfalussy process that would “develop a common set of harmonised technical rules that would satisfy the needs both of regulators and market participants”. It calls for the adoption of regulations as a means to implement the framework principles set out in the level 1 directives, so that “a unique source of rights and obligations in the EU harmonised regulatory fields” would ensue. Thus, the long


\(^{55}\) See http://www.c-ecb.org/.


\(^{57}\) The admission of prospectuses is mentioned as an example where single decisions for the entire market may make sense.

\(^{58}\) The supervision of rating agencies is a case in point.

\(^{59}\) CESR’s headquarters are in Paris.


\(^{61}\) Some of the responses, e.g. that of the European Banking Federation, indicate that the banking industry itself prefers to see CESR focus on the current framework rather than proposing “one-stop shop” decision-making, as this would imply a rewriting of recent directives. See CESR’s website at: http://www.cesr-eu.org/.

\(^{62}\) See footnote 47.
implementation process and the inconsistencies in national implementation could be remedied.

The ECB, in its Opinion on the implementation in the EU of the so-called Basel II agreement\(^63\), the set of standards that will replace the current Basel solvency rules\(^64\), calls for more consistency and a single source of EU-wide rules based on so-called level 2 measures (i.e. the implementing measures of the framework directives), as it did in its earlier Opinion on the proposed extension of the Lamfalussy approach to the other sectors of the financial services industry.\(^65\) Quoting from the latter Opinion, the ECB endorses a development under which Level 2 acts would emerge

“as the main body of technical rules applicable to EU financial institutions. At the same time, those aspects that could be more appropriately dealt with in EU legislation could be transferred from national legislation to Level 2 acts. The ECB is convinced that such a harmonised, simplified set of European rules would contribute significantly to further integrating financial markets, would considerably reduce regulatory costs for financial institutions and would enhance consumers’ rights in relation to financial services.”

Its most recent Opinion specifically calls for Community regulations to be used for implementation.

Apart from the issue of a single and consistent source of financial market regulation, the question of coordination among supervisors is a recurring theme in the papers and opinions mentioned above.

The coordinating role played by the supervisor on a consolidated basis of financial conglomerates\(^66\), and the possibility of group-wide use of the internal ratings-based (IRB) approach to solvency\(^67\), requiring coordinated competences of national supervisors, are examples of cases which alter the supervisory landscape.

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67 See paragraph 16 of the ECB’s Opinion on the EU’s implementation of Basel II, mentioned in footnote 64.
5  POTENTIAL DEVELOPMENTS

All of these developments and tentative scenarios still fall short of a European banking supervisory agency, or a Europe-wide financial services supervisory authority, in either case linked to or coinciding with the ESCB. Arguments in favour of such an agency have however been put forward. Information-related synergies between supervision and core central banking functions, the central banks’ focus on systemic risk, their independence and expertise, as well as the historic involvement of central banks in supervision and the possibilities opened by the close networking of supervisors already in the Eurosystem, all argue in favour of central banks’ close involvement in prudential supervision at the very least, if not of a full attribution of exclusive supervisory powers to central banks. They also suggest that a systematic and overall regulation of the facility of exchanging supervisory information is required, instead of the current patchwork of rules and roadblocks.\(^{68}\) Regulatory and supervisory overlaps and the heavy regulatory burden for commercial undertakings in the financial services industry support the need for schemes that allow reporting to a single agency. Additionally, they argue for, if possible, a single agency to be the counterpart of an undertaking for the entirety of its supervisory compliance within the single market. Preferably, this agency should be “close at hand” yet should act in a coordinated fashion according to a European mandate with EU-wide responsibility for the proper execution of the single market’s standards. Moreover, the necessity for home State supervisory authorities to include the externalities of their decisions which apply to a company’s Europe-wide financial services provision should be brought into sharper focus. Stronger coordinating mechanisms and central responsibilities for the overall stance of supervision would be helpful in this respect, especially when cross-border financial services groups are concerned.

Issues of accountability and the concentration of power are valid concerns that should be given careful consideration. It is submitted that accountability can be properly organised at the EU level as well. It may vary in relation to the area concerned, with the level of independence from other public bodies and institutions the greatest in the core Eurosystem task, namely the pursuit of price stability, with four basic tasks that form an exclusive European competence, and with far more involvement of non-central bank policymakers in the area of prudential supervision. In addition, the size of the European market, and the vastness of the area of supervision, should not lead to a large bureaucracy, but

rather should result in a central body responsible for overall decision-making
that relies on local supervisors who know their parts of the market and their
supervised undertakings best. The 2004 proposal by the European Financial
Services Round Table (EFR) to designate a home State supervisory authority
to oversee the EU-wide activities of financial services groups operating in
various Member States represents an intermediate step towards more centralised
responsibilities for prudential supervision.

The adoption of regulations as the main instruments for setting Europe-wide
standards for the financial services industry would represent an important first
step in the right direction, as this would create a common set of norms, no longer
unduly influenced by the specific aspects woven into current financial services
law in the process of national implementation. State-centred enforcement is the
second element which should be tackled to end what can only be described as
the current “balkanisation” of the single market in financial services, at least
at the retail level.

In my view, the ESCB should be closely aligned with any developments towards
enhancing Europe-wide regulatory and supervisory responsibilities. A legal basis
for the establishment of central supervisory responsibilities can be found in
Article 308 of the Treaty (Article I-18 of the European Constitution, the so-called
flexibility clause). The ESCB’s involvement – whether directly or as closely
involved in the supervisory authority’s activities – could, additionally, be based
on its competences as discussed in this paper.69 It should provide the coordinating
role, bringing into instances of major decision-making a perspective which
reflects the implications for the entire market and its citizens, as well as for the
single currency. A further debate on the proper place of supervision of financial
services industry in an integrated Europe is called for. To my mind, the single
currency and the internal market provide important arguments for Europe-wide
responsibilities that would make supervisors not only look at their national
audience, but also to address a wider European constituency.70

69 Despite the fact that the continued exception for “insurance undertakings” from the enabling clause (Article
III-185 (5) of the European Constitution and Article 25.6 of the Statute) is an anomaly, the more so when one
acknowledges that this exclusion was proposed by the Dutch in 1991 even though in the Netherlands the central
bank and the Insurance Inspection Board have since merged, making De Nederlandsche Bank competent for
insurance supervision as well. Mario Grande, in his commentary on Article 25.2 of the Statute (in H. von der
Groeben and J. Schwarze (eds), Kommentar zum Vertrag über die Europäische Union und zur Gründung der
Europäischen Gemeinschaft, 6th edition (Baden-Baden: Nomos Verlag, 2003), p. 487), remarks that the
reasoning underlying this restriction, namely that the insurance sector is more remote from central bank
functions than the banking and securities markets, is no longer valid in the view of recent developments in
the financial markets.

70 For a proposal to give national supervisors a European mandate as well, see D. Schoenmaker, “Financial
CENTRAL BANK INDEPENDENCE AND RESPONSIBILITY FOR FINANCIAL SUPERVISION WITHIN THE ESCB: THE CASE OF IRELAND

Joseph Doherty and Niall Lenihan

ABSTRACT

La vigilanza delle istituzioni creditizie e finanziarie non rientra tra i compiti attribuiti dal Trattato al SEBC. Il contributo descrive come, in pratica, tale tipo di vigilanza sia organizzato secondo un’ampia varietà di strutture giuridiche nei venticinque Stati membri, con diversi gradi di coinvolgimento da parte della banca centrale. Lo studio descrive il nuovo assetto giuridico creato in Irlanda dal 2003, secondo cui la vigilanza della pressoché totalità del settore finanziario, istituti di credito compresi, è competenza di un organismo indipendente, ricompreso nella personalità giuridica della Banca Centrale Nazionale (BCN). Secondo tale schema, alla BCN compete, in termini giuridici, l’esclusiva responsabilità degli atti di vigilanza e regolamentari dell’autorità di vigilanza finanziaria. Ciò solleva la questione, ai sensi della legge irlandese, dei limiti della responsabilità della banca centrale per atti di vigilanza finanziaria. Il contributo analizza la giurisprudenza in Irlanda, nel Regno Unito e della Corte Europea di Giustizia in materia di responsabilità dell’autorità di vigilanza finanziaria secondo la legge irlandese e comunitaria, nonché le immunità statutarie di cui gode la banca centrale secondo la legislazione irlandese applicabile. I limiti della responsabilità della banca centrale per l’autorità di vigilanza finanziaria hanno rappresentato un punto critico nel parere rilasciato dalla BCE alle autorità irlandesi, allorché nel 2002 la BCE veniva consultata sulla ristrutturazione della Banca Centrale d’Irlanda. Il parere della BCE ha messo in luce che, istituendo un organo statutario dotato di funzioni indipendenti, ma ricompreso nella personalità giuridica di una BNC, la BCN sarebbe responsabile degli atti svolti da una parte costitutiva della banca centrale (l’autorità di vigilanza finanziaria), atti che rimarrebbero al di fuori del controllo dell’organo decisionale della banca centrale responsabile dello svolgimento dei compiti collegati al SEBC (il Governatore della banca centrale). La BCE ha considerato che tale struttura potesse causare dei rischi per l’integrità di una BCN, minacciando la sua indipendenza, contrariamente ai principi dell’Articolo 108 del Trattato. Il contributo descrive come la legislazione, nella sua attuazione, affrontasse le preoccupazioni della BCE, attribuendo al Governatore un ruolo preminente, relativamente alle problematiche connesse con la stabilità finanziaria. Lo studio conclude osservando che, nel suo parere sulla ristrutturazione della Banca Centrale d’Irlanda, la BCE ha chiaramente stabilito i limiti della riorganizzazione proposta, ammonendo contro il rischio che le funzioni di autorità di vigilanza finanziaria violino l’indipendenza della banca centrale.
I INTRODUCTION

The supervision of credit and financial institutions is not among the tasks attributed to the European System of Central Banks (ESCB) under the Treaty establishing the European Community (the “Treaty”). This paper will describe the wide variety of legal structures under which the supervision of credit and financial institutions is, with varying degrees of central bank involvement, organised in the 25 Member States (see Section 2). It will analyse the novel legal structure deployed in Ireland since 2003, whereby the supervision of practically the entire financial sector, including credit institutions, is carried out by an autonomous body forming part of the legal personality of the national central bank (NCB) (see Section 3). Under this construction the NCB bears, in legal terms, sole liability and responsibility for the acts of the financial supervisor. This raises the important question as to the extent of the NCB’s liability for the financial supervisor under Irish law. The paper will discuss in some depth the relevant case law in Ireland, the United Kingdom and the European Court of Justice shedding light on the scope of the NCB’s liability for the financial supervisor under Irish and EC law, as well as the statutory immunities enjoyed by the NCB under applicable Irish legislation (see Section 4).

The paper will describe how the NCB’s liability for the financial supervisor was a critical issue in the opinion provided by the ECB on the draft Irish legislation which restructured the Central Bank of Ireland by establishing the autonomous Irish Financial Services Regulatory Authority (IFSRA) as a constituent part of the renamed Central Bank and Financial Services Authority of Ireland. The paper will conclude by explaining how, in its opinion on the draft legislation restructuring the Central Bank of Ireland, the ECB clearly set the limits of the proposed reorganisation by warning against the risk of the IFSRA’s supervisory functions encroaching upon the NCB’s independence. As a result, the legislation, as enacted, ensured that the Governor of the CBFSAI has a significant role with respect to financial stability matters in order to protect the independence required of an ESCB national central bank under the Treaty (see Sections 5 and 6).

2 ROLE OF ESCB IN SUPERVISION OF CREDIT AND FINANCIAL INSTITUTIONS

2.1 PRUDENTIAL SUPERVISORY ROLE OF EUROSYSTEM UNDER TREATY

Although many NCBs in the ESCB are closely involved in the prudential supervision of credit and other financial institutions, such supervision is not one of the tasks attributed to the ESCB under the Treaty. These functions are therefore

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1 The authors would like to gratefully acknowledge the contribution that the late Paolo Zamboni made to some of the main ideas in this paper. The authors would also like to gratefully acknowledge the contributions of Kristine Drevina, Legal Counsel, ECB, Luc Roeges, former Principal Legal Counsel, ECB, Pedro Teixeira, Principal Expert, Financial Supervision Division, ECB, and helpful comments received from colleagues in the CBFSAI.

2 Article 105(6) of the Treaty contemplates the possibility that the EU Council may confer upon the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings. For background information regarding the discussions on the appropriate role for the ESCB in banking supervision during the Maastricht Treaty negotiations, see Smits, The European Central Bank: Institutional Aspects (Kluwer Law International 1997), pp. 334-38.
performed on the responsibility and liability of NCBs and are not regarded as being part of the functions of the ESCB. However, reflecting the close historical link between central banking and the prudential supervision of credit institutions, the Treaty prescribes a contributory role for the Eurosystem in the performance of supervisory tasks. In particular, Article 105(5) of the Treaty requires the Eurosystem 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. The European Central Bank (ECB) has taken the policy position that an institutional framework in which the Eurosystem's responsibilities for monetary policy in the euro area are coupled with extensive supervisory responsibilities of NCBs in domestic markets, and with reinforced co-operation at an area-wide level, would seem appropriate to tackle the changes triggered by the introduction of the euro, and that when viewed from a Eurosystem perspective, the attribution of extensive supervisory responsibilities (i.e., both macro and micro-prudential) to NCBs are likely to prove beneficial.

2.2 SUPERVISORY ROLE OF NCBS UNDER NATIONAL LAWS

In practice, the supervision of credit and financial institutions is organised under a wide variety of legal structures in the 25 EU Member States, with varying degrees of central bank involvement. At one end of the spectrum, in nine Member States NCBs are directly and fully responsible for the supervision of credit institutions. In some of these Member States (Greece, Italy) the NCB is, or

3 Article 14.4 of the Statute of the European Central Bank and of the European System of Central Banks (the “ESCB Statute”).
4 In accordance with Article 122(3) of the Treaty, Article 105 of the Treaty does not apply to Member States which have not adopted the euro.
5 See European Central Bank, The Role of Central Banks in Prudential Supervision, 2001, p. 3, published on the ECB website at http://www.ecb.int/press/pr/date/2001/html/pr010322.en.html. As noted by Dr. Duisenberg, former ECB President, “[t]he Eurosystem strongly supports a continued involvement of national central banks in prudential supervision, although the institutional set-up of financial supervision needs to be tailored to the structure of the respective national financial system. Any solution other than direct responsibility should be coupled with close co-operation and operational involvement of central banks in order to allow the potential synergies between central banking and prudential supervision to be exploited.” Dr. Willem F. Duisenberg, President of the European Central Bank, Amsterdam, 24 April 2002.
6 Cyprus: Section 26(1) of the Banking Law (No 66(1) of 1997); Section 6(2)(d) of The Central Bank of Cyprus Law of 2002 (No 138(I) of 2002); Czech Republic: Act on the Czech National Bank (Česká národní banka), Articles 2(2)(d) and 44; Greece: Law No. 2548, Provisions relating to the Bank of Greece, Articles 2(1)(d), 8; Italy: Consolidated Banking Law, Article 4; Lithuania: Lietuvos Bankas Act, Article 8 (6) and Chapter 7; Portugal: Banco de Portugal Organic Law, Article 17; Decree-Law No. 298/92 of 31 December of 1992, Article 93(1); Slovakia: The National Bank of Slovakia (Národná banka Slovenska) Act, Article 36; Slovenia: Bank of Slovenia (Banka Slovenije) Act, Article 23; Banking Act, Article 123; Spain: Law of Autonomy of Banco de España, Article 7 (6).
7 The Bank of Greece is responsible for the supervision of a small number of financial institutions in addition to credit institutions, including financial leasing companies, factoring companies, mutual guarantee companies, counterguarantee funds, bureaux de change and money market broker companies. Law No. 2548, Provisions relating to the Bank of Greece, Articles 2(1)(d), 8.
8 The Banca d’Italia has supervisory powers over credit institutions and financial intermediaries, and also has responsibility for the prudential supervision of investment firms and asset management companies. Consolidated Banking Law, Articles 4 and 5. A draft Law on Measures for the Protection of Savings was recently proposed, one of whose aims was to reform the institutional framework in Italy for the regulation and supervision of financial markets and intermediaries. The draft Law envisaged that the Banca d’Italia would be responsible for safeguarding financial stability and the prudential regulation and supervision of credit institutions, insurance companies, investment firms and other financial intermediaries. A newly established authority, the Authority for the Financial Markets (Autorità per i mercati finanziari – AmeF), would be responsible for conduct of business regulation and supervision. See Opinion of the European Central Bank of 11 May 2004 on a draft Law on Measures for the Protection of Savings (CON/2004/16), published on the ECB’s website at http://www.ecb.int/ecb/legal/pdf/en_con_2004_16_f_sign.pdf.
will shortly become (Slovakia⁹), responsible for the supervision of not only credit institutions, but also other financial institutions and activities. In these Member States NCBs would appear, logically, to be liable for their supervisory decisions to the extent provided under applicable national laws. At the other end of the spectrum, in eight Member States an independent public authority that is legally and operationally separated from the NCB is responsible for the supervision of practically the entire financial sector.¹⁰ In some of these Member States (Austria,¹¹ Latvia¹²) the NCB has an institutional role in the appointment and dismissal of the members of the supervisory authority’s decision-making body. Also, given the important financial stability role of NCBs, for example in connection with a central bank’s traditional lender-of-last-resort function, arrangements for co-operation between the supervisory authority and the NCB in these Member States are prescribed by law (e.g., Hungary¹³) or by less formal instruments (e.g., United Kingdom¹⁴). However, it would seem clear that in these Member States the NCBs are not in any way liable for supervisory decisions.

The remaining eight Member States have adopted nuanced variations on these two contrasting structures, laying down mechanisms allowing for varying degrees of central bank involvement in the conduct of supervision. In legal terms there are certain similarities with the structures deployed in four of these

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⁹ A legislative reform is underway in Slovakia as a result of which responsibility for the supervision of the non-banking financial sector (capital markets, insurance business and pension schemes) will be transferred to the Národná banka Slovenska on 1 January 2006. See Opinion of the European Central Bank of 22 September 2004 at the request of Národná banka Slovenska on a draft law on supervision of the financial market (CON/2004/31), published on the ECB’s website at http://www.ecb.int/ecb/legal/1341/1345/html/index.en.html.


¹¹ The Oesterreichische Nationalbank (OeNB) names persons for the function of deputy chairperson of the Supervisory Board, as well as two additional members of the eight-member Supervisory Board and one member of the two-member Executive Board of the Austrian Finanzmarktaufsicht (Financial Market Authority or FMA), who are appointed by the Federal Ministry of Finance (in the case of the Supervisory Board members) and the Federal Government (in the case of the Executive Board members). The Federal Ministry of Finance is required to hear the OeNB prior to the dismissal of a member of the FMA Supervisory or Executive Boards that the OeNB named, except in case of imminent danger. Federal Act on the Institution and Organisation of the Financial Market Authority (Finanzmarktaufsichtsgesetz), Sections 5, 7 and 8.

¹² The Chairperson and the Deputy Chairperson of the Council of the Latvian Financial and Capital Market Commission (FCMC) are appointed by the Parliament for a period of six years upon a joint proposal of the Governor of Latvijas Banka and the Minister of Finance. One of the grounds for dismissal of the Chairperson and his/her Deputy by the Parliament is where an application for dismissal is submitted jointly by the Governor of Latvijas Banka and the Minister of Finance. The Chairperson of the FCMC appoints and removes the other members of the FCMC’s Council, and is required to co-ordinate his/her decision with the Governor of Latvijas Banka and the Minister of Finance. Law on the Financial and Capital Market Commission, Articles 13(3), 13(4) and 14(4).

¹³ The Act on the Hungarian Financial Supervisory Authority (FSA) explicitly addresses the FSA’s relationship with the National Bank of Hungary (NBH), requiring the FSA to co-operate with the NBH in the course of performing its tasks, and requiring the FSA, in the cases specified by law, to issue or withdraw licenses after requesting the preliminary opinion or agreement from the NBH. Act. No. CXXIV of 1999 on the Hungarian Financial Supervisory Authority, Article 6/C.

¹⁴ A Memorandum of Understanding (MoU) between the UK Treasury, the Bank of England and the UK Financial Services Authority (FSA) establishes a framework for co-operation between the Treasury, the Bank and the FSA in the field of financial stability. The MoU clarifies that the Bank of England is responsible for the overall stability of the financial system as a whole, which will involve, inter alia, being able in exceptional circumstances to undertake official financial operations in order to limit the risk of problems in or affecting particular institutions spreading to other parts of the financial system. See Memorandum of Understanding Between HM Treasury, the Bank of England and the FSA, para. 2, published on the Bank of England’s website at http://www.bankofengland.co.uk/legislation/mou.pdf.
Member States (Belgium, Franc, Germany and Poland), insofar as the NCB makes a substantial contribution to the performance of supervisory tasks, but is not as such responsible for supervision. Notwithstanding the substantial role of the NCBs it would appear to be clear that in these four Member States the NCBs are not, logically, liable for supervisory decisions.

In the Netherlands a legislative reform is currently being implemented as a result of which De Nederlandsche Bank will be assigned responsibility to carry out prudential supervision (i.e., the financial soundness of financial enterprises and contributing to the stability of the entire financial sector), while an independent body, the Autoriteit Financiële Markten (AFM) or Authority for Financial Markets, will be assigned responsibility to carry out the supervision over the conduct of business in the financial markets. Under this functional, so-called ‘twin peaks’ structure, both De Nederlandsche Bank and the AFM will supervise the entire financial sector in close cooperation with one another in matters concerning their respective fields of competence. It would be interesting to ascertain whether it is possible for the boundaries between the liability of these two public authorities for supervisory decisions affecting individual institutions to be clearly drawn.

A somewhat novel legal structure is deployed in Estonia, Finland and Ireland whereby the supervision of practically the entire financial sector, including credit

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15 In Belgium the Banking, Finance and Insurance Commission, an independent body with legal personality, is the single supervisor of the financial sector. The Commission and the Banque Nationale de Belgique (BNB)/Nationale Bank van België (NBB) are obliged to collaborate closely on all issues of common interest and in particular with regard to international co-operation in respect of prudential matters, inter-sectoral aspects of prudential policy relating to various providers of financial services, macro-prudential analyses and legal studies. Staff members of the BNB/NBB may be seconded to the Commission and vice-versa. Also, three of the seven members of the Commission’s Management Committee are required to be appointed from among the members of the Board of Directors of the BNB/NBB. Law of 2 August 2002 relating to the supervision of the financial sector and on financial services, Article 44 et seq., particularly Articles 49, § 6, third sentence, 55, 117 and 118.

16 In France the prudential supervision of credit institutions is carried out by the Commission Bancaire, a service of the French State (service de l’État). The Governor of Banque de France chairs the Commission Bancaire, and the Banque de France provides the General Secretariat of the Commission Bancaire with staff and resources necessary for carrying out on-site inspections of credit institutions. See in this respect the relevant provisions of the Financial and Monetary Code, and in particular the provisions concerning the Commission Bancaire (Articles L.613-1 to L.613-34).

17 In Germany the BaFin (Bundesanstalt für Finanzdienstleistungsaufsicht – Federal regulatory agency for financial services and financial markets) is the consolidated supervisor of the financial sector under the legal and professional supervision of the Federal Ministry of Finance. The BaFin and the Deutsche Bundesbank are required to work together, and this cooperation includes ongoing monitoring of credit institutions by the Bundesbank, including analysing and assessing documents, audit reports and annual accounts submitted by credit institutions, conducting and analysing banking audits to determine the reasonable equity capital and risk management procedures of credit institutions and evaluating audit findings. The cooperation between the Bundesbank and the BaFin is further defined in an inter-institutional agreement in which the details of their respective roles in day-to-day supervision are defined. The Bundesbank is required to follow the BaFin’s guidelines when performing its extensive operational functions in the supervision of credit institutions. Law on the Federal agency for financial services regulation, Articles 1, 2; Gesetz über das Kreditwesen (KWG or Banking Law), Article 7; Vereinbarung über die Zusammenarbeit der Bundesanstalt für Finanzdienstleistungs- aufsicht und der Deutschen Bundesbank bei der Beaufsichtigung der Kredit- und Finanzdienstleistungsinstitute, available on the web page of BaFin at www.bafin.de;

18 In Poland banks are supervised by the Commission for Banking Supervision, which is chaired by the President of the Narodowy Bank Polski. The decisions of the Commission are carried out and co-ordinated by the General Inspectorate of Banking Supervision, a separate organisational unit within the structure of the Narodowy Bank Polski that is designated by law as the executive body of the Commission for Banking Supervision. The General Inspector of Banking Supervision is appointed and recalled by the President of the Narodowy Bank Polski, acting in agreement with the Minister of Finance. The Act of the National Bank of Poland (Narodowy Bank Polski), Articles 25(1), 26(1), 29.

institutions, is carried out by an autonomous body forming part of the legal personality of the NCB. The focus of this article is the liability implications of this structure for Ireland’s NCB.

3 ESTABLISHMENT OF CENTRAL BANK AND FINANCIAL SERVICES AUTHORITY OF IRELAND AND IRISH FINANCIAL SERVICES REGULATORY AUTHORITY

The Central Bank and Financial Services Authority of Ireland Act, 2003 (the “Act”) reorganised and re-named the “Central Bank of Ireland” as the “Central Bank and Financial Services Authority of Ireland” (CBFSAI). As was previously the case within the Central Bank of Ireland, the Governor of the CBFSAI continues to have sole responsibility for the performance of the central bank’s ESCB-related functions, consistent with his position as a member of the ECB Governing Council.

The main reform introduced by the Act was the establishment of a new “body” called the Irish Financial Services Regulatory Authority (IFSRA) as a constituent part of the CBFSAI, whose statutory functions and powers broadly relate to the supervision of virtually all credit and financial institutions and insurance undertakings in Ireland, as well as the protection of consumers of financial services. The IFSRA comprises no fewer than eight and no more than ten members appointed by the Minister for Finance, three of whom are a Chairperson, a Chief Executive responsible for the day-to-day management of the IFSRA and a Consumer Director responsible for monitoring the provision of financial services to consumers.

The IFSRA is stated to be a “body” that is separate from its members and continues in existence despite any vacancy or change in its membership. Notwithstanding this semi-personification of the IFSRA, the IFSRA is also stated to be “a constituent part of” the CBFSAI. Only the CBFSAI has been endowed with legal personality, with the body corporate formerly called “Central Bank of Ireland” being continued, but with the corporate name of “Central Bank and Financial Services Authority of Ireland”.

“Except as expressly provided by the Act”, the CBFSAI’s affairs are managed and controlled by its board of directors. The CBFSAI’s board of directors comprises twelve persons: the Governor, who is also the Chairperson of the

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21 See, e.g., section 5 of the Central Bank Act 1942, as amended. References in these footnotes to the Central Bank Act 1942, as amended, shall be understood as referring to the Central Bank Act 1942, as amended by the Central Bank and Financial Services Authority of Ireland Acts 2003 and 2004.
22 Section 19A(2) of the Central Bank Act 1942, as amended.
23 ESCB Statute, Article 10.1.
24 Sections 33A through 33AF of the Central Bank Act 1942, as amended.
25 Sections 33E(1), 33E(2), 33F(1), 33F(4), 33H(1), 33L(1), 33LQ(1), 33Q(4) and 33S(1) of the Central Bank Act 1942, as amended.
26 Sections 33(B)(1), 33B(3) of the Central Bank Act 1942, as amended.
27 Section 33B(2) of the Central Bank Act 1942, as amended.
28 Section 5(1) of the Central Bank Act 1942, as amended.
29 Section 5(4) of the Central Bank Act 1942, as amended.
board, the CBFSAI’s Director General, the Secretary General of the Department of Finance, the IFSRA Chairperson, the IFSRA Chief Executive and seven other directors appointed by the Minister for Finance, four of whom are members of the IFSRA. It is important to emphasise that the CBFSAI board does not have primary responsibility for the performance of the CBFSAI’s main central banking or supervisory activities since the ESCB-related functions are exclusively vested in the Governor and the functions relating to the supervision of credit and financial institutions are primarily vested in the IFSRA. The residual functions of the CBFSAI which remain under the responsibility of the CBFSAI’s board of directors include carrying out the efficient and effective co-ordination of the activities of the constituent parts of the CBFSAI and the exchange of information among those parts.

4 LIABILITY OF CENTRAL BANK AND FINANCIAL SERVICES AUTHORITY OF IRELAND FOR SUPERVISORY ACTIVITIES OF IRISH FINANCIAL SERVICES REGULATORY AUTHORITY

Ireland has thus established a legal structure for the supervision of credit and financial institutions and insurance undertakings by a statutory body enjoying independent functions, but located within the legal personality of its NCB. The NCB is endowed with legal personality as a corporate body, while the IFSRA is a statutory body within and forming a constituent part of the NCB that does not enjoy any separate legal personality as a corporate body. While this construction is quite unique in that Irish statutory bodies are normally endowed with legal personality, as a matter of Irish administrative law the legal form and personality of a state-sponsored body is entirely dependent on the statute under which it is established.

Consistent with its legal personality, the CBFSAI may take legal proceedings and be proceeded against in its corporate name. The IFSRA may, in relation to the functions of the CBFSAI that the IFSRA is to perform, bring and defend legal proceedings, and do any other thing, in the name of the CBFSAI, and any act done in the name of, or on behalf of, the CBFSAI by the IFSRA in the performance of the IFSRA’s functions is taken to have been done by the CBFSAI. Under this construction the CBFSAI bears, in legal terms, sole liability and responsibility for the supervisory acts of the IFSRA. It is therefore of critical importance to understand the precise scope of the CBFSAI’s liability for the supervisory activities of the IFSRA under Irish law. This paper will therefore outline in some depth the relevant case law in Ireland, the United Kingdom and the European Court of Justice shedding light on the scope of the

30 Sections 18B(1), 18B(2) and 18B(5) of the Central Bank Act 1942, as amended.
31 Section 5A(1) of the Central Bank Act 1942, as amended.
33 Section 5(2) of the Central Bank Act 1942, as amended.
34 Section 33C(6) of the Central Bank Act 1942, as amended. (The powers given to the IFSRA Chief Executive in the second sentence of this sub-section derive from his or her position as a statutory office-holder exercising functions of the CBFSAI vested in the IFSRA.)
35 Section 33C(12) of the Central Bank Act 1942, as amended.
CBFSAI’s liability for the IFSRA under Irish and EC law, as well as the statutory immunities enjoyed by the CBFSAI under applicable Irish legislation.

4.1 LIABILITY OF FINANCIAL SUPERVISOR FOR NEGLIGENCE AT COMMON LAW

The leading Irish precedent on the liability of a financial supervisor is *McMahon v. Ireland, the Attorney General and the Registrar of Friendly Societies*. The case concerned an action brought by a depositor who lost money as a result of the liquidation of the Private Motorists’ Protection Society (PMPS). The aggrieved depositor brought an action against the Registrar of Friendly Societies, the body responsible for the supervision of industrial and provident societies. The depositor argued that the Registrar had failed in his duty of care to prospective depositors with the PMPS by not taking action sooner, for example by exercising his statutory power to direct the PMPS to suspend the acceptance of deposits.

The High Court per Blayney J. held that the Registrar was not liable in negligence as there was insufficient proximity between the Registrar and the depositors to give rise to a duty of care on the part of the Registrar in these circumstances. Blayney J. held that the Registrar was entitled to the protection of the principle referred to by Finlay C.J. in the Supreme Court decision in *Pine Valley Developments Ltd. v. The Minister for the Environment* that “[i]f a man is required in the discharge of a public duty to make a decision which affects, by its legal consequences, the … property of others, and he performs that duty and makes that decision honestly and in good faith, it is … a fundamental principle of our law that he is to be protected. It is not consonant with the principles of our law to require a man to make such a decision in the discharge of his duty to the public, and then leave him in peril by reason of the consequences to others of that decision, provided that he acted honestly in making that decision.” Blayney J. concluded from this that the Registrar was “entitled to immunity from the type of claim being made by the [depositor].”

In *McMahon*, Blayney J. cited at length and explicitly followed the advice of the UK Privy Council in *Yuen-Kun-Yeu v. Attorney General of Hong Kong*. That case concerned a negligence action brought by Hong Kong residents who had deposited money with a company authorised to accept deposits by the Hong Kong Commissioner of Deposit-Taking Companies. After the company went into liquidation the depositors argued that the Commissioner knew or ought to have known that the company’s affairs were being conducted fraudulently, speculatively and to the detriment of its depositors, and that the Commissioner...
should never have registered the company as a deposit-taking company, or should have revoked its registration so as to save the depositors from losing their money.

The Privy Council per Lord Keith advised that the Commissioner did not owe members of the public who might be minded to deposit their money with a deposit-taking company in Hong Kong a duty, in the discharge of his supervisory powers, to exercise reasonable care to see that such members of the public did not suffer a loss through the fraudulent or improvident management of the company. The fact that the Commissioner had “cogent reason to suspect that the company’s business was being carried on fraudulently and improvidently”, based on information not available to the public raising serious doubts about the company’s stability, did not create a special relationship so as to give rise to a duty on the part of the Commissioner to take reasonable care to prevent the company from causing financial loss to subsequent depositors.

In considering the Commissioner’s discretion to remove the company from the register, Lord Keith noted that “[i]t might be a very delicate choice whether the best course was to deregister a company forthwith or to allow it to continue in business with some hope that, after appropriate measures by the management, its financial position would improve.” Lord Keith also noted that “[t]he Commissioner did not have any power to control the day-to-day management of any company, and such a task would require immense resources. His power was limited to putting it out of business or allowing it to continue.” Lord Keith further noted that the class to whom the Commissioner’s duty is alleged to have been owed must include the many inhabitants of Hong Kong who might choose to deposit their money with any deposit-taking company.

In Yuen the depositors made a related argument that they had relied on the registration of the company when they deposited their money with it, and that by registering the company and allowing the registration to stand the Commissioner had negligently made a continuing representation that the company was creditworthy. The Privy Council rejected this argument, holding that “reliance on the fact of registration as a guarantee of the soundness of a particular company would be neither reasonable or justifiable”. In this regard, Lord Keith stated the registration system “was designed to give added protection to the public against unscrupulous or improvident managers of deposit-taking companies, but it cannot reasonably be regarded, nor should it have been by any investor, as having instituted such a far-reaching and stringent system of supervision as to warrant an assumption that all deposit-taking companies are sound and fully creditworthy.”

Finally, from a public policy perspective, Lord Keith noted obiter that, even if the Commissioner were to be held to owe actual or potential depositors a duty of care in negligence, “the prospect of claims would have a seriously inhibiting

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44 Ibid. at 190-98.
45 Ibid. at 196.
46 Ibid. at 195.
47 Ibid.
48 Ibid. at 197.
effect on the work of his department” and “[a] sound judgment would be less likely to be exercised if the Commissioner were to be constantly looking over his shoulder at the prospect of claims”.49

To sum up, the McMahon case, taken together with the Yuen case, establish that the CBFSAI is insulated under common law from liability for negligent decisions of the IFSRA.

4.2 STATUTORY IMMUNITIES OF CENTRAL BANK AND FINANCIAL SERVICES AUTHORITY OF IRELAND

This insulation at common law of the CBFSAI from liability for negligent supervisory decisions has been confirmed by Irish legislation conferring a series of elaborate statutory immunities on the CBFSAI.50 Thus, the CBFSAI, the members of its board, the members of the IFSRA and employees and agents of the CBFSAI or any of its constituent parts are not liable for damages for anything done or omitted in the performance or purported performance of their functions, unless it is proved that the act or omission was in bad faith.51 Without limiting the effect of this general immunity,52 it is also provided that the fact that the CBFSAI has authorised or revoked an authorisation, or regulated the activities, of a person, under any of its functions is not a warranty by the CBFSAI as to the person’s solvency or performance.53 It is also provided that neither the CBFSAI nor the Irish State is liable for losses incurred because of the insolvency, default or performance of any such person or body.54 Finally, it is provided that neither the CBFSAI, the members of its board, the members of the IFSRA and employees and agents of the CBFSAI or any of its constituent parts are liable to pay damages arising out of a failure to comply with the IFSRA’s responsibility to increase awareness among the public of available financial services, the costs to consumers and associated risks and benefits.55

These detailed provisions put beyond any doubt that the CBFSAI enjoys immunity from liability to depositors and other creditors of a failed bank or financial institution where the IFSRA is negligent in the way it carries out its

49 Ibid. at 198.
50 These immunities are of some interest on account of their elaborate drafting, and have attracted some international academic attention in the context of comparative law studies regarding the liability of bank supervisors. See Hüpkes, The Legal Aspects of Bank Insolvency: A Comparative Analysis of Western Europe, the United States and Canada (Kluwer Law International, 2000), p. 137, n.73; Smits and Luberti, Supervisory Liability: An Introduction to Several Legal Systems and a Case Study, in International Bank Insolvencies: A Central Bank Perspective (Giovanoli and Heinrich eds., Kluwer Law International, 1999), p. 363, at p. 366.
51 Sections 33AJ(1) and 33AJ(2) of the Central Bank Act 1942, as amended.
52 Sections 33AJ(6) of the Central Bank Act 1942, as amended.
53 Sections 33AJ(3) of the Central Bank Act 1942, as amended. Section 9(5) of the Central Bank Act 1971 provides in similar terms that the grant of a licence to a bank shall not constitute a warranty as to the solvency of the bank to whom it is granted. Sections 33AJ(4) of the Central Bank Act 1942, as amended, also provides in similar terms that the fact that the CBFSAI in performing any of its functions has approved or revoked the approval, or regulated the affairs or activities, of a stock exchange or a financial futures or options exchange, or has approved, amended, revoked or imposed rules, or has consented or refused to consent to amendments of rules, is not a warranty by the CBFSAI as to the solvency or performance of the exchange or any member of the exchange.
54 Sections 33AJ(5) of the Central Bank Act 1942, as amended. Section 9(5) of the Central Bank Act 1971 provides in similar terms that the CBFSAI shall not be liable in respect of any losses incurred through the insolvency or default of a bank to whom a licence is granted.
55 Section 33C(4) of the Central Bank Act 1942, as amended.
supervisory functions. These immunities also confirm the CBFSAI’s common law immunity from any liability for negligent misrepresentation.

4.3 LIABILITY OF BANK SUPERVISORS UNDER EC LAW

The question of whether bank supervisors can be held liable for losses resulting from defective supervision under Community law has recently been resolved by the European Court of Justice (ECJ). In the Peter Paul case, depositors in a bankrupt German bank sought compensation in respect of the loss of their deposits beyond the amount recoverable under the Deposit-Guarantee Schemes Directive on the grounds of allegedly defective supervision by the former Bundesaufsichtsamt für das Kreditwesen (Federal Office for the Supervision of Credit Institutions). As a matter of German law, the liability of the Bundesaufsichtsamt to compensate third parties for any damage arising from a wilful or negligent breach of official duty under the German Civil Code is statutorily precluded. However, the depositors challenged this statutory immunity on the ground that it was contrary to Community law, and in particular the three banking directives subsequently codified in the Consolidated Banking Directive.

The ECJ, on a preliminary reference from the Bundesgerichtshof (Federal Court of Justice), held that the directives in question do not preclude a national rule preventing individuals from claiming compensation for damage resulting from defective supervision on the part of the national authority responsible for supervising credit institutions. The ECJ took note of the supervisory obligations


57 While there is much discussion regarding whether it is competent for the Irish Oireachtas (National Parliament) to establish special statutory rules of immunity for State-sponsored bodies under the provisions of the Irish Constitution, this issue would appear to be moot where, as here, the relevant immunities are simply declaratory of the underlying position at common law. See generally Hogan and Morgan, Administrative Law in Ireland (3d. ed., Round Hall Sweet & Maxwell, 1998), pp. 809-10 (citing Byrne v. Ireland [1972] I.R. 241; Ryan v. Ireland [1989] I.R. 177; W. v. Ireland (No. 2) [1997] 2 I.R. 142).


60 The legal basis of this immunity was Article 6(4) of the KWG or Banking Law, which provided that the Bundesaufsichtsamt exercised the supervisory functions assigned to it only in the public interest. This provision was adopted in response to two decisions by the German Supreme Court during the 1970s where it was held that the objective of banking supervision as set out in the Banking Law was not only to protect the stability and soundness of the German banking system in general, but also to protect individual creditors against risks arising from hazardous banking activities, with the result that the banking supervisory authority could be liable for breach of official duty under the Bürgerliches Gesetzbuch (BGB or German Civil Code). See Wetterstein, 15 February 1979, BGHZ 74, 144 (148) (= NJW 1979, 1354, 1355); see also the decision of the Supreme Court in Herstatt, 12 July 1979, BGHZ 75, 120 (= NJW 1979, 1354). Paragraph 6(4) of KWG or Banking Law was designed to conform that banking supervision is exercised solely in the public interest and not in the interest of third parties, such as depositors or other creditors of the financial institution, thereby barring suits on the ground that the banking supervisory authority violated an “official duty owed to a third person”. See Hüpkes, The Legal Aspects of Bank Insolvency: A Comparative Analysis of Western Europe, the United States and Canada (Kluwer Law International, 2000), pp. 132-34.


62 It is noted that the conclusions of the ECJ are similar to those reached earlier by the British House of Lords in the BCCI case, Three Rivers District Council v. Bank of England, [2000] 2 W.L.R. 1220, 1236-58, 1270-73 (per Lords Hope and Millett).
imposed on national authorities vis-à-vis credit institutions under those directives, and of the fact that the objectives pursued by those directives also include the protection of depositors.63 However, the ECJ considered that it does not follow from this that those directives confer on individual depositors rights capable of giving rise to liability on the part of the State on the basis of Community law in the event that the deposits are unavailable as a result of defective supervision on the part of the competent national authorities.64 Rather, the ECJ took the view that those directives are restricted to the harmonisation of that which is essential, necessary and sufficient to secure the mutual recognition of authorisations and of prudential supervision systems, making possible the granting of a single licence recognised throughout the Community and the application of the principle of home Member State prudential supervision.65 The ECJ concluded that the coordination of the national rules on the liability of national authorities in respect of depositors in the event of defective supervision does not appear to be necessary to secure these results.66

The ECJ also noted that, as under German law, it is not possible in a number of Member States for the national authorities responsible for supervising credit institutions to be liable in respect of individuals in the event of defective supervision. In this regard the ECJ noted that those rules are based on considerations related to the complexity of banking supervision, in the context of which the authorities are under an obligation to protect a plurality of interests, including more specifically the stability of the financial system.67

Thus, the statutory and common law immunities enjoyed by the CBFSAI under Irish law would appear to be beyond challenge as a matter of current Community law.68

4.4 TORTIOUS LIABILITY FOR MISFEASANCE IN PUBLIC OFFICE

Thus far, it would appear that the CBFSAI enjoys a robust immunity from liability for the decisions of the IFSRA under Irish law. However, the CBFSAI’s immunities are not absolute, and liability still lies for acts or omissions that are proved to have been in “bad faith”.69 In the context of a financial supervisor’s activities, this is understood to include liability in cases of intentional wrongdoing by that authority’s officials, where damages may be recovered for the tort of misfeasance in public office and a range of other intentional torts.70

While the tort of misfeasance in public office has a long history, its precise contours remain a matter of much debate.71 Liability for misfeasance in public

63 Paragraphs 35-39 of the judgement.
64 Paragraph 40 of the judgement.
65 Paragraph 42 of the judgement.
66 Paragraph 43 of the judgement.
67 Paragraph 44 of the judgement.
69 Sections 33AJ(1) and 33AJ(2) of the Central Bank Act 1942, as amended.
office has been successfully established against public bodies in some modern
Irish cases. The most scientific judicial definition of the tort would appear to
be that of Keane J. in McDonnell v. Ireland, who approved a formulation that
“misfeasance in public office is committed where an act is performed by a public
official, either maliciously or with actual knowledge that it is committed without
jurisdiction, and is so done with the known consequence that it would injure the
plaintiff.” In Corliss v. Ireland Hamilton J. suggested that the necessary degree
of malice “may be inferred from recklessness”. The judgement of Finlay C. J.
in Pine Valley suggests that misfeasance arises where a public official’s actions
“constitute such a gross abuse of power or wholly unreasonable exercise of power
as to lead to an inference that he was aware that he was exercising a power which
he did not possess”. A broader view was taken by the Supreme Court in Deane
v. Voluntary Health Insurance, where the Court indicated that a public body
might be liable for misfeasance in public office if its statutory powers were
merely exercised “unreasonably and unfairly” in a manner which caused loss
and damage. Commentators have noted that the decisions in other common law
jurisdictions do not set the boundaries of liability for misfeasance of public
office so widely insofar as they require that the public authority was knowingly
reckless outside the scope of its legal powers or, if professedly acting within
them, was doing so “maliciously” in the sense of being activated by an ulterior
predominant purpose, such as to hurt the plaintiff for conduct unconnected with
the exercise of the power.

4.5 LIABILITY OF FINANCIAL SUPERVISOR FOR MISFEASANCE IN PUBLIC OFFICE:
BCCI CASE

In 1991 the Bank for Credit and Commerce International, S.A. (BCCI), a
Luxembourg-incorporated entity, went into insolvent liquidation as a result of
“fraud on a vast scale perpetrated at a senior level in BCCI.” UK depositors
sought to circumvent the difficulties presented by common law precedents on
the question of supervisory negligence by bank supervisors, and the associated
statutory immunities, by bringing proceedings against the Bank of England for
the tort of misfeasance in public office. In very general terms, the BCCI
depositors alleged that from the time that the Bank of England granted BCCI
a full licence as a deposit-taker in 1980 until shortly before its collapse in 1991
the Bank was not legally entitled under applicable UK banking laws to rely on
the supervision of the Luxembourg bank regulators because BCCI’s principal
place of business was in London rather than Luxembourg. The depositors further

72 See Callinan v. Voluntary Health Insurance Board, unreported, Supreme Court, July 28, 1994; Re “The La
Lavia”, unreported, High Court, July 26, 1994 (cited in Hogan and Morgan, Administrative Law in Ireland
73 Unreported, Supreme Court, July 23, 1997 (cited in Hogan and Morgan, Administrative Law in Ireland
74 Unreported, High Court, July 23, 1984 (cited in Hogan and Morgan, Administrative Law in Ireland (3d. ed.,
76 Unreported, Supreme Court, July 28, 1994, p. 29 (per Blayney J.), discussed in McMahon and Binchy, Law
77 McMahon and Binchy, Law of Torts (Butterworths, 3d. ed., 2000), p. 553; see also Hogan and Morgan,
alleged that the Bank knew or was reckless that losses to depositors would result both from its granting BCCI a licence and then failing to revoke BCCI’s licence in the years preceding its collapse.

In its first decision in this case, *Three Rivers District Council v. The Governor and Company of the Bank of England,⁸⁰* the House of Lords outlined the main elements (or, in the words of Lord Steyn, “matrix”) of the tort of misfeasance in public office that would have to be established for the Bank of England to be held liable to the BCCI depositors. *First,* the defendant must be a holder of public office, a broad concept covering the Bank of England, which may be vicariously liable for the acts of its public officials. *Second,* there must be an exercise of power in the exercise of public functions, a requirement satisfied by the exercise of public functions by named senior officials of the Bank of England’s Banking Supervision Department. *Third,* the public officer must have a required state of mind comprising (i) targeted malice (i.e., conduct specifically intended to injure a person) and/or (ii) knowledge, foresight, or a lack of an honest or good faith belief that the public officer has no power to do the act complained of and that the act will probably injure the plaintiff. An act performed in a state of mind of reckless indifference (i.e., subjective recklessness) as to the illegality or outcome of the act is sufficient to ground liability for the tort. *Fourth,* any plaintiff must have a sufficient interest to found a legal standing to sue. There is no reason why such an action cannot be brought by a particular class of persons such as depositors at a bank, even if their precise identities were not known to the Bank of England. *Fifth,* the public officer’s act must, as a factual matter, have caused the plaintiffsdamage. *Sixth,* regarding damages recoverable, the public officer must know that his act would probably injure the plaintiff, or a person of a class of which the plaintiff was a member (e.g., depositors). Foresight or subjective recklessness about the consequences, in the sense of not caring whether the consequences happen or not, is sufficient.⁸⁶

In *Three Rivers* it was noted that imposing liability for acts which although wrongful were not committed with foresight or injury to the plaintiff “may have a stultifying effect on governance without commensurate public benefit”⁸⁷ by “not allowing public officers, who must always act for the public good, to be assailed by unmeritorious actions”.⁸⁸

In its second decision, the House of Lords, by a slender 3-2 majority, held that the depositors pleaded a reasonable cause of action against the Bank.⁸⁹ This decision merely established that the depositors were entitled to a full trial on

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⁸¹ Ibid. at 1230h (per Lord Steyn) and 1268h-1269a (per Lord Hobhouse).
⁸² Ibid. at 1231a (per Lord Steyn) and 1267a (per Lord Hutton).
⁸³ Ibid. at 1231b-1232d (per Lord Steyn) and 1269d-e (per Lord Hobhouse).
⁸⁴ Ibid. at 1233d-e (per Lord Steyn).
⁸⁵ Ibid. at 1233g (per Lord Steyn).
⁸⁶ Ibid. at 1234a-1235h (per Lord Steyn) and 1261h-1262c, 1265f-h (per Lord Hutton).
⁸⁷ Ibid. at 1265d (per Lord Hutton).
⁸⁸ Ibid. at 1235h (per Lord Steyn).
the merits of their case, and not that the Bank of England was in any way liable for its supervisory actions. Indeed, two of the five members of the House of Lords would have barred the depositors’ claim outright on the basis that it had no realistic prospect of success.90

Three Rivers establishes the important legal precedent that a bank supervisor may potentially incur liability to a depositor for misfeasance in public office. In view of the high profile of the BCCI litigation, the case has been a source of concern to supervisors in other common law jurisdictions, such as Ireland, which apply the tort of misfeasance in public office.91 In this respect, it is clear that Three Rivers would be treated as a highly persuasive precedent by any Irish court considering the potential liability of a financial supervisor for misfeasance in public office.

4.6 LIABILITY OF FINANCIAL SUPERVISOR FOR OTHER INTENTIONAL TORTS

Misfeasance in public office is not the only intentional tort for which a supervisor may be liable under Irish law. Potentially, a number of other torts may provide a basis of liability in certain cases, including the torts of interference with contractual relations,92 intimidation93 and malicious prosecution.94 It has been suggested that the tort of intimidation may be relevant to bank supervision where the threat of taking ultra vires supervisory action is used to coerce a supervised institution to conform to the supervisor’s wishes by behaving in a way involving loss to themselves (e.g., by abstaining from entering into transactions of a particular description or by participating in the costly rescue of another institution) or to a third party (e.g., by “blackballing” that third party and abstaining from any contractual relationship with it).95 Inducement to breach of contract could also be relevant in situations involving the application by a financial supervisor of informal pressure on a regulated institution.96 An action was, for example, commenced on this ground against the Bank of England by a merchant banker accused of fraud, but ultimately acquitted of criminal charges, in connection with the Guinness insider-dealing affair, who allegedly lost his job as a result of pressure exercised by the Bank on his employer in pursuance of the Bank’s responsibility to ensure the prudent management of banks.97 Liability for malicious prosecution could potentially arise where a financial supervisor or its officers are activated by improper motives in the prosecution of criminal offences.98

93 Ibid., at pp. 830-34.
94 Ibid., at pp. 981-86.
96 Ibid., at p. 369.
97 Ibid., at pp. 369-70.
98 Ibid., at p. 368.
4.7 CONCLUSIONS RE CBFSAI’S LIABILITY FOR SUPERVISORY DECISIONS UNDER IRISH AND EC LAW

To sum up, in the McMahon case the Irish High Court held that a financial supervisor is not liable to depositors of a failed deposit-taking institution for negligence in the exercise of its supervisory functions. In reaching this conclusion the High Court followed the advice of the UK Privy Council in the Yuen-Kung-Yeu case, where similar conclusion was reached that a Hong Kong supervisory authority was not liable to depositors of a failed deposit-taking institution for negligence. This insulation at common law from liability for negligent supervisory decisions has been confirmed by Irish legislation conferring a series of statutory immunities on the CBFSAI. The recent decision of the European Court of Justice in the Peter Paul case has confirmed that bank supervisors may not be liable for losses resulting from defective supervision under Community law, meaning that the statutory and common law immunities enjoyed by the CBFSAI under Irish law would appear to be beyond challenge as a matter of current Community law.

However, the CBFSAI’s immunities are not absolute, and liability still lies for acts or omissions that are proved to have been in “bad faith”. This would include liability for cases of intentional wrongdoing by the financial supervisor’s officials, where damages may be recovered for the tort of misfeasance in public office and a range of other intentional torts. The potential scope of a financial supervisor’s liability for misfeasance in public office has become a more live topic in recent years as a result of modern developments in Irish and English case law. Liability for misfeasance in public office has been successfully established against public bodies in some modern Irish cases. The judgement of Finlay C. J. in the Pine Valley case suggests that misfeasance may arise where a public official’s actions constitute such a gross abuse of power or wholly unreasonable exercise of power as to lead to an inference that he was aware that he was exercising a power which he did not possess. A broader view was taken by the Supreme Court in the Deane case, where the Court indicated that a public body might be liable for misfeasance if its statutory powers were merely exercised unreasonably and unfairly in a manner which caused loss and damage.

The decision of the British House of Lords in the BCCI case would be treated as a highly persuasive precedent by any Irish court considering the potential liability of a financial supervisor for misfeasance in public office. At the risk of generalisation, the BCCI case establishes the precedent that a bank supervisor may potentially incur liability to a depositor for misfeasance where a public officer has the required state of mind comprising targeted malice (i.e., conduct specifically intended to injure a person) and/or knowledge, foresight or a lack of an honest or good faith belief that the public officer has no power to do the act complained of and that the act will probably injure the plaintiff. An act performed in a state of mind of reckless indifference (i.e., subjective recklessness) as to the illegality or outcome of the act is sufficient to ground liability.
Misfeasance in public office is not the only intentional tort for which a financial supervisor may be liable under Irish law. Potentially, a number of other torts may provide a basis for liability in certain cases, including the torts of interference with contractual relations, intimidation and malicious prosecution.

5 COMPATIBILITY OF CBFSAI’S LIABILITY FOR FINANCIAL SUPERVISOR WITH CENTRAL BANK INDEPENDENCE REQUIREMENTS UNDER TREATY

The ECB was consulted by the Irish Department of Finance on the draft Central Bank and Financial Services Authority of Ireland Bill, 2002, and delivered its opinion on the draft legislation on 5 June 2002. The central concern in the ECB opinion was whether the CBFSAI’s liability for the new supervisory authority was compatible with central bank independence requirements under the Treaty.

The ECB opinion highlighted the fact that the legislation would establish a structure for the supervision of financial institutions which involved setting up a statutory body enjoying independent functions (the IFSRA), but located within the legal personality of a NCB. Having particular regard to the unique structure of the IFSRA as a constituent part of the CBFSAI, the ECB noted that Ireland’s NCB would be accountable or liable for acts performed by a constituent part (the IFSRA) which would be outside the control of the CBFSAI’s key decision-making body responsible for its ESCB-related tasks (the Governor). The ECB considered that such a structure could pose a risk to a NCB’s integrity, threatening its overall institutional independence. In this regard, the ECB noted that under Article 108 of the Treaty, when exercising the powers and carrying out the tasks and duties conferred upon it by the Treaty and the ESCB Statute, neither a NCB nor any member of its decision-making bodies shall seek or take instructions from, inter alia, any government of a Member State ‘or from any other body’, which would include a statutory body such as the IFSRA.

The final legislation restructuring the Central Bank of Ireland addressed the ECB’s concern by ensuring that the Governor has a significant role with respect to financial stability matters. While the Governor does not serve as the Chairperson, Chief Executive or a member of the IFSRA, the Governor has been given a number of specific financial stability powers. First, the IFSRA is required to consult the Governor, and may act only with the agreement of the Governor, on any matter relating to the financial stability of the Irish State’s financial system, including (but not limited to) the issue, revocation and


100 Ibid., paragraph 6.
suspension of a licence or other authority. 101 Second, the Governor has been given powers to authorise a CBFSAI employee to investigate the business and carry out on-site inspections of licensed credit institutions, building societies, trustee savings banks, approved stock exchanges, authorised investment business firms and authorised collective investment schemes. 102 Third, the Governor may, with respect to his functions, issue guidelines to the IFSRA as to the policies and principles that the IFSRA is required to implement in performing the CBFSAI’s functions. 103 Fourth, whenever requested, the IFSRA is required to provide the Governor with advice, information and assistance with respect to the performance of the Governor’s functions. 104

The ECB opinion expressed the view that all these provisions are fundamental – and should be made the most of in practice – to allow for the continued close involvement of the central banking functions in supervision matters. Indeed, the ECB opinion noted that this involvement is a necessary condition to allow the Eurosystem to contribute adequately to monitoring the risks to financial stability in the euro area, and that, in addition, it also safeguards a smooth co-ordination between the central banking functions exercised at the Eurosystem’s level and the supervisory functions carried out at national level. 105

6 SUMMARY AND CONCLUSIONS

The prudential supervision of credit and financial institutions is not among the tasks attributed to the ESCB under the Treaty. In practice, the supervision of credit and financial institutions is organised under a wide variety of legal structures in the 25 EU Member States, with varying degrees of central bank responsibility. At one end of the spectrum, in nine Member States NCBs are directly and fully responsible for the supervision of credit institutions. At the other end of the spectrum, in eight Member States an independent public authority that is legally and operationally separated from the NCB is responsible for the supervision of practically the entire financial sector. The remaining Member States have adopted nuanced variations on these two contrasting

101 Sections 33C(9), 33C(9A) and 33C(9B) of the Central Bank Act 1942, as amended. In an opinion issued on a subsequent CBFSAI Bill, the ECB considered that a non-judicial administrative review of financial stability decisions taken by the IFSRA with the agreement of the Governor proposed as part of the remit of a new Financial Services Appeals Tribunal would be inconsistent with the independent discharge of the Governor’s ESCB-related task of contributing to the stability of the Irish State’s financial system. See Opinion of the European Central Bank of 19 November 2003 at the request of the Irish Department of Finance on a draft Central Bank and Financial Services Authority of Ireland Bill (No.2) 2003, paragraph 6, published on the ECB website at http://www.ecb.int/ecb/legal/pdf/en_con_2003_24_f_sign.pdf.


103 Section 33D(1), (2) of the Central Bank Act 1942, as amended.

104 Sections 33C(1)(c) and 33C(8) of the Central Bank Act 1942, as amended.

structures, laying down mechanisms allowing for varying degrees of central bank involvement in the conduct of supervision. For example, in Belgium, France, Germany and Poland NCBs make a substantial contribution to the performance of supervisory tasks, but are not as such responsible for supervision.

A somewhat novel legal structure is deployed in Ireland whereby the supervision of practically the entire financial sector is carried out by an autonomous body forming part of the legal personality of the NCB. Under this construction the NCB bears, in legal terms, sole liability and responsibility for the acts of the financial supervisor. This raises the important question as to the extent of the NCB’s liability for the financial supervisor under Irish law.

Under Irish law the CBFSAI is immune from liability for negligence on the part of the financial supervisor. However, the CBFSAI’s immunities are not absolute, and liability still lies for acts or omissions of the supervisor that are proved to have been in “bad faith”. This would include liability for cases of intentional wrongdoing by the supervisor’s officials, where damages may be recovered for the tort of misfeasance in public office and a range of other intentional torts, including the torts of interference with contractual relations, intimidation and malicious prosecution. The potential scope of liability for misfeasance in public office has become a live topic in recent years. Liability for misfeasance in public office has been successfully established against public bodies in some modern Irish cases, and a broad view regarding the scope of liability for misfeasance has been taken by the Irish Supreme Court in one case. The decision of the British House of Lords in the BCCI case, which establishes that a bank supervisor may potentially incur liability to a depositor for misfeasance in public office, would also be treated as a highly persuasive precedent by any Irish court considering the CBFSAI’s potential liability for misfeasance on the part of the supervisor.

The extent of the NCB’s liability for the financial supervisor was a critical issue in the opinion delivered by the ECB to the Irish authorities on the draft legislation restructuring the Central Bank of Ireland and establishing the autonomous financial supervisor as a constituent part of the newly restructured central bank. The ECB opinion highlighted that, by setting up a statutory body enjoying independent functions, but located within the legal personality of a NCB, the NCB would be accountable or liable for acts performed by a constituent part of the central bank (the financial supervisor), but which would be outside the control of the central bank’s decision-making body responsible for its ESCB-related tasks (the CBFSAI Governor). The ECB considered that such a structure could pose a risk to a NCB’s integrity, threatening its overall institutional independence, contrary to the independence required of an ESCB central bank under Article 108 of the Treaty.

The final legislation restructuring the Central Bank of Ireland addressed the ECB’s concern by ensuring that the Governor has a significant role with respect to financial stability issues. In particular, the financial supervisor is required to consult the Governor and to act with the Governor’s agreement with respect
to any matters relating to the stability of the Irish State’s financial system, including the supervisor’s decisions relating to the issue, revocation and suspension of licences. The Governor has independent powers to investigate the business and carry out on-site inspections of credit and financial institutions. The Governor may issue binding guidelines as to the policies and principles that the supervisor is required to implement. Finally, the supervisor is required to provide the Governor with all necessary advice, information and assistance with respect to the performance of the Governor’s functions.

To sum up, the ECB has a strong policy in favour of the attribution of extensive supervisory responsibilities to NCBs. Such an attribution fulfils the Eurosystem task under Article 105(5) of the Treaty 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. However, by locating an autonomous financial supervisory authority within the legal personality of a NCB, the restructuring of the Central Bank of Ireland posed a risk to a NCB’s institutional independence by making the NCB accountable or liable for acts performed by a constituent part of the central bank, but outside the control of the central bank’s decision-making body responsible for the discharge of its ESCB-related tasks. The fundamental philosophical premise underpinning the ECB opinion is that to saddle an ESCB NCB with liability and accountability for a financial supervisor, without endowing the central bank with a corresponding role with respect to the systemically significant decisions of the supervisor, would infringe the independence required of an ESCB NCB under the Treaty. In its opinion on the restructuring of the Central Bank of Ireland the ECB clearly set the limits of the proposed reorganisation by warning against the risk of the financial supervisor’s functions encroaching upon the central bank’s independence. As a result, important safeguards were introduced to protect the independence required of a national central bank member of the ESCB under the Treaty by ensuring that the Governor has a significant role with respect to financial stability issues.
MONETARY LAW
THE LEGAL STATUS OF THE EURO

Patrice de Lapasse †

ABSTRACT

La legge monetaria europea ha dovuto risolvere molti problemi fra i quali, la definizione della moneta (l’euro), dell’unità monetaria (un euro diviso in cento cents), la determinazione del valore di questa moneta ed anche della moneta di pagamento. Oltre a queste questioni, la legge incontrò due altri problemi di fondamentale importanza: (i) definire un’equivalenza fra l’euro e le monete nazionali preesistenti che fosse giuridicamente impegnativa e (ii) preservare la continuità dei contratti alla quale il mondo anglosassone era particolarmente legato.

Per iniziativa dell’Istituto Monetario Europeo, un gruppo composto dai giuristi delle Banche centrali sul quale Paolo Zamboni esercitò la propria influenza, si riunì e fu incaricato di trovare delle soluzioni. Benché non fosse necessario dal punto di vista giuridico, l’inserimento d’un provvedimento specifico nel regolamento comunitario sull’euro del 17 Giugno 1997 riuscì ad acquietare le preoccupazioni che la continuità dei contratti aveva fatto nascere. Per quanto riguarda l’equivalenza fra l’euro e le monete preesistenti, fu il concetto di fungibilità importato dal diritto romano e presente nel codice civile di parecchi paesi, a risolvere questa questione. Paolo Zamboni era, a buon diritto, molto fiero di vedere così ripresa una nozione di diritto romano tra i fondamenti dell’euro.

† This is a posthumous contribution. The author, Patrice de Lapasse, died in May 2005.
“À l’éminent juriste italien ami de la France, Paolo Zamboni Garavelli, que soit dédiée cette brève étude de droit monétaire, où se trouve entrelacé comme un souvenir de l’Union latine et de l’Union européenne, lesquelles furent aussi, entre les deux peuples, à leur manière, une amitié.”

I PREAMBLE

Defining the legal status of the new currency played a large part in the preparations for the introduction of the euro on 1 January 1999. The question was taken up by the entire legal community in both the European Union and the English-speaking world.

I shall stick to what I know best, namely the work carried out by the European Monetary Institute working group of legal experts, in which Paolo Zamboni represented the Bank of Italy and played a leading role in defining the legal status of the euro.

It is customary in monetary law to draw a distinction between those matters in which States have sovereignty, monetary law (lex monetae), and those which remain in the realm of the independent will (lex contractus). Monetary law has never been supposed to govern everything.

That is why one of the first concerns of the Community authorities, including the European Monetary Institute (EMI), was to organise the coexistence of monetary law with contract law (I). Paolo Zamboni played a leading role in the EMI’s work on the subject (II), which enabled the Community authorities to define Europe’s monetary law (III).

2 THE EUROPEAN MONETARY INSTITUTE AND EUROPEAN MONETARY LAW

A. Monetary law

It is generally accepted that monetary law contains at least three key provisions, whether or not they are included in a single text or dispersed throughout the legislation, as was long the case in France. These provisions are:

– definition of the currency and the currency unit,
– determination of the value of the currency,
– determination of the currency of payment.

The State that issues the currency in question has exclusive competence, within the meaning of public international law, to determine each of these three elements.

1 Note of the author.
Consequently the State – in this case the European Community – has a discretionary right to change its monetary law without the parties to a contract being able to assert such a change as grounds for refusing to perform their obligations under it.

If the parties have expressed their obligations in the currency that is affected by the change of monetary law, that change is binding on them. There is no need, under any circumstances, to presume their acceptance of that competence because the matter is not governed by contract law. As the Permanent Court of International Justice found in 1929, in a famous case involving Serbian and Brazilian loans, “it is a generally accepted principle that a State is entitled to regulate its own currency.”

The second principle found in all monetary laws is the payment value that the State bestows on its currency. This prerogative is merely the application of the principle of monetary nominalism; its consequence is that a debtor discharges a debt by paying the nominal amount of the debt. As Professor Jean Carbonnier says, nominalism means “that there is never any cause to take account of the currency’s intrinsic value and that the conversion rate asserted by the sovereign authority between two successive currencies raises an irrebuttable presumption of the ratio of their values” (Droit Civil, Vol. 3, Les Biens, 18th edition, no. 16). That is the rule enshrined in Article 1895 of the French Civil Code on loans of money: “The obligation which results from a loan of money is always for the numerical sum stated in the contract.”

The third principle found in all monetary laws is the determination of the currency of payment. In general, the common rule is that a payment made in the national currency is valid and must be accepted by the creditor.

B. Continuity of contracts

The general idea is that a change of monetary system, which is a matter of public law, should not under any circumstances prejudice pecuniary obligations contained in contracts between private individuals. If the name of the currency remains exactly the same from one system to another, the continuity of contracts is ensured automatically by the mere application of the nominalist principle: the subject of the obligation does not require any adaptive measure (thus, in 1928 and after, Germinal francs found themselves transformed, unwittingly, into Poincaré francs).

If, on the other hand, the successive names of the currency differ, the sovereign authority must intervene to set a ratio between the new currency that will be sole legal tender at the payment date and the previous currency that will no longer be valid (Carbonnier, Droit Civil, Vol. 3, Les Biens, 18th edition, no. 17).
From its establishment in late 1995, the European Monetary Institute created various working groups made up of experts appointed by the fifteen national central banks. The Working Group of Legal Experts (WGLE) – in which Paolo Zamboni represented the Bank of Italy –, was asked at its first meeting on 13 December 1995 to prepare the European regulations required for introduction of the euro and propose them to the Council of the European Monetary Institute. The European Monetary Institute was responsible for preparing the basic framework and preliminary draft regulations that the European Commission would subsequently submit to the Council of the European Union for final discussion and approval.

Two problems took a long time to solve, and it was partly thanks to Paolo Zamboni that the matter was finally settled. The first step was to establish the legal link between the euro and the national currencies during the transitional period so as to ensure – as the Treaty required – a legally binding equivalence between the euro and national monetary units and then to give market operators a guarantee that the introduction of the euro would not adversely affect the continuity of contracts in any way.

A. The legally binding link between the euro and national currencies

One of the tasks of the Council regulation defining the legal framework for use of the euro was to establish “a legally binding equivalence between the euro and national monetary units” (Madrid Summit, December 1994).

The experts feared that the sheer statement of existence of a fixed and irrevocable conversion rate between the euro and national currencies would not be sufficient to achieve this. They thought that, in the absence of a legally binding mechanism that would independently ensure the immutability of the result of the conversion of national currencies into euros and vice versa, the risk of substantial fluctuations, varying from one currency to another, should not be ruled out.

The outcome would have been to disorganise markets, whose assessment of national currencies would have differed from that which would have resulted from the straightforward application of the conversion rates set on the changeover to the euro. One of the effects would have been the appearance of interest-rate differentials, the negation of a single money market.

It was a legal line of reasoning, in which Paolo Zamboni played an important part, which overcame this difficulty. It started from the idea that one of the chief characteristics of a currency is its fungibility, or even its “absolute fungibility”, which goes much further than the fungibility of other goods (Carbonnier, Droit Civil, Vol. 3, Les Biens, 18th edition, no. 53). Fungibility needed being construed in the monetary regulation, and so it was when legally stating that payments in one unit would discharge debts in another unit. Thus, if the euro is fungible with

2 “Adopt the conversion rates at which their [the national] currencies shall be irrevocably fixed” (Art. 123(4)).
each national currency, the payment of 1 euro is equivalent to the payment of 6.55957 FRF or 1.95583 DEM, and monetary debts could be redeemed at such rates if the law so declared.

The insistence on fungibility undoubtedly reassured the markets. Moreover, the concept was easily incorporated into monetary law. Present in Roman law, fungibility is not peculiar to French law. It may be found at Article 337 of the Spanish Civil Code, Article 91 of the German Civil Code (BGB), Article 1243 of the Italian Civil Code and Article 561 of the Dutch Civil Code. It also provided a means for expressing in legal terms the principle according to which the national currencies and the euro, for as long as they had to coexist (i.e. until 2002), became different expressions of an identical currency in economic terms.

B. The continuity of contracts

Another concern that the legal experts had to address during the groundwork for the introduction of the euro was the problem of the continuity of contracts. Of all the legal issues surrounding the changeover to the single currency, it was its effects on the continuity of current contracts that most immediately attracted attention.

If substitution of the euro for national currencies had empowered the parties to a contract to change its terms, or even to terminate it unilaterally, legal certainty would undoubtedly have been destroyed and the fate of millions of contracts called into question.

English-speaking legal experts were the first to point out the danger, which was taken very seriously because of its inevitable effect on the smooth operation of financial markets. Studies of the subject by Community institutions (the Commission, the Monetary Committee and the European Monetary Institute) came to the same conclusion: replacing national currencies with the euro would have no effect on the continuity of contracts. However, it was necessary to reassure the markets, whose occasionally irrational reactions are well-known.

That is why Article 3 of Council Regulation (EC) 1103-97 of 17 June 1997 on certain provisions relating to the introduction of the euro, taken by the Council of the European Union on the basis of Article 235 of the European Union Treaty, contains the following provision, which is sufficiently important to quote in full: “The introduction of the euro shall not have the effect of altering any term of a legal instrument or of discharging or excusing performance under any legal instrument, nor give a party the right unilaterally to alter or terminate such an instrument. This provision is subject to anything which parties may have agreed.”

The markets welcomed this as the measure that finally lifted all the uncertainties mentioned earlier about the possible effect of the introduction of the euro on the continuity of current contracts. Even the English-speaking experts who had studied the question extensively and had proved the most alarmist let the issue drop.

Let us now see how all these principles were incorporated into European monetary law.
4 EUROPEAN COMMUNITY LAW

In Council Regulation 974-98 of 3 May 1998 concerning the introduction of the euro, the chief principles that underlie any monetary law, mentioned earlier, are treated as follows.

A. Definition of the currency and the currency unit

As from 1 January 1999, the currency of the participating Member States shall be the euro. The currency unit shall be one euro. One euro shall be divided into one hundred cent. (Article 2, Regulation 974-98 of 3 May 1998).

B. Determination of the payment value of the currency

The euro shall be substituted for the currency of each participating Member State at the conversion rate. (Article 3).

All contracts denominated in ECU without any other details are presumed to continue in euros at the rate of 1 for 1 unless the parties have provided otherwise in the contract. (Article 2, Council Regulation (EC) 1103-97 of 17 June 1997).

C. Determination of the currency of payment

On expiry of the transition period (31 December 2001), only banknotes issued by the European Central Bank and coins issued by the Member States shall have the status of legal tender. (Articles 10 and 11 of Regulation 974-98).

During the transition period, banknotes and coins denominated in a national currency unit that is a non-decimal subdivision of the euro shall retain their legal tender status within their territorial limits. (Article 9 of Regulation 974-98).

All these provisions, which may be considered to form part of Community public policy, apply ipso facto to current contracts, without of course posing any threat to their continuity.

Another reason for having complete confidence in the normal pursuit of current contracts on the changeover to the euro was the fact that the monetary law of the European Community ensured continuity between the ECU and national currency units on the one hand and the euro on the other.

This monetary continuity between different monetary units helped to guarantee the continuity of contracts in accordance with the nominalist principle. It was expressed as follows: the basket ECU was replaced by the euro at the rate of 1 for 1 and the private ECU, except where otherwise provided, was presumed to refer to the ECU as defined by Community legislation.

During the transition period, which lasted from 1 January 1999 to the disappearance of national currencies in 2002:

- the euro was divided into national currency units at the conversion rate and the Member States’ monetary law continued to apply;
– amounts denominated in national currency units were payable with amounts
denominated in euro units at the conversion rate;
– any sum denominated in euro units or in national currency units could be
credited to a creditor’s account in the currency unit of the account.

5 EPILOGUE

This brief study shows that thanks to the work in which Paolo Zamboni played
an active part, the European Union was able to endow itself with a monetary
law and ensure that the changeover to the single currency happened so naturally
that none of the predicted disasters occurred. It was an achievement that we owe
to people who, like Paolo Zamboni, were able to reason calmly, drawing on age-
old principles already enshrined in Roman law. At a time when there is much
discussion of the merits of the common law and civil law systems, it was a civil
law notion advanced by Latin legal experts that firmly secured the “legally
binding equivalence between the euro and national currency units” sought by
the Member States at the Madrid Summit of December 1994. And in a last nod
to history, it is Roman law that provided the definitive foundation for the euro.
Paolo Zamboni was rightly very proud.
HOW EURO BANKNOTES ACQUIRE THE PROPERTIES OF MONEY

Bernd Krauskopf

ABSTRACT

Lo studio considera dove e come le banconote denominate in euro sono divenute moneta dal punto di vista della legge monetaria ed esamina, sulla base della legislazione comunitaria relativa alle banconote denominate in euro, il significato giuridico dell’emissione delle banconote e della loro messa in circolazione. Viene analizzata la storia giuridica delle banconote, considerate le diverse valutazioni legali sulla loro origine e si giunge alla conclusione che le banconote denominate in euro acquisiscono le caratteristiche di moneta nel corso delle seguenti fasi: nelle pubblicazioni (ufficiali) sono rese note le caratteristiche peculiari delle banconote; l’emissione delle banconote è autorizzata dal Consiglio direttivo della Banca Centrale Europea e, da ultimo, l’atto effettivo della loro messa in circolazione deve essere posto in essere dalle Banche Centrali Nazionali. Per contro, la demonetizzazione avviene attraverso il rientro di una banconota alla Banca Centrale Nazionale oppure tramite il ritiro delle banconote di una specifica serie o denominazione.
1 COMMUNITY LEGISLATION CONCERNING THE ISSUE OF EURO BANKNOTES

The starting point of our deliberations on how euro banknotes acquire the properties of money is Community monetary legislation, specifically Article 106 (1) of the Treaty establishing the European Community (“the Treaty”). This provision gives the European Central Bank (ECB) the exclusive right to authorise the issue of banknotes within the Community. The ECB and the national central banks have the right to issue banknotes. Article 16 of the Statute of the European System of Central Banks and of the European Central Bank (“the Statute”) reiterates these rules and adds that the ECB should respect as far as possible existing practices regarding the issue and design of banknotes. The Council of the European Union set 1 January 2002 as the date for the introduction of euro banknotes and coins in Council Regulation (EC) No 974/98 of 3 May 1998 on the introduction of the euro. Through its decision of 7 July 1998 the Governing Council of the ECB determined the denominations and specifications of the euro banknotes and adopted (in addition to rules governing the reproduction of banknotes) provisions on the exchange and withdrawal of euro banknotes, which were supplemented by a Guideline addressed to the national central banks. With the decision of 6 December 2001 on the issue of euro banknotes the Governing Council of the ECB laid down a detailed division of responsibilities with regard to the issue of banknotes within the European System of Central Banks (ESCB).

2 ISSUERS OF THE EURO BANKNOTES

It is not immediately clear from the Treaty just what “issuing banknotes” means. It is therefore reasonable to resort to the traditional interpretation of the term, which distinguishes between the issue of banknotes and the act of putting them into circulation. For the difference between the two terms, see also R. Smits (1997), The European Central Bank: Institutional Aspects (The Hague: Kluwer Law International), p. 206.
is incurring a liability because the banknotes have a value.7 This liability is also listed on the balance sheet of the central banks. By contrast, putting banknotes into circulation indicates that a banknote has physically left the premises of a central bank with the purpose of constituting a means of payment in the market.8 However, it would be wrong to deny the act of putting banknotes into circulation any legal significance and to see in it nothing more than a description of actual procedures. Issuing and putting into circulation are not entirely unconnected but, instead, are mutually complementary.

Pursuant to Article 106 (1), second sentence, of the Treaty, the ECB and the national central banks may issue banknotes. Pursuant to Article 106 (1), third sentence, of the Treaty, only these banknotes have the status of legal tender within the Community. These provisions in primary Community law stipulate that, as a matter of principle, only the ECB, the national central banks, or the ECB and the national central banks together may issue banknotes.9 Paramount importance is attached to the principle of decentralisation with respect to decisions that the Governing Council of the ECB, as its supreme decision-making body, has to take on the performance of ESCB tasks. In accordance with Article 12 (1), paragraph 3, of the Statute, the ECB, to the extent deemed possible and appropriate, is to have recourse to the national central banks to carry out operations which form part of the tasks of the ESCB.

During the period between the launch of Stage Three of Economic and Monetary Union (EMU) and the introduction of euro banknotes and coins the national central banks alone were empowered by the Governing Council of the ECB to issue national banknotes in accordance with their national practices.10 The background to this decision was that, pursuant to Article 9 of Council Regulation (EC) No 974/9811, banknotes denominated in a national currency unit retained their status as legal tender within their territorial limits as of the day (i.e. 31 December 1998) before the entry into force of this Regulation.

The Governing Council of the ECB decided on 6 December 2001 that, with the introduction of euro banknotes and coins, both the ECB and the national central banks would issue banknotes in the legal sense.12 In the same Decision the Governing Council of the ECB laid down the distribution of responsibilities for

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8 See Zilioli and Di Preso, op. cit. footnote 7, Article 106 of the Treaty, margin number 11.
9 In order to take account of the special situation in the United Kingdom, where banknotes are issued not only by the Bank of England but also by commercial banks in Scotland and Northern Ireland although these banknotes do not have the status of legal tender, the possibility of other (private) issuers issuing banknotes with the authorisation of the ECB is not actually ruled out under primary Community law. However, these banknotes would not be deemed legal tender in the Community.
11 Cited in footnote 2.
the banknote cycle within the Eurosystem. The ECB is not involved in the physical issue of banknotes. These are put into circulation and withdrawn from circulation solely by the national central banks, pursuant to Article 3 of Decision ECB/2001/15 on the issue of euro banknotes. Procurement for the production of banknotes is also undertaken on the level of the national central banks, which purchase them on the open market, use their own banknote printing works or resort to public security printers.

Article 10 of Council Regulation (EC) No 974/98 stipulates that the ECB and the national central banks are to put euro-denominated banknotes into circulation as from 1 January 2002. The purpose of this was simply to fix the date for introducing cash. Rules governing the issuer of banknotes in the legal sense or the extent to which the ECB and the national central banks were to be involved in the physical issuance of banknotes were not intended to be affected by it. There was no intention to interfere with the competence of the Governing Council of the ECB.

These rules enshrined in Community monetary legislation on the euro provide no definitive answer to the question we posed at the beginning: how and when do euro banknotes acquire the properties of money. It therefore seems appropriate to examine our understanding of the subject in the German context.

3 DEVELOPMENT OF PAPER MONEY

Let us start by taking a look at the historical development of paper money and at the legal environment in which the various stages of this development occurred. This will make it easier to understand the legal implications of paper money today. In its present form, paper money is a recent phenomenon. Money in the Europe of antiquity, the Middle Ages and early modern times took the form of coins. Initially, these were made mostly from gold or silver and thereby transformed these precious metals, which were used as a measure of exchange, into manageable monetary units. The actual value of the metal was the deciding factor. One therefore speaks of commodity money. Later, coins were minted whose intrinsic value was less than their face value. These mark the transition to money which has only a nominal monetary value but no intrinsic value (fiduciary money). Banknotes developed from deposit certificates for gold or silver, which were issued by bankers or goldsmiths who promised in these certificates to pay out a certain quantity of gold or silver on presentation of the certificates. Soon the issue of notes began to take place independently of the actual amount of precious metal deposited, with the result that the promise of

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13 This takes account of the principle of decentralisation cited in Articles 9 (2) and 12 (1) of the Statute. See Recital 8 of Decision ECB/2001/15.
15 See P. Badura (1963), Das Verwaltungsmonopol (Berlin: Duncker & Humblot), p. 99, which contains further references.
16 See K. Olivecrona (1957), The Problem of the Monetary Unit (Stockholm: Almqvist & Wiksell), p. 49.
an exchange came to the fore. However, these notes did not lose their properties as a security at first but continued to represent a claim under private law. This means that they were bearer debt securities with which a redemption commitment on the part of the issuer was securitised and which were treated under the law of negotiable instruments (representative money).

Historically, various bodies were engaged in the issue of (covered) notes. In Germany, for example, not only state central banks had the right to issue their own notes; in the past private banks also enjoyed this prerogative. It was not until a unified Nation State had been founded in Germany in 1871 that this right was restricted to one (state-owned) central bank, the Reichsbank, which was established in 1876.

The promise to pay the bearer in gold was also abolished eventually. This finally brought about a development which had long been advocated in political debate. As far back as the 18th century Sir John Sinclair saw the freeing of paper money from the redemption commitment as a prerequisite for any economic growth. Yet, a promise to redeem these notes in gold remained on the banknotes of many countries for quite some time. However, the practical value of the redemption commitment was always marginal as it would probably have functioned only as long as it was not really required. With the abolition of the redemption guarantee the development of the banknote from being a security to being a monetary token or a public monetary token (fiat money) was complete.

The previously securitised right to fulfilment is having an effect on the legal treatment of banknotes to this day. Duden has arguably provided the most apt explanation of how we should understand the terms “redemption” or “cover” in the case of today’s money which is non-convertible, i.e. cannot be exchanged.

17 See H. H. Schaelchlin, *Das Geld als ökonomische und juristische Kategorie* (dissertation, Freiburg/Schweiz, 1948), p. 71. The right to the exchange or replacement of (damaged) banknotes (which still exists today) has its origins in public law, at least in Germany; see L. Gramlich (1988), *Bundesbankgesetz* (Köln et al.: Heymann), section 14, margin number 10.

18 For the history of the central banks in Germany up to 1936, see B. Sprenger (1986), “Banknotenprivileg in Deutschland”, in Die Bank, p. 533 et seq.


20 “It was a great discovery when a metallic medium was substituted for barter; it was also a great discovery when paper was made convertible into gold and silver; but a third discovery was reserved for our own times, namely that with an inconvertible paper currency, agriculture, commerce and manufactures might advance in a career of unexampled prosperity.” Sir John Sinclair, as quoted by J. Harvey (1877), *Paper Money, the Money of Civilization. An Issue by the State, and Legal Tender in Payment of Taxes* (London: Provost & Co.), p. 16.

21 See Olivecrona, op. cit. footnote 16, p. 49 et seq., who refers to the promise to pay which still appeared on US and UK banknotes at that time but which, he claims, is meaningless. However, this promise may have remained in use not only for reasons of tradition and to increase confidence in the currency but also for legal considerations because in the UK, for example, the guarantee to pay in gold was only suspended initially and was not abolished completely until later.

22 See A. Nussbaum (1925), *Das Geld in Theorie und Praxis des deutschen und ausländischen Rechts* (Tübingen: Mohr Siebeck), p. 31 et seq., who refers to Ludwig Bamberg’s description of the redemption guarantee as a “fur for dog days”.

23 For the development of paper money, the partial gold cover and the (false) wording “I promise to pay”, see Harvey, op. cit. footnote 20, p. 8.


25 See also *Bundesverwaltungsgericht* (the German Supreme Administrative Court), judgement of 23 November 1993, BVerwGE 94, 294 = Neue Juristische Wochenschrift (1994), p. 954. The court explicitly rejected the qualification of banknotes as bearer debt securities.
for precious metals or precious metal coins. Duden points out that today money is neither covered contractually nor legally by certain assets which would be linked to its security but, instead, that solely “appropriate banking operations” guarantee the cover of bank money.26

Closely associated with the question of cover or redeemability is the government order which stipulates that the acceptance of banknotes is mandatory and which is encapsulated in the term “legal tender”.27 The question is whether it is essential for money to be subject to unrestricted mandatory acceptance before one can speak of “money”.28 The property of money as “legal tender” emphasises first and foremost its exclusive claim to be the money of a given currency area and renders legal actions easier. However, it would be equally conceivable to leave its acceptance to the discretion of the marketplace. It has been rightly pointed out that, although the general mandatory acceptance implied by the term “legal tender” is customary nowadays for monetary tokens, it is not essential for a certain object to be a monetary token.29 In contrast to coins, banknotes were not recognised as legal tender for a long time. It was even maintained that paper money can be regarded as money in the legal sense only if it is at one and the same time legal tender as only coins were real money.30 In Germany, for example, even the banknotes issued by the Reichsbank were not legal tender until declared so by the Coinage Act of 1 June 1909.31

If the State refrains from granting any monetary token the status of legal tender, problems will arise, if at all, only in the case of weak currencies. However, events in the 1930s in Switzerland, where there was no legal tender in circulation between 1930 and 1936, show that, even when none of the monetary tokens issued has the property of legal tender, the tokens in circulation, such as banknotes denominated in Swiss francs, can be accepted in transactions without difficulty. They are therefore also to be treated as money in the legal sense.32

Nowadays, it is sensible and consistent with tradition to grant banknotes the status of legal tender. However, it does not appear to be absolutely essential. By contrast, the value of the material or the redemption commitment are meaningless. Distinguishing between coins and paper money within the same monetary legislation is no longer appropriate.33 In the case of the euro the European legislators decided to grant euro banknotes the status of (sole) unrestricted legal tender.34

27 See Nussbaum, op. cit. footnote 22, p. 32.
28 Again, see Nussbaum, op. cit. footnote 22, p. 32; for a critical appreciation of the term “legal tender” see also Duden, op. cit. footnote 26, p. 15.
31 In Article 3 of this Act, RGBl. 1909, p. 507; see also Nussbaum, op. cit. footnote 22, p. 30.
32 See Schaelchlin, op. cit. footnote 17, p. 73.
33 Regarding the legal division of responsibilities, it must be remembered that in many countries the right to mint coins and the right to issue banknotes are not held by the same institutions. The central bank is frequently responsible for issuing the banknotes while the “coin prerogative”, as it is called, belongs to the government.
34 Article 106 (1) of the Treaty and Article 16 of the Statute, reiterated by Article 10 of Council Regulation (EC) No 974/98.
4 MONETISING EURO BANKNOTES

With respect to the euro banknotes any legal notification of the origin of paper money must state not only that banknotes which are stored in the vaults of the central banks (either because the central banks have not yet put them into circulation or because the banknotes have flowed back to them) are not shown on the liabilities side of these central banks’ balance sheets but also that the ECB, which does not put banknotes into circulation itself, nevertheless lists, as the issuer of banknotes, such banknotes as liabilities on its own balance sheet and receives from the Eurosystem profits arising from the banknote issue.35

No standard legal definition (or one agreed at the international level) of money exists at present.36 Civil law and criminal law each have their own way of looking at money as a phenomenon. The definition of money in civil law has remained (almost) unaffected by the changes in the term “money” in the economy as a result of the increase in book money and is still largely determined by a physical notion of money.37 Owing to the principle of nulla poena sine lege, criminal law requires precise definitions. It is therefore not surprising that an early definition of money in German law introduced in a united Germany after 1871 is to be found in a decision delivered in a criminal case on counterfeiting. The Supreme Court defined money as “any means of payment certified as a medium of value by the State or by any body authorised by it and destined for public circulation”.38 In monetary legislation, money is defined as what is proclaimed by the State to have valor impositus and which must be, or at least is, accepted to repay debts.39

It is clear from these definitions that the emergence of the property of “money” is not a purely factual matter but rather a legal matter. Given the necessary technical know-how, anyone can produce printed paper with colourful designs and special security features.40 If such a product is to become (paper) money which will be accepted by third parties as a universal means of exchange, a legal act to that effect is required. There is a broad consensus within the field of jurisprudence in Germany that the legal act denoting the “birth” of a banknote belongs to the sphere of public law41 for the mere reason that the issuance of banknotes in Germany was, and is, a task reserved exclusively for public bodies,


36 Nothing has changed with respect to the finding of S. Simitis (1960), “Bemerkungen zur rechtlichen Sonderstellung des Geldes”, in Archiv für die civilistische Praxis, Bd 159, p. 406 and p. 465, to the effect that there is no such international definition of money.

37 See H. U. Franzke (1964), Geldhöheit und Währungssteuerung (Frankfurt am Main: Knapp), p. 106.

38 Reichsgericht (Supreme Court of the German Reich), judgement of 11 July 1924, RGSt 58, 255, 256. This definition which was derived from the court decision, was generally taken over by the legal literature; see W. Ruß, in H.-H. Jescheck, W. Rus and G. Wilms (eds) (2000), Leipziger Kommentar Strafgesetzbuch, 11th edition (Berlin and New York: de Gruyter) section 146, margin number 4; W. Stree and D. Sternberg-Lieben, in A. Schöne and H. Schroeder (2001), Strafgesetzbuch Kommentar, 26th edition (Munich: Beck), section 146, margin number 2; H. Tröndle and T. Fischer (2001), Strafgesetzbuch und Nebengesetze, 50th edition (Munich: Beck), section 146, margin number 2; K. Kühl in K. Lackner and K. Kühl (2001), Strafgesetzbuch mit Erläuterungen, 24th edition (Munich: Beck), section 146, margin number 2; Häde, op. cit. footnote 29, p. 90.

39 See Schaelchlin, op. cit. footnote 17, pp. 70 et seq., who describes this money as “money par excellence”.

40 However, certain materials used in the manufacture of banknotes are given special protection against unauthorised use, section 127 of the Gesetz über Ordnungswidrigkeiten (Act on Breaches of Administrative Regulations).

both prior to entry into Stage Three of EMU and after the introduction of the euro. Consequently, the unauthorised issue of monetary tokens is a punishable offence, pursuant to section 35 of the Bundesbank Act.

The act of monetisation, through which a moveable object is accorded the function of a general means of exchange, or, in other words, the function of money, is supposed to be identifiable by an outwardly recognisable mode of behaviour. However, owing to the undeniable difficulties, some commentators avoid specifying by what outwardly recognisable act the transformation from printed paper to banknote is manifest. They restrict themselves to the statement that this act is an administrative act with no particular addressee and bring it close to the status of dedication. Many even see a similarity between dedicating a banknote and dedicating any object to be a public entity. In German law this is understood to be a measure by which the government or other national bodies with sovereign powers acquire specific physical control, which leaves private property untouched but burdens it with public servitude. Accordingly, the issue of banknotes is said to be the dedication of banknotes to the public entity of money in the form of unrestricted legal tender. As a counter to this legal construction, however, it has been argued that the jurisdiction of the holder of the paper money is not restricted but, instead, is extended because the paper acquires a value in addition to its purely material value. Furthermore, neither public use nor public ownership coupled with the transfer of money to private use is associated with money. These weaknesses are recognised by others, and the act of dedication is deemed to be sui generis.

However, this does not bring us much further in answering the questions posed at the beginning because that depends crucially on what outwardly visible act the monetisation act is associated with from a legal point of view. There are three possible options:

(a) Manufacturing banknotes;

43 The same applies to non-interest-bearing bearer debt securities. In the history of law, this again illustrates the origin of the modern uncovered banknote, which arose from the bearer debt security of a central bank.
44 For a definition of the monetising act, see U. Häde (1991), Geldzeichen im Recht der Bundesrepublik Deutschland (Baden-Baden: Nomos), p. 50.
45 For example, Grenz, op. cit. footnote 24, p. 179, although she does not deal with the preconditions and consequences of this act of dedication in more depth; also, more recently, D. von Stebut (1982), “Geld als Zahlungsmittel und Rechtsbegriff”, in Jura, p. 561 and p. 563.
46 See G. Pfennig (1971), Die Notenausgabe der Deutschen Bundesbank (Berlin: Duncker & Humblot), p. 47 et seq.; H. Dilcher, in J. von Staudinger (1995), Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetzen und Nebengesetzen, sections 21-103, 13th revision (Berlin: de Gruyter), section 91, margin number 13; with regard to its dedication to be a public entity, see also L. Gramlich (1987), “Die Begebung von Geldzeichen”, in Zeitschrift für das gesamte Kreditwesen, p. 548 and p. 552, although he assumes the existence of an “inherent power” arising from the actual process of putting the monetary tokens into circulation, a phenomenon which he detects in the issuance by the Bundesbank.
47 See Pfennig, op. cit. footnote 46, p. 47.
49 See Dilcher, op. cit. footnote 46, section 91, margin number 13.
50 See, for example, K. Schmidt, in: Staudinger (1997), Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetzen und Nebengesetzen, sections 244-248 (monetary legislation), 13th revision (Berlin: de Gruyter), before section 244, margin number B 2; see also Häde, op. cit. footnote 44, p. 183; see also Hahn, op. cit. footnote 41, p. 65.
51 For terminology, see Häde, op. cit. footnote 44, p. 51 et seq.
(b) Announcing the distinguishing features on a particular banknote denomination or banknote series;

(c) Putting an individual banknote into circulation.

The first thing that has to be emphasised is that the production of banknotes, just like the minting of coins, cannot be said to have direct legal effects as they are both purely technical processes. Money does not come into being simply as the result of the production of “banknotes”. Even if one wanted to regard this juncture as the moment when a banknote is “born”, the transformation of printed paper into a banknote would occur, if at all, at the time this technical process took place and not as a result of that process in itself. Grenz believes that the characteristics of money are bestowed on printed banknote paper at the point of manufacture itself by virtue of that very process and, moreover, that the act of manufacture undergoes an act of dedication which gives it monetary value. Here, she follows older German authors who developed this explanation for the minting of coins. She classifies the act of dedication as an administrative act with no particular addressee. According to Grenz, the customary signatures depicted on banknotes are to be seen as a “certification of banknotes” just as the government stamp is on coins. These thoughts evidently stem from the similarity between seals and coin motifs but are hardly valid now that the ability to reproduce these processes is so simple. Hahn, by contrast, maintains that, once a particular banknote denomination has been announced or, in the absence of such an announcement, has been put into circulation, every other banknote of this type acquires the characteristics of money on completion. A related idea is linked to the creation theory held in some quarters with respect to the German law on securities. According to this theory, a security becomes such as soon as it is issued and does not depend, for its properties of being a security, on the subsequent act of issuance by the issuer. That does not explain why banknotes which are not in circulation but, instead, are stored in the vaults of a central bank are not banknotes in the legal sense and do not appear on the central bank’s balance sheet. These opinions are therefore widely rejected.

Another point of reference for monetisation could be the (official) announcement of a banknote series. The Governing Council of the ECB laid down the denominations and features of the euro banknotes by virtue of a decision which was published in the Official Journal of the European Union. At the same time this decision is an expression of the ECB’s intention that euro banknotes should be issued with certain features. Pursuant to section 14 (1), sentence 3, of the

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52 See Hahn, op. cit. footnote 41, p. 65; and Grenz, op. cit. footnote 24, p. 173, who makes a distinction between the printing of banknotes and the creation of their monetary properties.

53 See Grenz, op. cit. footnote 24, p. 179. However, she sees monetary value as a subjective public right.

54 See, for example, Grenz, op. cit. footnote 24, p. 175 et seq.

55 See below.

56 Hahn, op. cit. footnote 41, p. 69; and Schmidt, op. cit. footnote 50, before section 244 margin number B 3; Nussbaum, op. cit. footnote 22, p. 35; von Spindler, Becker and Starke, op. cit. footnote 42, section 14, footnote 2.

57 Nussbaum, op. cit. footnote 22, p. 35; for a similar line of argument, see also Grenz, op. cit. footnote 24, p. 171.

58 See Dilcher, op. cit. footnote 46, section 91, margin number 13.

59 For the first euro banknote series, reference may therefore be made to Decision ECB/1998/6. This decision has since been replaced by Decision ECB/2003/4 (both Decisions cited in footnote 3).

60 This expression of willingness was demanded by H. Fügén (1969), Geld- und Währungsrecht (Munich: Beck), p. 21.
Bundesbank Act, the Bundesbank is also required to announce publicly the
denominations and distinguishing features of the banknotes which it issues. Prior
to the introduction of the euro it published these features in the Federal Gazette.
It has retained this practice for the euro banknotes.

The essential purpose of these announcements is to inform the general public
about the distinguishing features of the banknotes. However, illustrations of the
euro banknotes appear neither in the official announcements of the ECB nor in
those of, for example, the Bundesbank. The announcement in the relevant legal
provisions is therefore legally necessary but in practice hardly sufficient. Large
sections of the general public are probably informed about the issue of new
banknotes not through official publications but, instead, through media
campaigns commissioned by the central banks. A crucial role is therefore
attached to the supplementary publicity work carried out by the central banks.
Prior to the introduction of the euro banknotes and coins this work focused on
the visual appearance of the euro banknotes and on how to recognise the security
features incorporated into the euro banknotes.

It might actually be worth ascertaining whether announcement in this context
would not mean more than publication in official journals, and whether it
requires the central banks to undertake publicity work rather than just allowing
this work.

Voigt regards the announcement of denominations and distinguishing features
in the Federal Gazette as a legal norm (i.e. a statutory regulation) because, he
says, by its very nature it ascribes the characteristics of money to all the relevant
monetary tokens and consequently regulates the rights and obligations of every
individual participating in the economy as a whole.61 He rejects any further act
of creation or dedication that may be associated with the issue of the tokens.62

Others do not see the announcement of a new banknote series as a condition for
the bestowing of the function of money on it.63 Even the publication of the
distinguishing features is seen by some as unnecessary for transforming a note
into money. Accordingly, a banknote issued without prior announcement is also
to be ascribed a monetary value. The announcement of the denominations and
the distinguishing features has no normative value, it is claimed; nor does it have
any direct legal effect. This can be seen in the fact that the security of the payment
system would be endangered unless each banknote put into circulation by the
authorised bodies were given the characteristics of money.64 However, some add
the qualification that banknotes which were not put into circulation by the central
bank but were lost by it prior to issue can be acquired honestly only if such an
announcement were made.65 This argument is not convincing. The security of the

p. 197.
62 See Voigt, op. cit. footnote 61, p. 198.
63 See Hahn, op. cit. footnote 41, p. 66; see also Grenz, op. cit. footnote 24, p. 177.
64 See Grenz, op. cit. footnote 24, p. 175 et seq.
65 See Grenz, op. cit. footnote 24, p. 171 et seq.
paper-based payment system is based precisely on the fact that authorised banknotes are distinguishable from other banknotes. This attaches paramount importance to their outward appearance. The general public uses both the graphic elements and the special security features (special printing techniques, watermarks, security threads and the embossed “ECB” acronym) to ascertain whether a particular piece of printed paper is a genuine banknote or not.

Häde sees in the announcement of the new issue of a banknote series the crucial and publicly discernible declaration of intent on the part of the issuer which gives the printed paper the characteristics of banknotes. Even so, he qualifies this by adding that this declaration can refer only to the banknotes already produced at the time of the announcement. By contrast, he sees the manufacturing order as the deciding act for subsequently produced banknotes of a series already introduced. This view is not convincing because it creates an artificial split in a process that cannot be detected from outside the bank. Furthermore, the contract to produce the banknotes is awarded before the actual production of the notes begins. Evidently Häde uses this construct simply to avoid attributing legal significance to the act of production itself.

It is therefore clear that the decision to issue a banknote series and to announce this decision is a necessary but not a sufficient condition for monetising euro banknotes. The actual “transfer of banknotes to the public” as the decisive act in their transformation into money is carried out by the national central banks, which also put into circulation the banknotes issued by the ECB.

In our opinion, putting the banknotes into circulation with the authorisation of the Governing Council of the ECB is an essential element of their transformation into money and fulfils the decision to issue banknotes manifest in the announcement. The transfer of ownership is to be seen as the moment when the banknotes take on a monetary value. The transfer, which is to be viewed as an act under civil law, simultaneously has an impact under public law because the granting of the characteristics of money is a sovereign act. In principle, the act of putting the banknotes into circulation is carried out by bodies endowed with sovereign authority. In this way, the national central banks implement the decisions taken by the Governing Council of the ECB.

66 See Häde, op. cit. footnote 44, p. 73. However, Grenz, op. cit. footnote 24, p. 177, rejects the announcement as the point of transformation into money, asserting that the announcement has no direct temporal connection with the act of creation.


68 See Fögen, op. cit. footnote 60, p. 22, for the importance of the transfer of the ownership of money in line with the provisions for movable property; the characteristics were highlighted earlier by Schaelchlin, op. cit. footnote 17, p. 74.

69 For a similar situation where Community law is implemented by national authorities without procedural rules laid down by treaty or secondary legislation, see C. Koenig and A. Haratsch (2000), Europarecht, 3rd edition (Tübingen: Mohr Siebeck), p. 50, margin number 129.
In the Eurosystem the task of putting the banknotes ascribed to the ECB into circulation was also transferred to the national central banks. In Germany the banknotes are put into circulation through the branches of the Bundesbank which in turn pass them on to the holders of current accounts at these branches (as a rule, these account holders are credit institutions or cash-in-transit companies).

Accordingly, it can also be conclusively stated that banknotes do not acquire the characteristics of money until they are put into circulation by being transferred to a third party and that banknotes which flow back to the central bank (or to one of the other national central banks within the Eurosystem) again lose their characteristics of money as a result and, further, that these banknotes which are now out of circulation are not shown as a liability item on the central bank’s balance sheet. Only when it is retransferred to the public does a banknote regain the characteristics of money.

At least according to German legal interpretation, the acquisition of monetary value can also be ascribed to “banknotes” which become lost at the issuing central bank. The question here is whether and, if so, when these lost “banknotes” become money in the legal sense. These notes are definitely not money in the legal sense when held by parties in bad faith. The solution here is therefore likely to be found in a bona fide approach. German law on the acquisition of property in good faith stipulates that ownership of lost property cannot be acquired in good faith (see section 935 (1) of the Civil Code.) However, section 935 (2) of the Civil Code makes an exception in the case of money. It is widely held that, pursuant to section 935 (2) of the Civil Code, at least by analogy, ownership of this printed paper can be acquired as in the case of money. The characteristics of money would arise with the acquisition of the property through a bona fide third party as the central bank does not lose ownership until this point and the situation is therefore comparable with the deliberate transfer of ownership in the case of putting banknotes into circulation. In support of this argument reference has sometimes been made to the historical origin of the banknote as a physical bearer debt security: banknotes could not be subject to less protective provisions for the general public than physical bearer debt securities and therefore the transformation into money accompanies in any event the bona fide acquisition.

Putting banknotes into circulation through a body specifically authorised for the purpose, i.e. the national central banks in the case of the Eurosystem, is therefore the last step in the process of printed paper acquiring the characteristics of money.

70 See Article 3 (1) of Decision ECB/2001/15, cited in footnote 5.
71 It is only if every moveable object is regarded as money, assuming the nature of its production and appearance is consistent with the general conception of money, that such a case does not pose problems. See, for example, Nussbaum, op. cit. footnote 22, p. 35. For the reasons given above, however, this production-related approach should be rejected.
73 See Grenz, op. cit. footnote 24, p. 170; F.A. Mann (1970), for example, in Juristenzeitung, p. 212 and p. 409, emphasises more strongly the analogy with section 794 of the Civil Code concerning the obligation on the part of the issuer arising from a debt security that he or she has lost or that has been put into circulation against his or her will; Pfennig, op. cit. footnote 46, p. 69; and (for coins) Gramlich, op. cit. footnote 17, section 8, margin number 4, of the Coinage Act.
A banknote can lose the characteristics of money in two ways. First, a (temporary) demonetisation can occur in the cash cycle if the banknote flows back to the cash office of the central bank and its value is credited to an account or if it is exchanged for another banknote. Second, a banknote can lose its monetary properties if banknotes are recalled or withdrawn from circulation.

Recall and withdrawal are used to replace one banknote series with another or to introduce individual banknote designs with a new design. Recalled banknotes have to be exchanged. This stems from an obligation under public law to grant replacements; it arises from the nature of monetary sovereignty and concerns the nominal value of the banknotes. An expiry period for the exchange is customarily defined. Once this exchange period has expired, the banknotes become invalid and lose their monetary properties. Under German law the recall of a banknote is tantamount to an administrative expropriation which divests the holder of the note of his/her subjective public right to the monetary value of the banknote, but leaves him/her in ownership of the banknote paper. However, this expropriation is lawful as long as such government action serves the common weal and as long as the length of the exchange period is adequate.

The ECB’s rules governing the recall of a banknote series, an event which has so far not taken place since the start of Monetary Union, are still rudimentary and provide for the adoption of a Decision by the Governing Council of the ECB, which will be published in the Official Journal of the European Union (and in other media). Furthermore, the national central banks are required to announce this decision in the national media at their own expense.

Some people have also seen a termination of a banknote’s monetary properties in the wear and tear or other physical mutation which results in a banknote being deemed no longer fit for circulation. However, this is countered by the fact that central banks are also required to exchange these banknotes. Moreover, cash payments would be fraught with considerable risks as it would be unclear at what point of deterioration the banknotes would lose their monetary properties.

74 That, however, does not rule out the fact that such a period of exchange will be waived, at least for the time being, as it happened, for example, at the Bundesbank with respect to Deutsche Mark banknotes when the euro banknotes were introduced.
75 To understand monetary value as a subjective public right, see Grenz, op. cit. footnote 24, p. 38 et seq. and p. 170.
77 See Gramlich, op. cit. footnote 46, p. 548 and p. 553.
80 See Nussbaum, op. cit. footnote 22, p. 38, for whom it was also immaterial whether this could be supported by statutory provisions or not.
81 Regarding Deutsche Mark banknotes, see Bundesverwaltungsgericht, judgement of 23 November 1993, cited in footnote 25.
6 SUMMARY

According to the Treaty and secondary EC legislation, both the ECB and the national central banks have the right to issue banknotes. The Governing Council of the ECB has decided to allow the ECB and the national central banks to issue banknotes and has published the distinguishing features of the euro banknotes in a Decision.

As we understand it, printed paper becomes a euro banknote as a result of its being put into circulation through its transfer by a national central to a third party following the announcement of the Decision by the Governing Council of the ECB to issue and the said Council’s authorisation to issue.

Conversely, demonetisation occurs either through the return of a banknote to a national central bank or through the recall of a banknote series or a specific denomination.
THE LEGAL PROTECTION OF THE EURO AS A MEANS OF PAYMENT

Giuseppe Napoletano

ABSTRACT

Concentrandosi sulla protezione dell’euro quale moneta a corso legale, il cui utilizzo ha efficacia liberatoria nell’adempimento delle obbligazioni pecuniarie, il contributo delinea il modo in cui gli Stati membri dell’Eurosistema hanno messo in comune la loro sovranità monetaria per creare un nuovo “bene europeo”, l’euro, protetto legalmente a livello europeo.

Esponendo gli elementi essenziali del quadro istituzionale per l’emissione dell’euro, lo studio evidenzia il fondamento a doppio strato della lex monetae dell’euro: gli atti legali degli organi europei e quelli della Banca Centrale Europea.

Il contributo descrive quindi gli sforzi effettuati per garantire protezione penale all’euro nei confronti delle contraffazioni. In questo senso, molti sforzi sono stati compiuti al fine di armonizzare, nei limiti del possibile, le previsioni di legge nazionali in materia penale.

Un altro aspetto della protezione dell’euro è la progressiva integrazione, a livello sia europeo che nazionale, tra le strutture organizzative, per prevenire e reprimere le falsificazioni.

Infine, le regole fondamentali sulla riproduzione delle banconote in euro dimostrano come la protezione dell’euro si estenda oltre i limiti della tutela penale, coinvolgendo anche aspetti di tutela della proprietà intellettuale.
I INSTITUTIONAL FRAMEWORK

With the adoption of the European single currency, euro area Member States’ sovereignty and monetary sovereignty were separated. Although traditionally considered as an inseparable part of a state’s sovereignty,1 monetary sovereignty was actually shared between the Member States that adopted the euro2 within the institutional framework of the European Union (EU), where the issue of the euro is governed by the European System of Central Banks (ESCB), consisting of the European Central Bank (ECB) and the national central banks (NCBs).3 The ECB and the NCBs of the Member States that have adopted the euro are known as the “Eurosystem”, and together they conduct the monetary policy of the Union.4

As the institution where the decision-making bodies of the ESCB operate, the ECB alone may authorise the issue of euro banknotes and coins.6 The ECB and the NCBs may issue banknotes, and these are the only legal tender in the Union.7 Member States may issue coins subject to the approval of the ECB as far as the volume of issue is concerned.8

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1 See F. A. Mann (1992), The Legal Aspects of Money, (Oxford: Clarendon Press), p. 416 et seq. There have been some derogations to the principle, such as the “Latin Monetary Union” or “Latin League”, in the second half of the nineteenth century; the so-called currency board, consisting of creating a link between the national money and a foreign currency that is taken as a benchmark; or the Articles of Agreement of the International Monetary Fund, which bind national monetary policies. On these topics, see M. Perassi, “Il cammino dell’Euro: da moneta virtuale a moneta effettiva” (Messina, 20 December 2001), mimeo. The Latin League was created by an International Convention on 23 December 1865, whereby Belgium, France, Italy and Switzerland created a common monetary area, in which golden and silver national coins had to be accepted in the other Member States. Greece joined the League in 1875. The International Agreement was dissolved on 24 December 1925. On this last topic, see P. Pecorari (1999), La lira debole. L’Italia, l’Unione monetaria latina e il “bimetallismo zoppo” (Padua: Cedam).


4 The conduct of the monetary policy implies the definition and the implementation of the monetary policy of the Union: Article 105 (2) of the Treaty establishing the European Community (“the Treaty”). See also Articles I-30 (1) and III-185 (2a) of the Treaty establishing a Constitution for Europe (“the European Constitution”), OJ C 310, 16.12.2004, p. 1. The references in this article to the European Constitution are based on the assumption that the respective Treaty will actually enter into force, in accordance with Article IV-447.

5 Article 107 (3) of the Treaty. See also Articles I-30 (2) and III-187 (1) of the European Constitution.

6 Article 106 of the Treaty. See also Article I.30 (3) and III-186 of the European Constitution.


8 Article 106 (2) of the Treaty. See also Article III-186 (2) of the European Constitution.
The European political bodies – the Parliament, the Council and the Commission – play an important role in defining the law of the euro, and there are many ways for such bodies and the ESCB to exchange views.

All these bodies, together with the Member States, concurred in defining the rules for the introduction of the euro, so as to ensure a smooth use of the currency afterwards. This is based on awareness of the interaction between legal certainty and monetary stability, since a well-defined body of law is one of the elements that, in combination, may provide stability to a currency.

As a result, the introduction of the euro was accompanied by a close grid of rules, which vary in nature between civil, administrative and penal. In this way, the institutional rules for the governing of the euro, the lex monetae; the operational criteria that citizens and firms had to observe during the transition to the euro; and the common rules for the protection of the euro, either as the object of intellectual property or, most of all, as a means of payment, were all defined.

2 THE LEX MONETAE

Sharing monetary sovereignty implies an immediate effect on the legal sources that define the money and control its use. In actual fact, if, as a rule, each currency is defined by the State that issues it, then the definition of the lex monetae of the euro is basically a competence of the political bodies of the European Union. The Parliament, the Council and the Commission may thus issue European laws and framework laws to establish “the measures necessary for use of the euro as the single currency”, upon consultation and without prejudice to the competences of the ECB.

9 With reference to the European Constitution, see Articles I-34 and III-191.
10 The President of the EU Council and a member of the Commission may participate, without voting rights, in the meetings of the Governing Council of the ECB. The President of the EU Council may submit a motion for deliberation by the Governing Council of the ECB. The President of the ECB is invited to the meetings of the EU Council when it discusses issues related to the objectives and the tasks of the ESCB. The ECB submits an annual report to the European Parliament, the EU Council, the Commission and the European Council, while the President of the ECB presents the report to the EU Council and the European Parliament, which can also proceed on this basis to a general debate. The President of the ECB and the other members of the Executive Board of the ECB may be heard by the competent committees of the European Parliament (Article 113 of the Treaty).

The ECB will also be invited to participate in the informal meetings of the Euro Group, provided for by a Protocol to the European Constitution, whose members are the ministers of the Member States that adopted the euro plus the Commission (Article I of the Protocol on the Euro Group, annexed to the European Constitution).

11 Article 105 (1) of the Treaty. See also Article I-30 (2) of the European Constitution. The stability of the currency is essential to the welfare of society, as the recent Argentinian experience has shown. The stability of money as a reserve of value protects first of all the weakest parts of the population, who live from their jobs, provides firms with certainty in their investment plans and in their business, and strengthens the function of means of payment. For these reasons, the euro was created with price stability in mind; in its Preamble, the Treaty on European Union underlines the willingness of the Member States to create “a single and stable currency”. This is a key element in ensuring the stability of prices, which the European Constitution assumes is a basis for the “sustainable development” of Europe (Articles I-3 (3), III-177, second and third periods and III-185 (1) of the European Constitution) and which it assigns to the ESCB as the “primary objective”. See ECB (ed.) (2001), Why Price Stability? (Frankfurt am Main: ECB).

12 Major difficulties were faced with reference to the penal protection of the euro, because Member States share monetary sovereignty regarding the euro, but retain their legislative powers in the penal field; still, it is necessary to punish any counterfeiting of the euro and, in general, any unauthorised reproduction.


14 Articles I-33 and I-34 of the European Constitution.

15 Article III-191 of the European Constitution.
The EU Council defined some aspects of the *lex monetae* of the euro through Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro\(^\text{16}\), and through Regulation (EC) No 974/98 of 3 May 1998 on the introduction of the euro.\(^\text{17}\) Besides scheduling the times and the modalities for the changeover to the euro\(^\text{18}\) and introducing some contractual rules\(^\text{19}\), these Regulations provide that the banknotes denominated in euro are the only general means of discharging pecuniary obligations, while no person or business is bound to accept more than 50 euro coins in a single payment.\(^\text{20}\)

National provisions that limit cash payments for reasons of public interest are expressly declared compatible with European rules, “provided that other lawful means for the settlement of monetary debts are available”.\(^\text{21}\)

In fact, the *lex monetae* of the euro is not only established in Council Regulations. As mentioned above, the power of other European bodies in this field does not prejudge the competencies of the ECB, according to which view its exclusive power to authorise the issue of banknotes encompasses that of *adopting* “all necessary legal measures to protect the integrity of the euro banknotes as a means of payment”, including the adoption of a regime, common to central banks, to exchange mutilated or damaged banknotes\(^\text{22}\) and to “withdraw euro banknotes and to establish a common regime under which the ECB and the NCBs can perform this withdrawal”.\(^\text{23}\)

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18 As from 1 January 1999 the euro is the currency of the Member States of the European Union that adopted the single currency, with the exception of Greece, which joined the single currency as from 1.1.2001 (Article 2 of Regulation (EC) No 974/98, as amended by Regulation (EC) No 2596/2000). From 1 January 2002, the euro, formerly a “virtual” money, became money under any effect, since it circulates and is legal tender in all the States that adopted the single currency. The conversion rates between the euro and national currencies were established by EU Council Regulation (EC) No 2866/98 of 31.12.1998, OJ L 359, 31.12.1998, p. 1. During the transitional period (1 January 1999-31 December 2001), the national currencies had to be considered as subdivisions of the euro according to the irrevocable conversion rates, and could still circulate in each respective Member State as legal tender according to the respective national rules (Article 6.1 of Regulation (EC) No 974/98). In any case, on the basis of Article 52 of the Statute of the European System of Central Banks and of the European Central Bank (“the Statute”), it was possible until 31 March 2002 to exchange national currencies among themselves according to the respective conversion rates with the euro (Guideline of the ECB of 20 July 2000 on the implementation of Article 52 of the Statute after the end of the transitional period (ECB/2000/6), OJ L 55, 24.2.2001, p. 66, amended by Guideline of the ECB of 25 October 2001 (ECB/2001/10), OJ L 304, 21.11.2001, p. 281. The “virtual” character of the euro during the transitional period meant that the euro could be used only on a voluntary basis – according to the principle of “no prohibition no compulsion” – for non-cash payments.

19 The provision that the introduction of the euro is without prejudice to the continuity of the contracts and of the other legal instruments to the lex *contractus* more to the lex *monetae* 1103/97, unless the parties agree in a different way or, of course, the parties sign a contract to cover exchange rate risk, in which case the introduction of the euro directly affects the contractual consideration. On this and other aspects related to the introduction of the euro, see A. Giardina (1999), “L’euro: Aspetti Internazionalprivatistici”, in Rivista di Diritto Internazionale Privato e Processuale, 4, pp. 789-800.

23 See “whereas” clause (12) of Decision ECB/2003/4.
As a rule, genuine euro banknotes which have legal tender and that are mutilated or damaged can be exchanged at the NCBs if more than 50% of the banknote is presented to the counter or if the bearer can demonstrate that the missing parts were destroyed.\textsuperscript{24} Such an exchange is refused if the NCBs are certain or if they have sufficient reason to believe that a crime was committed in relation to the presented banknote; in this case, the NCBs shall seize the banknote and transmit it to the judicial authorities.\textsuperscript{25}

The ECB has not yet established a general regime for withdrawing euro banknotes from circulation; nonetheless, it has established, on the one hand, that such a regime shall include as a minimum the indication of the type or of the series of the banknote that has to be withdrawn, “the duration of the exchange period”, the date on which the banknote will lose its legal tender status, and “the treatment of the euro banknotes presented once the withdrawal period is over and/or they have lost their legal tender status” and, on the other hand, that the rules on the withdrawal have to be published for purposes of general information in the Official Journal of the European Union and in other means of communication.\textsuperscript{26}

3 CRIMINAL PROVISIONS

Ever since the Geneva Convention of 20 April 1929 on the Suppression of Counterfeit Currency, counterfeiting has been a matter of special attention at international level.\textsuperscript{27} This is probably one of the reasons why Regulation (EC) No 974/98, which established the legal principles for the euro, briefly states that “participating Member States shall ensure adequate sanctions against counterfeiting and falsification of euro banknotes and coins”.\textsuperscript{28}

Nonetheless, a more profound awareness about the risks of counterfeiting regarding the euro was slowly developing, taking into account the introduction of a completely new monetary sign at European level, the treacherousness of counterfeits, especially during the first period of circulation of the euro, when European citizens were not yet fully accustomed to the basic features of euro banknotes, and the greater potential that new digital techniques offer for reproduction, which are now more diffused than ever before.

Thus, the ECB, in the middle of 1998, issued a Recommendation for the European bodies and the Member States to review their policies in the fight against counterfeiting, to provide a new evaluation of the possibilities of

\textsuperscript{24} Article 3.1 of Decision ECB/2003/4.
\textsuperscript{25} Article 3.3 (b) of Decision ECB/2003/4.
\textsuperscript{26} Article 5 of Decision ECB/2003/4.
\textsuperscript{27} Under the Convention, the signing States shall: a) punish the forgery of counterfeited banknotes and coins, the counterfeiting of genuine banknotes and coins, their putting into circulation, the procurement of such values and of the instruments necessary for the forgery or the counterfeiting; and b) punish those facts even if they concern foreign money or were committed abroad. The only requirement is that the forgeries must have been committed on banknotes or coins with legal tender.
\textsuperscript{28} Article 12. In fact, all Member States already had national criminal provisions in place against counterfeiting, in some cases also entailing very severe sanctions.
harmonising national criminal laws in this field, and to improve cooperation at institutional, judiciary and police level, also by analysing the new techniques which are available for banknote counterfeiting. The ECB stated that all Member States should make it mandatory for banks and other professional handlers of cash to seize suspected counterfeit banknotes and to send them to the competent law enforcement authorities, as already provided for in Germany.

In a short time, the modalities to prevent and punish counterfeiting were reconsidered, specifically to protect the euro. Major steps towards the harmonisation of criminal provisions on counterfeiting were taken, and administrative structures were created to study counterfeiting techniques both at a technical (with reference to comparisons between counterfeit and genuine banknotes) and at an intelligence level, with specific reference to methodologies and resources dedicated to investigations.

The harmonisation of penal elements regarding the crime of counterfeiting was obtained on the basis of the Council Framework Decision of 29 May 2000 on increasing the protection provided by criminal penalties and other sanctions against counterfeiting in connection with the introduction of the euro and Council Regulation No 1338/2001 of 28 June 2001, which laid down measures necessary for the protection of the euro against counterfeiting. These acts defined the common elements of the crime of counterfeiting in the EU Member States and created an administrative structure for European cooperation, with the aim of preventing and studying the phenomena related to counterfeiting.

Under Framework Decision 2000/383/JHA of 29 May 2000, Member States shall ensure adequate protection of the euro against counterfeiting, with criminal

31 On 28 May 1999, the EU Council adopted Resolution 1999/C 171/01, OJ C 171, 18.6.1999, p. 1, which urged Member States and the European bodies to cooperate more closely to protect the euro against counterfeiting. In November 1999, the ECB published a Report on the legal protection of euro banknotes in the EU Member States, which identified distinct areas of intervention and revealed the measures that the ECB considered as necessary. On the basis of a comparative analysis, the Report ascertained that four kinds of counterfeiting were punishable in the Member States: the duplication without legitimacy of genuine banknotes or the alteration of their value; putting into circulation money which was counterfeited as indicated above; holding, acquiring or transporting false money; and producing or distributing instruments to produce false money. The ECB immediately underlined the need for close cooperation among the European police forces.
32 From a legal point of view, the interventions of the European bodies are founded on different legal bases: some acts have been adopted on the basis of Title VII of the Treaty on economic and monetary policy. Other measures are founded on the so-called third pillar of the EU, which means the provisions of the Treaty regarding the cooperation of the police and the judiciary in the penal field (JHA).
33 Council Framework Decision 2000/383/JHA of 29 May 2000 on increasing protection by criminal penalties and other sanctions against counterfeiting in connection with the introduction of the euro, OJ L 140, 14.6.2000, p. 1. The content of the Framework Decisions may be similar under some aspects to that of a Directive, since they, in order to harmonise the legal systems of the Member States (Article 34.2 (b) of the Treaty on European Union), introduce some obligations for Member States. Regarding the differences between the Framework Decisions and the Directives, see C. Koenig, A. Haratsch and M. Bonini (2000), Diritto Europeo (Milan: Giuffrè), p. 357.
provisions. “Currency” means “paper money (including banknotes) and metallic money, the circulation of which is legally authorised including euro banknotes and euro coins, the circulation of which is legally authorised pursuant to Regulation (EC) 974/98” (Article 1, second indent). Criminal penalties shall be “effective, proportionate and dissuasive” and they shall include “penalties involving deprivation of liberty which can give rise to extradition”; “the offences of fraudulent making or altering of currency [...] shall be punishable by terms of imprisonment, the maximum being not less than eight years” (Article 6).37

Moreover, Member States shall also provide for “the necessary measures to ensure that legal persons can be held liable for the offences [...] committed for their benefit by any person, acting either individually or as part of an organ of the legal person, who has a leading position within the legal person” (Article 8.1).38

In order to create a common space of freedom, security and justice, the European Union simplified the procedures for judicial cooperation, introducing a “European arrest warrant”39, which consists of the application (which also applies to forgery and counterfeiting of the euro and to the counterfeiting of means of payment (Article 2.2, 10th and 24th indents)) of the principle of mutual recognition of a series of judicial penal measures, such as definitive sentences (therefore going beyond the formal procedure for extradition), the provisional measures of sequestration and confiscation of goods, and arrest.

Regulation (EC) No 1338/2001 created an administrative structure to prevent counterfeiting of the euro, which is characterised by the integration between European and national administrations. It is provided that each State shall designate national competent authorities that are enabled to identify counterfeited banknotes and coins, to collect and to analyse technical and statistical data and to perform intelligence activities on counterfeits as well.40

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36 To achieve this, it is provided that Member States shall punish as a crime the following: the fraudulent making or the alteration of currency, whatever means are employed; the fraudulent uttering of counterfeit currency; the importation, exportation, transport, receiving or obtaining of counterfeit currency with a view to uttering the same and with knowledge that it is counterfeit; the fraudulent making, receiving, obtaining or possession of instruments, articles, computer programs or other means peculiarly adapted for the counterfeiting or altering of currency, or of holograms or other components of currency that serve to protect against counterfeiting (Article 3.1).

37 Framework Decision 2000/383/JHA was amended by Council Framework Decision 2001/888/JHA of the Council, of 6 December 2001, OJ L 329, 14.12.2001, p. 3, which introduced a “European recidivism”, consisting of the duty to recognise as a cause of recidivism the final judgements of conviction issued in other Member States for the crimes of counterfeiting, whatever the counterfeited money is.

38 The liability of the legal entity shall imply the imposition of “effective, proportionate and dissuasive sanctions”, comprising criminal or non-criminal fines and possibly other sanctions, including: a) the exclusion from entitlement to public benefit or aid; b) the temporary or permanent prohibition to exercise commercial activities; c) the placing under judicial surveillance; and d) a judicial winding-up order (Article 9.1).

39 Council Framework Decision 2002/584/JHA of 13 June 2002 on the European arrest warrant and the surrender procedures between Member States, OJ L 190, 18.7.2002, p. 1. According to the Framework Decision, a French judicial authority, for instance, can order the arrest of someone who has counterfeited banknotes in France and, if the author of the crime has returned to, say, Italy, the Italian judicial authority shall execute the French arrest warrant and shall surrender the person after verifying that the crime falls within the categories provided for in Article 2.2 of the Framework Decision. There is no need for a corresponding crime to exist in Italy. As far as counterfeit banknotes are concerned, in this example, the Italian judicial authority shall transmit them to France, unless another trial is pending in Italy regarding the same banknotes, in which case the Italian authority may decide that the banknotes shall temporarily stay in Italy or that they should be delivered to the French authorities upon the condition that they shall be returned.

40 Article 2 (b) of Regulation (EC) No 1338/2001.
Under Regulation (EC) No 1338/2001, banks and other professional handlers of banknotes and coins shall seize counterfeits and remove them from circulation each time they “know or have sufficient reason to believe [them] to be counterfeit”, in order to ship them “immediately” to the national competent authorities (Article 6 (1)). These authorities shall convey the banknotes and coins which are suspected to be false to the National Analysis Centres (NACs) or to the Coin National Analysis Centres (CNACs), respectively, so as to allow them to conduct the first analysis and classification of the technical and statistical data concerning the counterfeit; the final evaluation shall then be performed by the ECB or by the European Technical and Scientific Centre (Articles 4 and 5). The technical data concerning the counterfeits are then communicated to the ECB so that they can be included in the Counterfeit Monitoring System (CMS), a database created within the ESCB that permits users to analyse and manage technical and statistical data related to euro counterfeits.41

Forms of cooperation concerning intelligence activities are also provided: Member States, the Commission, the ECB and Europol shall cooperate by exchanging information and by mutually assisting each other by means of scientific support, training and logistical support (as per Article 7 of Regulation (EC) No 1338/2001).

With reference to collaboration between polices, the European authorities chose to strengthen the role of Europol, which performs intelligence activities by collecting, storing, elaborating and analysing information42, by extending its mandate to fight against the counterfeiting of money and other means of payment.43 To help in the performance of the tasks assigned to Europol, the Member States shall ensure that Europol is informed about the result of the analyses carried out by the national analysis centres on banknotes and coins denominated in euro that are suspected to be false, within the criminal procedures against counterfeiting.44

The extension of the Europol mandate to counterfeiting of money and other means of payment automatically implies that Eurojust is also competent for the same issues.45 Eurojust is a European office with a decentralised structure which is entrusted with the tasks of stimulating, coordinating and supporting both criminal investigations and judicial procedures, when at least two Member States are involved. In the exercise of its tasks, Eurojust closely cooperates with Europol and may exchange information with national, European and other

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42 The tasks of Europol are to facilitate the exchange of information between Member States; to acquire, collect and analyse information; to inform promptly the competent authorities of Member States about crimes that can be of interest to them, also because these may be connected to other crimes, to assist the investigations in the Member States, and to manage a database of relevant information.
43 Council Decision 1999/C 149/02, of 29 April 1999, extending Europol's mandate to deal with forgery of money and other means of payment, OJ C 149, 28.5.1999, p. 16; in this Decision, the concept of forgery of money and other means of payment is defined in relation to Article 3 of the Geneva Convention of 20 April 1929.
44 Article 3 of Decision 2001/887/JHA.
45 Article 4.1(a) of Council Decision 2002/187/JHA of 28 February 2002, setting up Eurojust with a view to reinforcing the fight against serious crime, OJ L 63, 6.3.2002, p. 1. This Decision was also taken under the third pillar of the EU Treaty.
international bodies and organisations (for instance, the ECB and the NCBs which have been designated as NACs), as well as with authorities of third countries which have competence in criminal investigations and judicial procedures.46

4 UNAUTHORISED REPRODUCTION

Copyright on euro banknotes belongs to the ECB47; the copyright on the design of the common face of euro coins belongs to the European Union, represented by the Commission.48 Therefore, the protection of copyright on the designs of euro banknotes and coins is left to the initiative of the central banks of the ESCB, as far as banknotes are concerned, and to the Member States with reference to coins; such a solution is in keeping with the civil and pecuniary nature of the protection mainly offered by copyright law.

It should be mentioned that criminal sanctions against the breach of copyright also exist, and that overall protection of copyright permits the completion of the protection that is ensured in punishing counterfeiting by extending the control of the police and the courts to cases that, although not strictly falling under the criminal provisions, create unauthorised reproductions of banknotes and coins that can confuse the public with regard to the exact individuation of genuine monetary signs with legal tender, or that can damage the image of the issuing institutions.

The purposes of reproductions of the euro may vary, but they can be classified into two categories. The first refers to the creation and circulation of banknotes or metallic pieces that, by reproducing more or less faithfully the legal tender or by making reference to some elements that identify them (e.g. the name “euro”, possibly with a prefix or a suffix), are intended to be means of payment in a more or less wide context (e.g. displays, fairs). In the second category, the object of reproduction is the design of the banknotes or of the coins, and its purpose is cultural or educational (e.g. photos in specialised magazines, inclusions in pieces of art) or commercial (e.g. on t-shirts, chocolates, etc.). This therefore creates a grey zone, where reproductions – according to their nature – may on the one hand be irrelevant from a legal point of view, but could on the other hand imply a breach of copyright and/or damage to the image of the issuer.49

The rules on reproduction, although based in copyright in a first moment50, later found a wider legal basis. In actual fact, the legal basis to regulate reproduction

46 The Treaty of Nice amending the Treaty on European Union and the Treaties establishing the European Communities and certain related acts (Nice Treaty) modified Article 29, second paragraph, second indent, of the Treaty on European Union to mention explicitly Eurojust among the instruments of judicial cooperation (Article 1.7 of the Nice Treaty).
47 See “whereas” clause (3) and Article 1.2 of Decision ECB/2003/4.
48 Communication from the Commission on copyright protection of the common face design of the euro coins, 22 January 2001, paragraph 1.
49 For example, reproductions with pornographic elements.
50 Commission, op. cit. footnote 48, paragraph 2, “Reproduction regime”.

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of the euro was found in the power of issuing the banknotes that are legal tender; it can be assumed that such power, as a rule and without prejudice to different provisions, includes the competence to adopt the legal measures which are necessary to protect the integrity, as a means of payment, of banknotes and coins that are expressed with the relevant monetary sign.51

Since the integrity of the means of payment is at stake if there is any confusion on the part of the public with regard to the exact individuation of the values that are legal tender, the criterion which was chosen to distinguish lawful reproductions from those that are illicit was the existence of a danger of confusion among the general public.52

Therefore, while the Commission adopted reproduction rules for the common face of euro coins on the basis of its power as the representative of the European Union, which is the holder of the copyright on the common face of euro coins53, the ECB distinguished between “unlawful” reproductions (of banknotes denominated in euro), in that they do not fulfil the criteria established by the ECB to avoid the risk of confusing the public, and reproductions that infringe the ECB’s copyright on the design of euro banknotes.54 Both typologies are defined as “non-compliant” and, in connection with this, mechanisms of activation of central banks are provided.55

The ECB indicated either those elements that, in se, do not exclude the illicit character of the reproduction (e.g. the reproduction technique, the addition of elements that do not belong to the original design of the genuine banknote), as well as the criteria designed to eliminate the danger of confusion; the ECB also provided for an instrument of legal certainty, such as the safe harbour represented by the possibility given to citizens to ask central banks in written form to provide an evaluation as to whether or not a specific reproduction that is not in line with the above-mentioned conformity criteria could confuse the general public.56

5 INFORMATION FOR CITIZENS

Any rule on the use of the euro, any criminal provision against counterfeiting, and any criterion issued to discourage unauthorised reproduction of the euro would risk being insufficient if citizens did not possess adequate knowledge of the basic features of banknotes and coins denominated in euro.

51 See “whereas” clause (4) of Decision ECB/2003/4.
52 Article 2 of Decision ECB/2003/4; Commission, op. cit in footnote 48, paragraph 2, third period; and (4) and Article 2 of the Commission Recommendation of 19 August 2002 concerning medals and tokens similar to euro coins, OJ L 225, 22.8.2002, p. 34.
53 Commission, op. cit footnote 48, paragraph 2, “Reproduction regime”.
54 As far as violations of copyright on the design of banknotes are concerned, the ECB recommended to the Member States to ensure that designs on banknotes may benefit, under the law, from the protection provided for the registered marks (Point 3 of Recommendation ECB/1998/7).
56 Article 2.1, 3 and 4 of Decision ECB/2003/4.
For this reason, European bodies and central banks placed great importance on the provision of adequate information, to be furnished especially to the most vulnerable parts of society, such as elderly people, persons in economic or social difficulties, persons with inabilities of a physical, sensorial or mental nature, or young people outside the educational system.

Initiatives in European schools were set up by the European Parliament with a view to the introduction of the euro, when information campaigns were designed by EU bodies, central banks and national governments and local authorities.

6 THE EURO AS A “EUROPEAN GOOD”

The European interventions aimed at defining the legal regime of the euro characterise the euro as a “European good”.

The development of the euro into a good of a European nature is currently under way following a track that started from the adoption of the single currency, passed through the creation of the ESCB as a European structure to govern the money, to come to the explicit provision, in the European Constitution, of the Euro Group.

Although most attention is generally paid to the dialogue between the EU representative bodies and the ESCB and to the financial instruments used to conduct the monetary policy, the stability of the euro cannot be obtained without adequate measures of legal protection; such measures are another important element in ensuring that European citizens can trust in the euro as a means of payment with legal tender and, thus, to contribute to its stability.

With this in mind, the legislative and monetary authorities in Europe have defined a system to protect the euro, which now can genuinely be qualified as a “European good”, not only in a political and economic sense, but also in a legal sense.

The protection of the euro is the object of European interest for a variety of reasons, including the social welfare of European citizens, which is closely linked to their trust in the euro as a means of payment with legal tender; and the pecuniary interest of the issuers operating at the European level. The European rules therefore protect the euro sometimes directly, and sometimes through the Member States or the NCBs of the Eurosystem.

57 Article 1.1 of the Recommendation of the Commission 2000/C 303/05 of 11 October 2000, on the measures to facilitate the preparation of economic operators to the changeover to the euro, OJ C 303, 24.10.2000, p. 6, which is addressed on this point to the Member States.
58 Article 3.3, last period, of the Recommendation of the Commission of 23 April 1998, concerning the dialogue, monitoring and information provided to facilitate the transition to the euro, OJ L 130, 15.1998, p. 29.
The protection is pursued by convergent actions, also of an informational nature, that are performed by the central banks and by the European and national authorities. A significant level of co-ordination of the actions of police forces and courts in the Member States was provided on the basis of the harmonisation of criminal provisions. A strong impulse was given towards the harmonisation of the rules on the use of the euro among citizens.\(^{60}\)

CENTRAL BANK INDEPENDENCE AND CENTRAL BANK STATUTES
Il contributo fornisce un breve resoconto del contesto in cui si è svolto il lavoro sulla legislazione relativa alle banche centrali condotto dall’Istituto Monetario Europeo (IME) e delinea i requisiti indicati dall’IME e, successivamente, dalla Banca Centrale Europea (BCE). Lo studio ne esamina anche l’influenza in alcuni paesi esterni all’Unione Europea (UE).


In retrospettiva, la BCE e i requisiti di indipendenza stabiliti dal WGLE hanno avuto una influenza significativa sulla legislazione relativa alla banca centrale in molti paesi. Gli standard UE sono considerati lo “stato dell’arte” e rappresentano a livello internazionale la migliore prassi in materia di legislazione per la banca centrale. L’adozione di questi standard da parte della UE ha anche chiaramente dimostrato agli altri paesi che la politica monetaria può e dovrebbe essere delegata a banche centrali indipendenti.
I INTRODUCTION

This paper provides a brief account of the background behind the work on central bank legislation conducted by the European Monetary Institute (EMI), and outlines the requirements set out by the EMI and, later on, by the European Central Bank (ECB). The paper also examines their influence on some countries outside the European Union (EU).

As several studies have demonstrated, for example those by Finn Kydland and Edward Prescott¹, governments in democratic countries may have a time consistency problem. If economic policymakers lack the ability to commit in advance to a specific decision rule, they will often not implement the most desirable policy later on. What Kydland and Prescott offer is a common explanation for events that, until then, had been interpreted as separate policy failures. Their award-winning work on how economies become trapped in high inflation even though price stability is the stated objective of monetary policy established the foundations for an extensive research programme on the credibility and political feasibility of economic policy. This research shifted the practical discussion of economic policy away from isolated policy measures and towards the institutions of policymaking, a shift that has largely influenced the reforms undertaken by central banks and the design of monetary policy in many countries.

The importance of adequate institutional arrangements for conducting monetary policy had been periodically highlighted by some economists from the 1940s onwards, but it was not until the end of the 1970s that this topic came to the fore and was more broadly studied and discussed. The reaction to the oil crisis was an expansionary fiscal policy, partially financed by the printing press, which ultimately resulted in inflation and stagnation – dubbed “stagflation” – because fiscal policies were solely focused on creating demand instead of addressing the underlying structural deficiencies caused by the new relative prices that OPEC had imposed on the industrialised economies. The immediate effect of this was the introduction in many countries during the 1980s of an explicit statutory price stability objective for the monetary policy, and the limiting of direct central bank credit to the government. However, such provisions rarely qualified the concept of price stability, and central bank laws seldom contained statutory provisions stating the independence of the central bank to define and execute its monetary policy to attain this objective. In some small open economies, the political authorities chose to peg the national currency to a foreign currency, which implied the need to adjust the economic policy, in particular the inflation rate, to that other currency. By contrast, the political authorities in some other countries were hesitant or unwilling to delegate such powers to the central bank. This may partly be attributed to an unwillingness to relinquish important

economic powers to technocrats, and additionally by the fact that under Keynesianism, which emerged during the depression of the 1930s, the cost of inflation was not fully appreciated. However, in all fairness, it must be recognised that politicians in control of government are understandably reluctant to relinquish monetary policy, since they would still be perceived by the electorate as being responsible for the economic policy of the country as a whole.

The Working Group of Legal Experts (WGLE) at the EMI was established in 1995 to conduct research and make proposals on legal issues related to the establishment of the ECB and the introduction of the single currency, the euro. One of its main tasks was to make proposals on the criteria according to which the so-called legal convergence requirements should be applied by Member States, with the aim of ensuring that the national central bank (NCB) statutes should be compatible with the Treaty and the Statute of the European System of Central Banks (ESCB) and of the European Central Bank (henceforth “the Statute”), as well as contain provisions securing the independence of each NCB, with the latter requirement also applying to central banks that had not yet adopted the single currency.

At one of the first meetings of the WGLE, at which the extent to which the EMI should accept, if at all, so-called national peculiarities in NCB laws was discussed, some members argued that the EMI should allow for some flexibility. In retrospect, those members were probably all eventually extremely content with the majority decision to stand firm. National peculiarities were accepted to a very limited extent, and the requirements to be set up by the EMI, as the forerunner to the ECB, were, in principle, to be strictly applied.

The ECB and the independence requirements set out by the WGLE have had a remarkable influence on central bank legislation in many countries. In particular, with regard to the target of autonomy, the EU standards are considered to be state of the art and constitute international best practice for central bank legislation. The EU’s adoption of these standards has also clearly demonstrated to other countries that monetary policy can and should be delegated to independent central banks.

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2 The WGLE was composed of lawyers of the EMI and of each national central bank of the EU Member States under the chairmanship of Jean Guill, Director of the Institut Monétaire Luxembourgeois (Luxembourg Monetary Institute). Upon the establishment of the ECB, the WGLE was transformed into the Legal Committee of the ECB. Paolo Zamboni was one of the most influential and, it must be said, most charismatic members of the WGLE and the Legal Committee.

3 Article 121 (ex Article 109j) of the Treaty establishing the European Community (“the Treaty”).

4 The European System of Central Banks (ESCB) consists of the ECB and the NCBs of the EU Member States. Most members of the WGLE, including Paolo Zamboni, had been directly involved in the drafting of parts of the Maastricht Treaty, including the drafting of the Statute of the ESCB and of the ECB.

5 These provisions do not apply to the United Kingdom according to the Protocol annexed to the Treaty.

6 Including, among other members, the author of this paper and Paulo Zamboni.

7 While the Treaty required “compatibility” of NCB legislation with the Treaty and the Statute of the ESCB and of the ECB, the EMI abstained from requiring harmonisation and still left some room for national peculiarities. See The EMI Convergence Report 2000, p. 73.
2 THE MAASTRICHT TREATY

Although important restrictions on German fiscal policy admittedly played a fundamental role in the building up of the strength of the Deutsche Mark, the Deutsche Bundesbank had for many years been internationally admired as one of the best, if not the best, models for central banks and, naturally, had a great impact on the legal framework for the ECB as the Maastricht Treaty was being drafted. Central bankers worldwide had long appreciated the Bundesbank’s focus on price stability; its independent status in its relations with the political establishment; and, not least, the remarkable price stability that the Bundesbank had delivered for several decades. To the founding fathers of the Maastricht Treaty, the Bundesbank clearly deserved to serve as the model for the ECB and the NCBs of the ESCB.

Central bank independence had already been on the agenda at several international meetings of central bankers. The Deutsche Bundesbank Act was not the only model that was being studied and discussed; the importance of removing monetary policy issues from the political scene had been discussed in some other countries and, in various forms, implemented in the legal framework of several central banks, for example in New Zealand and Chile. However, when it came to designing the independence of the ESCB, the Bundesbank model was the natural choice on which to build the fundamental legal framework for the future central banking system that would administer the single currency of the European Union.

3 THE LEGAL FRAMEWORK TO ENSURE THE INDEPENDENCE OF THE ESCB

The EU legal framework regulating the ECB is to be found in the Maastricht Treaty and in the Statute of the ESCB and of the ECB (which is part of the consolidated version of the Treaty). On the national level, all NCB laws and, in some countries, the Constitution as well (for example in Germany and Sweden) had to be amended to ensure the independence of the ESCB.

A. THE MAASTRICHT TREATY

The independence of the ESCB is founded on certain provisions in both the Maastricht Treaty and the Statute of the ESCB and of the ECB. Most of the Treaty provisions are copied (or almost copied) and transferred into the Statute. The most interesting provisions in this context are listed below:

NATIONAL LEGAL COMPATIBILITY

Article 109 (ex Article 108) is crucially important as it prescribes that each Member State shall ensure, no later than at the date of the establishment of the ESCB, that its national legislation, including the statutes of its NCB, is compatible with the Treaty and the Statute. Consequently, limitations on the independence of NCBs would be incompatible, and provisions in national legislation which would prevent the execution of ESCB-related tasks, or
compliance with decisions of the ECB, would be incompatible with the effective operation of the ESCB. With regard to the timing for removing incompatibilities, independence needed to be enforced at the date of the establishment of the ESCB, while provisions relating to the legal integration of NCBs into the ESCB only needed to enter into force when the euro was introduced as the single currency.

**PROHIBITION AGAINST INSTRUCTIONS**

Article 108 (ex Article 107) is one of the principal Articles of the Treaty on central bank independence and includes the prohibition of instructions. The ECB, each NCB and any member of their decision-making bodies are prohibited from seeking or taking instructions from Community institutions or bodies or from any government of a Member State or from any other body. This principle must be respected by Community institutions and bodies and by the governments of Member States. They must all undertake not to seek to influence the members of the decision-making bodies of the ECB and of the NCBs in the performance of their tasks.

**OTHER FEATURES**

Although the objectives and functions of each central bank are not, strictly speaking, elements of its independence, the maintenance of price stability is of fundamental importance, and is enshrined as the central bank’s primary objective (Article 105 of the Treaty and Articles 2 of the Statute). National legislation should, accordingly, be compatible with these stipulations. Another such issue is the prohibition against the central bank providing credits to the respective governments, which is explicitly regulated in the Treaty (Article 101, ex Article 104) and also reiterated in the Statute (Article 21), which had applied since the start of Stage Two of EMU, i.e. from 1 January 1994.

This had wide implications for the functioning of not only the ECB but also of the NCBs which, up to that point, had operated as government agencies under direct control by the government or by the Ministry of Finance in theory, and by the Minister of Finance in person in practice, in most Member States. European politicians, and politicians in most other countries too, had for a long time tended to consider their respective central banks to be basically the bank of the government. This meant that the central bank should not only support the economic policy of the government and provide additional funds for the government’s budget, if required, but also, if necessary, do so whenever this was politically desirable, even if economically unwise or inappropriate at a particular juncture. It may in many cases have been tempting (and perfectly understandable) for any government or Minister of Finance to order the central bank to conduct a lenient monetary policy to boost employment when general elections were approaching, for example. Notwithstanding this fact, this practice had in many countries repeatedly proven to be disastrous to the economy and to its long-run economic growth potential. It was believed that including an explicit price stability objective and a prohibition against providing credit to the government, in conjunction with a statutory prohibition against instructions, would provide an appropriate legal framework that could foster central bank independence in conducting monetary policy in accordance with the central bank’s statutory monetary policy objective.
B. THE STATUTE OF THE ESCB AND OF THE ECB

Article 7 of the Statute refers to Article 108 of the Treaty on the prohibition of instructions, and Article 14 of the Statute prescribes specific provisions for the NCBs, in this context in particular on:

- The compatibility of the national legislation of each Member State, including the statutes of its central bank, with the Treaty and the Statute (Article 14.1).
- The statutes of the NCBs shall provide that the term of office of the governor are no less than five years (Article 14.2, first paragraph).
- The governor of each NCB may be relieved of office only if he or she no longer fulfils the conditions required for the performance of his or her duties or if he or she has been guilty of serious misconduct; any decision to this effect may be referred to the Court of Justice of the European Communities (Article 14.2, second paragraph).

4 THE 1998 EMI CONVERGENCE REPORT

Evidently, the rather fragmented provisions on central bank independence in the Treaty and in the Statute had to be complemented and specified to provide a useful pattern of requirements against which the compatibility of the national legislation of the Member States, including the statutes of the NCBs, could be effectively compared. Some gaps had to be filled in, and the WGLE was entrusted with conducting an investigation into this and working out an appropriate proposal. This resulted in three progress reports in which the assessment methodology was successively developed.8

The conclusions of the WGLE were largely adopted by the Council of the EMI and published in the 1998 EMI Convergence Report, in which the EMI established a list of features of central bank independence, distinguishing between features of an institutional, personal, functional and financial nature, and identifying remaining incompatibilities in national legislation. The EMI concluded that neither the supremacy of the Treaty and the Statute over national legislation nor the nature of a specific instance of incompatibility affects the obligation to remove such incompatibilities.9

In addition to the statutory provisions in the Treaty and the Statute, the EMI specified the following, related to:

INSTITUTIONAL INDEPENDENCE

- The right of third parties to approve, suspend, annul or defer decisions by the NCBs is incompatible with the Treaty and the Statute as far as ESCB-related issues are concerned.

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– The right to censor decisions on legal grounds and subsequently submit them to political authorities for final decision would be equivalent to seeking instructions and is considered incompatible with the Treaty and the Statute.
– The right of representatives of external political authorities to participate in the decision-making bodies of an NCB with a right to vote is, even if not decisive, incompatible with the Treaty and the Statute; no voting rights for such representatives at board meetings may be acceptable.
– The right to be consulted (ex ante) on an NCB’s decisions is incompatible with the Treaty and the Statute. However, this does not prevent there being a dialogue between NCBs and the respective political authorities to provide information and exchange views, which is not considered incompatible with the Treaty and the Statute, provided that it does not result in interference with the decisions by the decision-making bodies of the NCBs, that the ECB’s competences and the special status of the governor as member of the ECB’s decision-making bodies are respected, and that any infringement of the confidentiality requirements in the Statute provisions is avoided.

**PERSONAL INDEPENDENCE**

– The minimum term of office for governors is five years, which does not preclude however a compulsory retirement age that is compatible with the Treaty and the Statute.
– The grounds for dismissal of governors must contain, in addition to the requirements set out in Article 14.2 of the Statute, provisions ensuring that governors are not dismissed for reasons other than those stated in Article 14.2.

**FINANCIAL INDEPENDENCE**

– The NCBs should be in a position to avail themselves of the appropriate means to ensure that their ESCB-related tasks can be properly fulfilled.
– Safeguards shall be in place to ensure that any ex post reviews by the government or parliament do not infringe upon the independence of the NCBs. In countries where the government or parliament are in a position, directly or indirectly, to influence the determination of the budget or the distribution of profits, the relevant statutory provisions should contain a safeguard clause to ensure that this does not impede the proper performance of the NCBs’ ESCB-related tasks.

**FUNCTIONAL INDEPENDENCE**

As the NCBs shall be integrated into the ESCB, their functional independence is secured if the degree of legal integration into the ESCB is deemed appropriate, in particular in the following areas:
– The statutory objectives (primary and secondary as stipulated in the Treaty).
– The tasks (compatibility with ESCB-related tasks).
– The instruments (any incompatibility with the Treaty and the Statute needs to be removed).
– The organisation (there should be no rule binding the governor in his or her voting at the ECB level or preventing any decision-making body from complying with the rules at the level of the ECB).
INTERNATIONAL BEST PRACTICE FOR CENTRAL BANK LEGISLATION

The repeated financial disasters during the 1990s, in particular in parts of Europe, Asia and Latin America, made it necessary for the international organisations responsible for fostering international financial stability, such as the International Monetary Fund (IMF) and the World Bank, to study what went wrong and why, and to identify effective means of preventing similar financial disasters from happening in the future. The legal institutional framework was one of the areas identified as being critical to improving financial stability. Monetary policy would be best conducted if policy decisions were removed from the political arena. Governments in democratic countries are naturally and understandably reluctant to take unpopular decisions before general elections, although these decisions may be the most desirable or necessary ones.

The IMF and the World Bank have endorsed internationally-recognised standards and codes in 12 areas as being important for their work and for which Reports on the Observance of Standards and Codes (ROSCs) are prepared. Standards in the areas of data, fiscal transparency and monetary and financial policy transparency have been developed by the IMF, while others have been developed by other standard-setting bodies including the World Bank, the Basel Committee on Banking Supervision, and the Financial Action Task Force (FATF). The work on standards and codes has been termed a “critical pillar” in the effort to strengthen the international financial system. There is now broad acceptance that standards can serve as a framework to focus policy decisions more effectively and to strengthen the functioning of markets not just in emerging market economies, but also in advanced economies.

Member countries have been encouraged by the IMF and the World Bank since the late 1990s to adopt and implement such standards and codes. This is deemed vital to the prevention of financial crises, which have proven to be particularly devastating to the poor and most vulnerable parts of the population in affected countries.

Notwithstanding the fact that no internationally recognised standards or codes exist on the principles of central bank legislation, except on monetary policy transparency (the IMF) and on the independent status of banking supervisors (the Basel Committee on Banking Supervision), the IMF provides guidance to member countries on central bank legislation based on international best practice. The latter is based, in accordance with principles accepted by the vast majority of economists, on the maintenance of domestic price stability as the primary monetary policy objective of a central bank, and its independence\(^\text{10}\) in formulating and executing monetary policy. These principles were formulated

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\(^{10}\) In the literature, *autonomy* is sometimes preferred to the frequently used term *independence*, as autonomy entails operational freedom while independence indicates a lack of institutional constraints. Even “independent” central banks typically have a strong commitment to pursuing price stability, follow a specific exchange rate policy, or comply with a target explicitly stipulated by the government. Although the term *autonomy* is often preferred by the Fund, the term *independence* is used in this context as it is viewed from the EU perspective, and additionally because it is the term used in the Treaty and the Statute and by the EMI/ECB.
in February 1998 in an Operational Paper of the IMF Monetary and Exchange Affairs Department (MAE) entitled “Elements of Central Bank Autonomy and Accountability”.

When compared the IMF’s Operational Paper with the 1998 EMI Convergence Report, it becomes clear that several items are identical or almost identical. This is particularly the case for items included in the IMF recommendations, such as:

- Price stability is the primary objective. A specific target (e.g. a direct inflation target, the maintenance of a fixed exchange rate, or monetary aggregate targets) should be established and published.
- The central bank should determine and implement monetary policy to achieve its target without interference from the government.
- There should be a statutory prohibition for central bank board members against seeking advice, and for anyone else against giving them instructions.
- The term of office of the governor should be longer than the election cycle of the body which has the main responsibility for selecting the governor.
- A governor should only be dismissed for breaches of qualification requirements or misconduct.
- Direct government representatives should be eliminated from the policy board and probably also from the monitoring board, if either of these exist. If a government representative is a member of a policy board, this should at a minimum exclude the right to vote.
- Basic consistency needs to be ensured between the exchange rate policy and the monetary policy. If the former is not solely the responsibility of the central bank, the bank shall nevertheless have sufficient authority to implement monetary policy within the constraint of exchange rate policy, and should be the principal advisor on exchange rate policy issues.
- The law should ensure that the central bank has sufficient financial autonomy to support policy autonomy, but within matching financial accountability.
- Policy and financial accountability should be clearly published. The central bank should prepare formal statements on monetary policy performance without the prior approval of the government. The statements should be forwarded to both the executive and the legislature and also published. Annual financial statements audited by external auditors should also be disclosed.

It should perhaps also be noted that, notwithstanding the obvious similarities with the EU requirements, some differences do exist. This is particularly the case with respect to certain items, such as:

- A conflict resolution process should be in place to resolve any policy conflicts between the central bank and the government by, for example, allowing the government to overrule the central bank. It should be absolutely clear to the executive, the legislature and the general public that responsibility for the

11 MAE Operational Paper, MAE OP/98/1. It should be mentioned that the views expressed in this paper are those of the MAE staff and do not necessarily represent the opinions of the Executive Directors of the IMF or other IMF staff.
results lies with the government, not the central bank, if the latter is overruled, its advice ignored or its effectiveness significantly limited by government policies.\textsuperscript{12}

- Lack of performance could constitute grounds for dismissal of the governor if required performance is clearly defined in terms of the primary objective and specific targets.\textsuperscript{13}

- If credits to the government are not strictly prohibited, they should be carefully limited to what is consistent with monetary policy objectives and targets.

- The statutory requirement for the central bank to obtain approval from the government should be in place in case the central bank needs to act as lender of last resort to insolvent institutions, if sufficient collateral is not available, in order to prevent a financial crisis affecting the financial sector as a whole.

- The central bank law should contain a procedure to be followed to provide, if necessary, additional funds to the central bank out of the government’s budget. Quasi-fiscal activities should be explicitly prohibited, although temporary and clearly limited central bank credit to the government is permissible, but with the sole aim of addressing seasonality of revenues and expenditures.

Since most member countries of the IMF that require technical assistance on central bank and banking legislation are at an earlier stage of economic and institutional development than the EU Member States, the IMF needs to recognise that identical requirements cannot be defined for all countries. There is no “one size fits all” approach, and any recommendation to upgrade the central bank law to the state of the art in one single step is clearly unrealistic in some countries. Accordingly, the IMF has not endorsed a model law but has instead formulated a toolbox of provisions designed to reflect the type of autonomy chosen, the functions of the central bank (in most countries that require IMF technical assistance, the central bank is also the supervisor of banks and other financial institutions), and country-specific conditions, including culture, legal traditions and political systems. The IMF recommendations must, in such cases, allow for a degree of leniency and flexibility that is not acceptable for EU Member States.

The 1998 IMF/MAE recommendations have subsequently been fine-tuned in practice and in light of experience gained, including the development of the International Financial Reporting Standards (IFRS). However, while these recommendations have been periodically modified since 1998, their main content is still valid.

\textsuperscript{12} In most countries, the central bank law is not entrenched in the Constitution to the same extent as in the EU. Accordingly, the legislature can ultimately amend the central bank law and thus make a good central bank law worse. However, as a safety valve in emergencies, it may be preferable if the government temporarily takes over responsibility for monetary policy by overruling the central bank, say in the case of war or natural disasters. Provided this is done in a transparent way, this could result in a smaller loss of credibility in monetary policy. Even some EU countries (such as the Netherlands) formerly had such provisions in their central bank law.

\textsuperscript{13} Central bank autonomy presumes professional central bankers. However, while central bankers should be protected from discretionary removal, they must also be made clearly accountable. The most clear-cut example of this practice is New Zealand, where the governor can be dismissed.
The EU standards have played a role in this process, not least by providing practical examples of independent central banks in the EU Member States. The recent EU enlargement, which added ten new Member States, many of these in former socialist-ruled countries, has shown that central bank laws ensuring the highest standard of independence are also possible in countries in transition to market economies.

The standards adopted in the Maastricht Treaty and further developed by the EMI and, later, by the ECB and the EU Commission have played, and continue to play, a pivotal role. The amendments that have had to be made in the NCB laws in Member States to make them compatible with the Treaty and the Statute provide useful approaches for independent central banks in other countries.

6 SOME EXAMPLES OF NON-EU CENTRAL BANK LAWS

Central bank laws in some countries outside the EU were studied and compared with international best practices for central banks for the purpose of this survey. This yielded the following key observations:

PRICE STABILITY

The insertion of the maintenance of price stability as an objective in central bank law may now broadly be considered as the internationally-accepted standard monetary policy objective in many, if not in most, countries, including some developing countries and countries in transition to a market economy. In some countries, this objective is even stated in the Constitution of the country, which may further strengthen public confidence that the political authorities are committed to price stability as the principal monetary policy objective of the central bank.

INSTITUTIONAL INDEPENDENCE

Central bank independence also appears, if this is evaluated based only on statutory provisions in the central bank laws, to be internationally a widely accepted standard. It may be found in a number of countries, and not only in industrialised ones. Its significance varies from country to country, however; unless central bank independence from outside pressure (political or non-political) is clearly specified, its autonomy in practice must be individually analysed for each country. The mere insertion of any of the words “independence”, “independently” or “autonomous” into the central bank law does not necessarily mean that the central bank takes its monetary policy decisions independently of political or other bodies. In countries where an

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14 The countries in question are Albania, Azerbaijan, Botswana, Egypt, Georgia, Iceland, Indonesia, Jordan, Lesotho, Mexico, Moldova, Mongolia, the Philippines, Russia, Serbia, South Africa, Sri Lanka, Switzerland, Turkey, Ukraine and Venezuela.
15 As in, for example, South Africa and the Ukraine.
16 For instance, in Albania, Azerbaijan, Georgia, Iceland, Indonesia, Jordan, Mexico, Moldova, the Philippines, Russia, Serbia, Turkey, Ukraine (“economic independence”) and Venezuela.
authoritarian regime has recently been replaced by a democratic one, the desirable and even necessary coordination of monetary policy with the government’s financial policy may be perceived as a tool for conducting discussions with the central bank management, which, in practice, is tantamount to unlawful political interference in the decision-making of the central bank.

As is the case with price stability, the independence of the central bank is stipulated in the Constitution in some countries.\textsuperscript{17} 

\textbf{PROHIBITION AGAINST INSTRUCTIONS}

Explicit statutory prohibition for members of central bank decision-making bodies against seeking or taking instructions from outside parties, and a reciprocal prohibition of outside parties giving such instructions, is widely recommended, as it defines in a clear manner the meaning of independence. If such a provision is not in place, the authorities might make their own definitions that could be misused. What remains to be explained, however, is that the prohibition against instructions should not prevent desired and even necessary discussions among the central bank, the government, the parliament, the financial community, academia, the media and the general public. Coordination with the government is for example needed on public debt policy. Moreover, all EU citizens should be entitled to express their views on monetary policy issues. The central bank should correspondingly make a great effort to explain its decisions publicly. It may also need to explain what types of monetary policy can and cannot be achieved, and should agree not to take any blame for what rightfully belongs to the government, for example.

Statutory prohibitions against instructions in central bank laws can be found in number of countries.\textsuperscript{18}

\textbf{PERSONAL INDEPENDENCE}

The EU standards on personal independence of the members of the central bank board (or of any equivalent decision-making body) have been partly implemented in many countries. They often apply, however, only to the governor of the central bank and only partly, or even not at all, to other members of the board.

The minimum term of office of the governor is often prescribed to be several years and sometimes five years or even more\textsuperscript{19}, which in most countries is a longer period than the terms for members of parliament.

\textsuperscript{17} For instance, in South Africa. Among the EU countries, this is so in Sweden’s case.
\textsuperscript{18} For example, Albania, Azerbaijan, Indonesia, Romania, Serbia and Switzerland.
\textsuperscript{19} This is the case in, for example, Albania (7 years), Azerbaijan (5 years), Georgia (7 years), Iceland (7 years), Indonesia (5 years), Jordan (5 years), Lesotho (5 years), Mexico (5-8 years), Moldova (7 years), Mongolia (6 years), the Philippines (6 years), Serbia (5 years), South Africa (5 years), Sweden (6 years), Switzerland (6 years), Ukraine (7 years) and Venezuela (7 years). For a survey of terms for governors and other non-ex officio members specified in more than 100 central bank laws, see Lybek and Morris (2004).
On the issue of dismissal of the governor and other board members, provisions fully satisfying international best practice can only be found in a few countries. There are, however, provisions in several central bank laws prohibiting a discretionary dismissal of the governor.20

**FINANCIAL INDEPENDENCE**

The power to determine the central bank’s budget is, in fact, assigned to the board of the central bank in some of the countries studied.21 However, in most of these countries, the political authorities appear reluctant to give the central bank board the full authority to avail itself of the resources it considers necessary to fulfil its duties in a proper manner. They are particularly reluctant to allow the central bank to offer salaries that differ from those customary in the public sector, even though this is necessary to attract candidates best suited for the positions. The salaries offered may, at best, be above customary salary levels in the public sector, but still substantially below those in the private sector. As the public sector may to some people be more attractive for other reasons, some difference may be justified, but central bank salaries should not be substantially lower than those in the private sector. Monetary policy and financial sector stability are challenging tasks and responsibilities, and should be assigned to professionals capable of and dedicated to carrying out those tasks.

In most countries, this reality is reflected in the somewhat higher level of salaries of employees of the central bank compared with employees in the public sector.22

**FUNCTIONAL INDEPENDENCE**

Functional independence mainly entails central bank independence with regard to political authorities in determining and executing monetary and banking supervision policies. The central bank board (or the equivalent body) should have sole authority to determine:
- The definition of price stability;
- The definition of financial stability;
- The means by which the central bank’s objectives shall be achieved;
- The authority to decide on its own and to issue binding monetary regulations and, provided the central bank is also responsible for banking supervision, banking supervisory regulations; and
- The sole power, within its authority set out in the central bank law, if any, to approve any credit to the government.

The observance and practical implementation of functional independence is difficult to measure simply by analysing the central bank law. The law may

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20 Among the countries studied in this survey, there are provisions against discretionary removals of the governor and, in some cases, of other members of the board of the central bank in Albania, Botswana, Georgia, Lesotho, Russia, Switzerland and Venezuela.

21 For example, in Egypt, Indonesia and Moldova.

22 However, this is not the case in the Banca d’Italia, where the central bank seeks to recruit, at attractive terms, the most qualified people in the banking and financial sector.
provide what is required but, in some countries, the implementation of adopted laws may not be satisfactory for a number of reasons, such as:

- Corruption in both the private and the public sectors, including within the judiciary;
- Insufficient and/or inadequate resources within the legal system; and
- A lack of tradition in respecting and upholding the rule of law.

This paper does not attempt to evaluate the practical implementation of the adopted central bank laws; this task remains to be carried out at some later stage.

7 FINAL REMARKS

What is next on the agenda? There are still many countries with central bank laws that need to be thoroughly revised to become compatible with international standards, provided the political authorities recognise that this is desirable or even necessary to make their monetary policy as effective as possible in contributing to long-term economic growth. The focus of the international debate has been moving from autonomy to accountability and transparency and, most recently, towards good governance and efficiency.

A major problem in some countries is the misuse of public funds by the central bank. Most central bank buildings are of a considerably higher standard than most other public buildings, and even in some low-income countries, central bank buildings are best described as luxurious. Poor governance is a problem in some countries. If the board does not truly function as an overseer of the central bank, the Minister of Finance has valid reasons for interference. Proper procedures to elect appropriate board members, clear objectives and responsibilities, and proper evaluation and accountability procedures should be in place in order to set up a central bank board that fulfils its duties in as effectively as possible.

Inefficient judicial systems and widespread corruption also cause severe problems in a number of countries and often present a major obstacle to the effective implementation of legal frameworks of standards, even in industrialised countries. Corruption is difficult to combat, particularly in countries where it is also widespread within the political establishment. If lawmakers are reluctant to combat corruption within the legal system and elsewhere in the society, it becomes difficult to set up organisations and other systems which can effectively govern any country to the benefit of the majority of its population. For this reason, governance issues are being increasingly focused upon in international efforts to combat poverty and improve conditions in many countries that are heavily burdened by corruption.

In many newly democratic countries, tradition still plays an important role. Substantial parts of the population are used to politicians not respecting the rule of law; and, in some countries which have recently become democratic on paper, politicians at times tend to act, even though they are lawmakers, as if they were not bound by the rule of law. The legal situation in some countries affected by such traditions is sometimes described as “unpredictable”, to use IMF jargon.
The importance of the rule of law and the importance of respecting and upholding it are concepts that are still unfamiliar in some countries that are currently or were previously ruled by authoritarian governments. In such countries, resources to ensure the rule of law are still scarce. This affects the transparency of the law, so that amendments are rarely if ever incorporated into published laws. Where the court system is under-dimensioned, the outcome of court proceedings may be severely delayed, which is particularly damaging in court proceedings involving banking or financial issues. Evidently, the outcome of court proceedings can be predetermined if even the judges are inclined to accept favours of some sort. In many countries, there is also a clear need to assist judges by informing them about how the banking system functions (including the central bank), how legal and accountancy principles can be applied, and how the market economy functions as a whole. Improvements in such areas would, obviously, represent a great step forward toward making the legal system a useful part of the public sector. This would support democracy and the market economy, which has proven, over the years, to be the most effective economic model for most people in the majority of countries. Simultaneously, it must be recognised that current salaries in the public sector (including the judiciary) are often substantially lower than in the private sector, and that governments in most developing countries have severe budget constraints that do not permit them to raise substantially the salaries of civil servants. Indeed, the low level of current salary levels in some countries even appears to suggest tacitly that some civil servants should raise extra funds on the side.

The effective implementation of legal provisions is a challenging task and an issue that needs to be carefully considered in a number of countries. To a varying degree this is also true for EU Member States: possible legal reforms must be thoroughly evaluated in, for example, upcoming EU assessments of the implementation of the legal convergence criteria in applicant countries.
NATIONAL EXPERIENCES IN ADDRESSING THE ISSUE OF INDEPENDENCE IN CENTRAL BANK STATUTES

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ABSTRACT

Il contributo evidenzia i principali cambiamenti negli statuti delle Banche Centrali Lituana, Maltese e Slovacca relativamente alla questione dell’indipendenza nel rispetto dei requisiti del Trattato UE e in particolare dello Statuto del SEBC. Particolare enfasi viene posta sulla maniera in cui gli aspetti personali, istituzionali, funzionali e finanziari di indipendenza sono stati riportati nei recenti emendamenti a tali statuti.


Mentre alcuni emendamenti sono comuni a tutti gli statuti (quali il mantenimento della stabilità dei prezzi come obiettivo primario, il termine di cinque anni della carica di Governatore, il divieto di chiedere istruzioni ex art. 108 del Trattato CE), altri sono tipici di uno o più statuti, per poter adeguatamente trattare a fondo la questione dell’indipendenza conformemente alla situazione contingente.
I CENTRAL BANK INDEPENDENCE – INTRODUCTORY REMARKS

Lietuvos bankas is the central bank of the Republic of Lithuania, and belongs to the State by the right of ownership. The State is therefore the sole owner of Lietuvos bankas. The principle of independence of Lietuvos bankas is established in Articles 125 and 126 of the Constitution of the Republic of Lithuania. The Republic of Lithuania Law on Lietuvos bankas (hereafter “the Law”)¹ and other laws of the Republic of Lithuania are designed to ensure the implementation of the principle of independence of Lietuvos bankas in all constitutive parts of the legal system of the Republic of Lithuania.

The principle of central bank independence vis-à-vis Community institutions and bodies, governments of the Member States of the European Union (EU) and/or any other body is laid down, in particular, in Article 108 of the Treaty establishing the European Community (hereafter “the Treaty”) and Article 7 of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank (hereafter “the Statute”). The criteria of central bank independence are laid down in detail in the statutory requirements to be fulfilled by the national central banks (NCBs) of the Member States in order to become an integral part of the European System of Central Banks (ESCB). These requirements were approved by the European Monetary Institute (EMI)², and further refined by the European Central Bank (ECB).

Article 108 of the Treaty and Article 7 of the Statute prohibit Community institutions or bodies and the governments of the Member States from seeking to exert influence on the members of the decision-making bodies of the ECB and the NCBs in the performance of their duties. It establishes the independence of the ECB and the NCBs, and prohibits them from seeking or taking instructions from Community and/or national institutions of legislative and/or executive power. The provisions of the Treaty and the Statute do not oblige the ECB and the NCBs to implement these decisions.

The Treaty and the Statute distinguish between four basic criteria of central bank independence: functional independence, institutional independence, personal independence and financial independence.

¹ The old version of the Law (No I-678 of 1 December 1994) has been amended and supplemented on several occasions. Two basic revisions of the Law were made in 2001 (No IX-205 of 13 March 2001) and 2004 (No IX-1998 of 5 February 2004) with a view to incorporating the provisions of the Treaty and of the Statute. These revisions dealt, in particular, with the establishment of statutory provisions designed to safeguard the independence of Lietuvos bankas. Other amendments and supplements of the Law in the areas of supervisory competences, provisions on settlement finality, powers to impose sanctions on reporting agents as well as provisions relating to financial collateral arrangements have since been added by other amendments. The ECB’s comments have been observed while making these revisions.
2 FUNCTIONAL INDEPENDENCE

The ESCB unifies the primary objective, tasks and functions of the constituent parts of the ESCB, i.e. the ECB and the NCBs, as laid down in Article 105 of the Treaty and Article 2 of the Statute. The 11 Member States of the European Community as of 1 January 1999, and 12 as of 1 January 2001, became the participating Member States and members of Economic and Monetary Union (EMU), adopting the euro as the single European currency. Having adopted the euro, the ECB and the NCBs participating in Stage Three of EMU now share the primary objective of maintaining price stability. 3 In addition to implementing this objective, the ECB and the NCBs of the participating Member States (hereafter “the Eurosystem”) are also responsible for defining and implementing the single monetary policy for all Member States of the Community; for conducting foreign exchange operations consistent with the Treaty; for holding and managing the foreign reserves of the Member States; and for ensuring the reliable operation of credit and settlement systems. To the maximum extent possible, these provisions have been reflected in the 2001 and 2004 revisions of the Law, which amended the following:

- Lietuvos bankas’ primary objective (Article 7)
- finances (Chapter 3)
- instruments of monetary policy (Chapter 4)
- foreign reserves held by Lietuvos bankas and operations with foreign financial and credit institutions (Chapter 5)
- functions of the State Treasury agent (Chapter 6)
- financial accounting and reporting (Chapter 8).

Finally, some amendments were also incorporated into the Law with a view to safeguarding against possible conflicts of interest (Articles 3 and 15), along with provisions anticipating grounds for dismissal and ensuring the right of judicial review (Article 12), as well as the obligation of professional secrecy (Article 19).

Following the provisions of Article 14.4 of the Statute, NCBs may perform functions other than those specified in this Statute assuming that these functions do not interfere with the primary objective, tasks and functions of the ESCB. The ESCB shall 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 as provided in Article 105(5) of the Treaty and Article 3.3 of the Statute. Hence, the provisions of the Law establishing the functions of Lietuvos bankas on the licensing and supervision of credit institutions (Chapter 7 of the Law) are fully in line with the tasks of the ECB and of the ESCB, and do not contravene the primary objective of the ESCB.

3 As of the date of accession to the EU on 1 May 2004, the Republic of Lithuania and the other nine new Member States participate in EMU as Member States with a derogation within the meaning of Article 122 of the Treaty. The ECB has noted that it would be more consistent with one of the guiding principles of the Community, namely, price stability, as well as with the spirit of the Treaty, to adapt the statutes of the NCBs of the Member States with a derogation at the moment of joining the ESCB, as this would more accurately reflect the ultimate objective of monetary policy to maintain price stability. This would comply with the principle of functional independence, as Article 4 (3) of the Treaty also applies to Member States with a derogation.
3 INSTITUTIONAL INDEPENDENCE

Article 108 of the Treaty and Article 7 of the Statute establish the principle of institutional independence of the national central banks.

The above-mentioned articles prohibit Community institutions and bodies as well as the governments of the Member States from giving instructions to and/or exerting influence on the members of the decision-making bodies of the ECB and the NCBs in the performance of their duties. The provisions of the Treaty and the Statute do not oblige the ECB and the NCBs to implement the decisions of legislative and/or executive power at a Community and/or national level if these decisions fall within the scope of regulation by the ECB and/or the NCBs, or if they interfere with the primary objective and/or key tasks of the ESCB.

The principle of institutional independence of each NCB is embodied in the five basic prohibitions that apply to the state institutions of legislative and/or executive power, preventing them from influencing in any way the activities of the central bank:

1. Prohibition on giving instructions – the state institutions of legislative and/or executive power are prohibited from giving instructions to the central bank;
2. Prohibition on approving, suspending, annulling or deferring decisions – any rights of state institutions of legislative and/or executive power to approve, suspend, annul or defer decision of the central bank are prohibited;
3. Prohibition on censoring decisions on legal grounds – state institutions of legislative and/or executive power are prohibited from censoring, on legal grounds established by the law or any other legal act, the decision of the central bank, presuming, as a consequence, coordination of this decision with the institutions of political or state power;
4. Prohibition on participating in the decision-making bodies of an NCB with a right to vote – participation of representatives of state legislative and/or executive power in the decision-making bodies of the central bank with the right to vote is prohibited;
5. Prohibition on ex ante consulting on an NCB’s decision – explicit statutory provisions obligating the central bank to coordinate its decisions with state institutions of legislative and/or executive power are prohibited.

The 2001 revision of the Law took into account the above prohibitions. Thus the provision of Article 1, Paragraph 5 of the Law on the accountability of Lietuvos bankas to the Seimas (Parliament of the Republic of Lithuania) has been abolished. As the central bank was formerly accountable to the state institutions of legislative and/or executive power, legal grounds for these institutions to interfere in the activities of the central bank had already been established; this was naturally incompatible with the prohibition on giving instructions to the central bank.

Before Lietuvos bankas joins the Eurosystem, this prohibition will be made more stringent. The uniform governance of the euro will require members of the decision-making body of Lietuvos bankas, when taking part in the activities of
the ECB’s Governing Council, to be independent and not bound by the instructions of the decision-making body (Board) of Lietuvos bankas or indeed any other instructions. This means a certain exemption from the application of national and/or any other norms of law.

4 PERSONAL INDEPENDENCE

Article 109 of the Treaty and Article 14.1 of the Statute state that the statutes of NCBs that are part of the ESCB must be compatible with the provisions of the Treaty and the Statute. Compatibility of national legislation with the Treaty and the Statute is to be ensured at the latest at the date of the establishment of the ESCB. Article 14.2 of the Statute contains the requirement that the minimum term of office of the Governor of an NCB is five years, which should be reflected in each NCB’s statute. Along with the requirement on the minimum term of office for governors, Article 14.2 of the Statute establishes a requirement to unify the grounds for the dismissal of governors from office prior to the expiration of their term of office. Governors may be relieved from office only if they no longer fulfil the conditions required for the performance of their duties, if they have been found guilty of serious professional misconduct or misconduct in office, or if they have been found guilty of a serious deed, i.e. an act or omission that is against the law. However, the concept of “serious misconduct” is not limited to any list of acts or omissions.

The provisions of Article 14.2 of the Statute require that the grounds for dismissal of governors of the NCBs are uniform in the NCBs’ statutes. Article 108 of the Treaty and Article 7 of the Statute, while referring to “the independence of the members of decision-making bodies” of the ECB and of the NCBs in the performance of their duties vis-à-vis state institutions of legislative and/or executive power at a Community and/or national level, do not restrict the security of tenure of office with regard to governors of the NCBs exceptionally. The Governor of an NCB is deemed to be one of the members of the board appointed to govern it and has one voting right without privileges, i.e. he or she is first among equals (primus inter pares). Following this approach, it is presumed that the provision of Article 14.2 of the Statute implying the uniformity of grounds for dismissal of governors applies not only to governors of the NCBs, but also to other members of decision-making bodies of the NCBs involved in the performance of the tasks and functions of the ESCB and ECB. This applies in particular where a Governor is first among equals among colleagues with equivalent voting rights, or where other members may have to deputise for the Governor.

4 According to the EMI, the NCBs had to be independent at the date of the establishment of the ESCB and entry into force of the ECB (1 June 1998). See “Legal Convergence in the Member States of the European Union as at August 1997”, EMI (1997), p. 2.

5 The indefinite term of office does not require the statutes of the NCBs to be adapted if the grounds for dismissal of a governor are in line with those of Article 14.2 of the Statute, as stated in Progress towards Convergence 1996, Chapter II: “Statutory Requirements to Be Fulfilled for NCBs to Become an Integral Part of the ESCB”, EMI (1996), p. 101.
Along with the requirement to unify the grounds for dismissal of governors and other members of decision-making bodies of the NCBs involved in the performance of the tasks and functions of the ESCB and ECB, Article 14.2 of the Statute establishes the right for persons who have held such office to apply to the court with regard to a decision on their dismissal. Members of a decision-making body may deputise for the Governor, and are equal vis-à-vis the law. Following Article 230 (4) of the Treaty, they, as EU citizens, retain the right to apply to the European Court of Justice as far as their ESCB-related tasks are concerned, and assuming that the decision to dismiss them from office falls within the meaning of Article 230 (4) of the Treaty.

Article 108 of the Treaty and Article 7 of the Statute establish the independence of the members of decision-making bodies of the NCBs involved in the performance of the tasks and functions of the ESCB and ECB from the instructions of the state institutions of legislative and/or executive power at the European Community and/or national level. Article 11.1 of the Statute refers to the right of ECB Executive Board members to work only in this institution; the Article further states that the Governing Council may grant in exceptional cases an exemption from the application of this rule. Generally, any activities of the members of decision-making bodies of the ECB and of the NCBs may be deemed unacceptable if they result in a conflict of interest between the members of decision-making bodies and the NCBs. With regard to the governors of the NCBs, the conflicts between the interests of the Governor of every NCB and the interests of the ECB should also be taken into account.

Along with the features of personal independence mentioned above, the former provisions of Article 10, Paragraph 4 of the Law, which granted discretion to the national parliament to fix and/or change the salary of the Chairperson of the Board of Lietuvos bankas, have been identified by the ECB as being incompatible with the criterion of personal independence of governors and other members of decision-making bodies of the central bank from the state institutions of legislative and executive power established by European Community law. This provision was abolished by the 2001 revision of the Law. Article 17, Paragraph 4 of the Law establishes the procedure for fixing the Chairperson’s salary, which is independent from the Republic of Lithuania’s state institutions of legislative and/or executive power.

The same revision of the Law took into account the ECB’s proposal to admit only those grounds for dismissal which are listed in Article 14.2 of the Statute. Thus the grounds referred to in Article 14.2 of the Statute were inserted into Article 12, Paragraph 1 of the Law, and now constitute the grounds for dismissal of the
Governor and other members of the Board of Lietuvos bankas, i.e. Deputy Chairpersons and members of the Board. The revision abolished an explicit list of grounds for dismissal, as the listed grounds were not incompatible with those mentioned in Article 14.2 of the Statute. However, the revision did not prescribe all possible cases of application of the grounds for dismissal referred to in Article 14.2 of the Statute. From the point of view of European Community law, only those grounds for dismissal referred to in Article 14.2 of the Statute are admissible in the law (statute) of an NCB which is a constituent part of the ESCB. European Community law does not restrict the enumeration in national legal acts of the cases of application of these grounds in the national legal system.

This doctrine might be appropriate in interpreting the provisions of Article 75 of the Constitution of the Republic of Lithuania, which grant certain discretion to the national parliament with regard to removing the Chairperson of the Board of Lietuvos bankas through a vote of non-confidence. Such grounds for dismissal must be abolished prior to joining the Eurosystem.

The 2004 revision of the Law took into account the ECB’s proposal. As a result, Article 16, Paragraph 1 of the Law now restricts employment of all the members of the Board of Lietuvos bankas to only this institution. This provision applies to the Chairperson, Deputy Chairpersons and members of the Board.

5 FINANCIAL INDEPENDENCE

The financial independence of an NCB is to be evaluated in the context of ex ante influence on it as well as in the context of ex post influence on an NCB. State institutions of legislative and/or executive power are assumed to influence ex ante an NCB when these institutions and/or third parties may take part in the composition of the NCB’s budget and/or allocation of its net profit (loss). The central bank will be influenced ex post when the state institutions of legislative and/or executive power and/or other third parties are permitted to review and evaluate the NCB’s accounts, and such a review and/or evaluation takes the form of accountability of the central bank to the state institutions of legislative and/or executive power and/or any other third parties.

The 2001 revision of the Law abolished the former provision of Article 11, paragraph 1, sub-paragraph 15, which could have had an adverse effect on the allocation of the annual estimate of Lietuvos bankas’ budget. The new version of Article 11, paragraph 1, sub-paragraph 15 of the Law, last revised in 2004, entrusts the Board of Lietuvos bankas with the right to approve Lietuvos bankas’ budget. The abolition of the provisions of the Law on the accountability of Lietuvos bankas to the Seimas took place alongside the abolition of ex ante coordination of Lietuvos bankas’ budget with the Seimas, the highest state institution of legislative power in Lithuania.

The profit (loss) of Lietuvos bankas is calculated by deducting expenses from income, as provided in the updated 2004 version of Article 22 of the Law.
23 of the Law establishes a revised order for the allocation of profit (loss) of Lietuvos bankas. Under this Article, the loss of a financial year may be covered from the reserve capital, the latter being accumulated by allocating on a regular basis the profit remaining from the accumulation of the authorised capital (Article 20, Paragraph 3 of the Law, in conjunction with Article 23, paragraph 3, sub-paragraph 3). The possibility of covering the losses of a financial year from the authorised capital of the central bank was abolished by introducing a statutory norm which ensures that any unsecured loss in a financial year should be covered from the reserve capital. This provision does not restrict the allocation of unsecured claims to the next financial year.

A certain safeguard clause granting the central bank the right to draw on the state budget in an emergency might be appropriate in this context. To the same extent, it is inappropriate for the central bank to favour the public sector in the form of regular donations and/or any other form of regular financing, as this contravenes the prohibition of monetary financing and/or the prohibition of privileged access by the public sector to central bank refinancing. These provisions were enshrined in the 2004 revision of Article 37 of the Law with respect to Lietuvos bankas.

Lietuvos bankas will manage its financial accounts following the ECB’s recommendations concerning the NCBs of the ESCB (Article 49 of the Law). An independent audit firm will carry out the statutory audit of Lietuvos bankas (Article 50 of the Law), in view of the fact that Article 27 of the Statute will take effect when Lietuvos bankas joins the Eurosystem.

6 APPLICATION OF THE CRITERIA OF CENTRAL BANK INDEPENDENCE TO LIETUVOS BANKAS AND THE FUTURE IMPLICATIONS OF THIS, IN VIEW OF THE FUTURE ADOPTION OF THE EURO

The Republic of Lithuania finally became an EU Member State on 1 May 2004. Following the provisions of Article 4 of the Act on the Conditions of Accession to the EU, the Republic of Lithuania, along with the other nine new Member States, now participate in EMU as Member States with a derogation within the meaning of Article 122 of the Treaty.

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10 The 2004 revision of the Law took into account the ECB’s proposal, and therefore abolished the second sentence of Article 50 of the Law, which had formerly prescribed coordination with the parliament of the terms of purchase of services from an audit company.
11 Act concerning the conditions of accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia, and the Slovak Republic, together with the adjustments to the Treaties on which the European Union is founded (in Official Journal of the European Union, 23 September 2003, No L 236, p. 34).
Article 124 (2) of the Treaty requires Member States with a derogation to treat their exchange rate policy as a matter of common interest. As new Member States of the EU, the Republic of Lithuania and the other nine new Member States are committed to eventually adopting the euro, with no opt-out clause possible.

The main instrument of exchange rate policy with regard to the currencies of the non-euro area Member States is the Exchange Rate Mechanism II (ERM II). As expected, the Republic of Lithuania joined ERM II in June 2004 as a precondition for the adoption of the euro.

However, the ECB (and before it, the EMI) has on a number of occasions stated that the most important element of the legal integration of the NCBs into the ESCB and hence into the Eurosystem was to remove any incompatibilities between national provisions and the Treaty and the Statute. National provisions should thus either be in line with the Treaty and the Statute, or should omit those statutory provisions that are already present in the Treaty and the Statute, as the provisions of the Treaty and the Statute take precedence over national provisions.

7 LIST OF REFERENCES

1. “Act Concerning the Conditions of Accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic and the Adjustments to the Treaties on which the European Union Is Founded”, Official Journal of the European Union, 23 September 2003, No L 236.
8. Role of the Eurosystem in the Field of Payment Systems Oversight, ECB (June 2000).

**ADDITIONAL SOURCES**

The Central Bank of Malta, a statutory body the capital of which is wholly owned by the government and which has a distinct legal personality, was established in 1968 subsequent to the enactment of the Central Bank of Malta Act of 1967.\(^1\)

The Central Bank of Malta Act ("the CBM Act") may be divided into six main parts dealing with the establishment and principal business of the Central Bank of Malta\(^2\); the conduct of monetary policy; financial provisions\(^3\); the collection of information; relations with government, with credit and financial institutions\(^4\), with the financial services regulator, and with international and other organisations; and with the issue of currency and protection against counterfeiting.

The CBM Act has been amended on a number of occasions. However, for the purposes of this paper, the more relevant amendments incorporating the principle of the independence of the Central Bank of Malta are those promulgated by Act No XVII of 2002 which entered into force on 1 October 2002. It was the Central Bank of Malta itself which, after extensive discussions with the Directorate-General Legal Services of the European Central Bank (ECB), took the initiative to draft these amendments way back in 1999 and to ensure their passage through Parliament in time for Malta’s accession to the European Union.

These amendments were intended to mirror the requirements of independence of a central bank as laid down in the EC Treaty and the Protocol on the Statute of the European System of Central Banks and the European Central Bank annexed to the EC Treaty. Consequent to these amendments, the CBM Act now provides that the primary objective of the Central Bank of Malta is to maintain price stability.\(^5\) The CBM Act further provides that the Bank forms an integral part of the European System of Central Banks (ESCB) and that it shall participate in carrying out the tasks and complying with the objectives conferred upon it by the Statute of the European System of Central Banks and of the European Central Bank ("the Statute"), and that it shall further assume all rights and obligations consequential to such a status.\(^6\)

The aspects of central bank independence have been classified by the ECB itself (and previously by the European Monetary Institute) in its various Convergence Reports and by learned authors in this field in a number of categories.\(^7\) For ease

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1 Chapter 204 of the Laws of Malta.
2 This part, Part II of the CBM Act, includes provisions on the setting up of the Board of Directors.
3 This part, Part III, mainly deals with the capital and reserves of the Bank and financial reporting.
4 This part, Part V, includes provisions on the regulation and oversight of payment systems.
5 Article 4 of the CBM Act.
6 Article 38D of the CBM Act, as amended by Act No III of 2004, which entered into force on 1 May 2004.
of reference, the amendments affected to the CBM Act shall be grouped into the following two main categories: the personal aspect of independence, concerning mainly the autonomy bestowed by law upon the Board of Directors; and the operational aspect, which broadly refers to the Bank’s independence in determining and selecting monetary policy instruments and its financial autonomy.

**PERSONAL INDEPENDENCE**

The Board of Directors of the Central Bank of Malta is composed of a Governor, a Deputy Governor and three other directors. In terms of the CBM Act, the Board of Directors is responsible for the policy and general administration of the affairs and business of the Bank, except in relation to matters of monetary policy, where decisions are taken solely by the Governor. The Governor presides as chairperson at Board meetings. Decisions are adopted by a simple majority of the votes of the directors present and voting. The Governor as chairman has a normal vote and, in the event of a tie, exercises a casting vote.

Prior to the 2002 amendments, the Governor and Deputy Governor were appointed for a period not exceeding five years, while the other three directors were appointed for a period not exceeding three years. The Governor and Deputy Governor were required to occupy an executive role within the Bank, and were authorised by law to act as chairmen or members of domestic or international boards or committees. In the event of the temporary absence of or in the case of a vacancy in the post of the Governor, the law empowered the Deputy Governor to assume the duties of the Governor. In addition, in the event of the temporary absence of both the Governor and Deputy Governor, the President of Malta, acting on the advice of the Prime Minister, could designate any other director or a senior official of the Bank to act as Governor during such a period of absence. On the other hand, in the case of a vacancy in the post of a director before the expiry of the term for which he or she was appointed, another person could be appointed to fill the vacancy for the unexpired term of office.

Evidently, this state of affairs did not augur well for the personal independence of the members of the Board of Directors. The 2002 amendments established that all members of the Board are appointed for a five-year period and are eligible for reappointment. The Governor and Deputy Governor are still required by law to occupy an executive role; however, they may only occupy roles as chairmen or members of other boards in their capacity of Governor and Deputy Governor respectively and provided that this activity is not, in the opinion of the Board, in conflict with the performance of their duties under the CBM Act. The other three directors are as before not required to occupy executive roles within the Bank. However, the law now prohibits them from holding other positions which may be in conflict with their duties as directors.

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8 Article 7 of the CBM Act.
9 Article 8 of the CBM Act in respect of the Governor and Deputy Governor, and article 9 in respect of the other three directors.
In the case of the temporary absence of or in the event of a vacancy in the post of the Governor, it is solely the Deputy Governor who may be appointed to perform the duties of the Governor. Alternatively, if a director dies or resigns or otherwise vacates his or her office before the expiry of his or her term of office, another person will be appointed in his or her stead for a whole term of five years.

Before the 2002 amendments, it was possible to dismiss any member of the Board on the grounds that he or she was incapable of carrying on his or her duties; was guilty of serious misconduct in relation to his or her duties; or was absent from the meetings of the Board without reasonable cause for a period deemed excessive by the Minister responsible for finance. In order to avoid any doubts as to whether this provision went beyond the grounds for dismissal as laid down in the Statute, the 2002 amendments changed this provision in the sense that any member of the Board may only be dismissed if he or she no longer fulfils the conditions required for the performance of his or her duties or if he or she has been guilty of serious misconduct.\textsuperscript{10}

**OPERATIONAL INDEPENDENCE**

The CBM Act provides in two instances that neither the Bank nor any member of the Board when exercising their functions, duties and powers under the law are to seek or take instructions from the Government or from any other body.\textsuperscript{11} This is in stark contrast to the situation that prevailed before the 2002 amendments, when the law contained various requirements to obtain the consent, or to act upon the recommendation, of the Minister responsible for finance. The classic case of ministerial intervention prior to the 2002 amendments regarded the empowerment of the Minister, in cases when he or she deemed it necessary in the national interest, and after consultation with the Governor of the Bank, to give the Bank written directions as he or she deemed appropriate in the light of the objectives of the Bank, with which the Bank was obliged to comply.\textsuperscript{12}

The requirement to obtain the Minister’s approval or consent was pervasive throughout the CBM Act. Even in the case of the prerogative traditionally given to central banks to act as lenders of last resort, the CBM Act obliged the Bank prior to the 2002 amendments to obtain the prior approval of the Minister before advancing any loan to a bank incorporated in Malta (against security), whenever this was deemed necessary to safeguard monetary stability or in other exceptional circumstances.\textsuperscript{13}

There are now no traces of the requirement to obtain the Minister’s approval, save in the case regarding the auditing of the Bank’s accounts, where the law

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\textsuperscript{10} Article 11 of the CBM Act.

\textsuperscript{11} The relevant provisions are contained in article 7 of the Act in so far as concerns the Bank and members of the Board. On the advice of the Legal Services of the ECB, the provision was repeated in article 17A, which specifically refers to the Bank and members of the Monetary Policy Advisory Council.

\textsuperscript{12} Former article 32 of the CBM Act, substituted by the 2002 amendments.

\textsuperscript{13} Former article 15 (m) of the CBM Act, substituted by article 15 (1) (g) after the 2002 amendments.
provides that the accounts of the Bank are to be audited by independent external auditors appointed annually by the Board with the approval of the Minister. Since the government is the sole shareholder of the Bank, it was deemed appropriate that on the basis of company law principles, the government should retain the right to approve the Bank’s external auditors, which are required by law to be independent.

A number of new provisions were introduced in 2002 to set up a new legal framework on monetary policy. Prior to these amendments, monetary policy matters were discussed by the Monetary Policy Council, a body set up by management and composed of a number of senior officers of the Bank and members of the Board of Directors. Decision-taking was however reserved to the Board of Directors who were (and still are) responsible for policy and general administration of the business of the Bank.

Following the 2002 amendments, the set-up of the Council was enshrined in law. It has become an advisory body and is now known as the Monetary Policy Advisory Council. It is composed of the Governor, Deputy Governor, the other three directors and three members appointed by the Governor, after consultation with the Board, from among the senior officials within the Bank or from among suitably qualified individuals from outside the Bank.

The 2002 amendments mentioned so far simply transferred into written law the practice that obtained prior to that date. The one novelty in this area – and a radical one at that – regarded a change in decision-taking in monetary policy matters, which is now reserved solely to the Governor, and in his or her absence the Deputy Governor, after taking into account the advice of the Council. This role was removed from the remit of the Board of Directors since the Board is partly composed of three (possibly) non-executive directors and, in the light of the stringent requirements of the autonomy of decision-taking in monetary policy matters, it was deemed advisable to vest the Governor with sole authority and responsibility to take decisions on monetary policy.

Ministerial intervention was perhaps most conspicuous in the financial provisions of the CBM Act. In terms of the law, the Central Bank of Malta is obliged to maintain a General Reserve Fund and a Special Reserve Fund. Prior to the 2002 amendments, the law provided that the Special Reserve Fund was available for the purposes of investing in the shares, bonds or debentures of any public body approved by the Minister for the purpose of promoting or financing development in Malta, or for any similar purpose approved by the Minister. Moreover, allocations could only be made to either of these funds with ministerial approval.

The law prior to 2002 further provided that the profits and losses attributable to any revaluation of the Bank’s net assets or liabilities made as a result of any

14 Part II A of the CBM Act.
15 The 2002 amendments took on board the Irish model in this respect.
16 Part III of the CBM Act.
adjustment of the external value of the Maltese lira were to be credited or debited (as the case may be) to a special Revaluation Account. The Minister was, in such instances, required to make proposals as to how any debit or credit balance in this account at the end of the previous year was to be dealt with.

Clearly, this state of affairs was untenable in view of EU accession, and the law was amended to iron out these requirements for ministerial interventions. The law now provides that the General Reserve Fund is available for any purpose as may be determined by the Board of Directors\textsuperscript{17}, while the Special Reserve Fund is available for the purposes of crediting or debiting any profits or losses attributable to any revaluation of the Bank’s net external assets or liabilities made as a result of the adjustment of the external value of the Maltese lira. The balance in this fund is then dealt with as determined by the Board.\textsuperscript{18}

\textbf{OTHER ASPECTS OF INDEPENDENCE}

The autonomy of the Central Bank of Malta stems from other equally relevant provisions of the law. The Bank is now prohibited from granting credit to the government or to a public undertaking, or to purchase government or public debt instruments from the primary market.\textsuperscript{19} This replaced a number of provisions obliging the Bank to invest in government or public instruments in various instances\textsuperscript{20}, and in particular it replaced a former provision stating that any balance of a temporary advance made by the Bank to the government and still outstanding on 1 January 2000 was to be repaid in full by 31 December 2000.\textsuperscript{21} This provision was intended as a temporary measure prior to the full enforcement of the provision on the prohibition of government financing.

An equally important provision evidencing the autonomy bestowed upon the Bank is that the Bank is now endowed with full responsibility to regulate and oversee domestic payment systems, including securities settlement systems, and has been delegated legislative powers to carry out this task.\textsuperscript{22}

\textsuperscript{17} Article 18 of the CBM Act.
\textsuperscript{18} Ibid., article 24.
\textsuperscript{19} Ibid., article 27.
\textsuperscript{20} For instance, prior to the 2002 amendments, article 15 (f) of the CBM Act provided that the Bank could purchase, sell, discount or rediscount government Treasury bills that form part of a public issue; article 15 (h) provided that the Bank could purchase and sell publicly issued securities of or guaranteed by the government maturing in not more than twenty years; article 15 (i) provided that the Bank could subscribe to, purchase and sell shares, bonds or debentures of any body corporate in Malta established by law or sponsored by, or set up under the authority of, the government, or of any other corporate body as approved by the Minister, for the purpose of promoting or financing development in Malta or for the purpose of promoting the development of a money or a securities market in Malta; article 15 (j) provided that the Bank could invest its staff and pension funds and other internal funds of the Bank in government securities or other first-class securities approved by the Board; and article 29 provided that the Bank could be entrusted with the issue and management of Treasury bills and government loans publicly issued in Malta upon such terms and conditions as could be agreed between the Minister and the Bank.
\textsuperscript{21} Former article 27 of the CBM Act, substituted by the 2002 amendments.
\textsuperscript{22} Article 36 of the CBM Act.
INCREASED ACCOUNTABILITY

The autonomy granted to the Central Bank of Malta and the persons entrusted with decision-taking within the Bank brought with it a strengthening of the reporting requirements incumbent upon the Bank.

The general reporting provisions were already contained in the CBM Act prior to the 2002 amendments and concern the obligation of the Bank to keep the Minister informed of the Bank’s policy.23

The financial reporting mechanism has been strengthened in the sense that prior to the 2002 amendments, the Bank was only obliged to transmit to the Minister a copy of the audited annual accounts and a report on its operations to be presented before Parliament and eventually published. Since 2002 the Bank has also been obliged to transmit a statement of the Bank’s investments to the Minister.24 This is meant to counterbalance the full autonomy given to the Bank to manage its external reserves.

New reporting procedures have been created with respect to monetary policy matters. As reiterated earlier, the Governor is now vested with sole responsibility for monetary policy decisions. The Governor is obliged to keep the Monetary Policy Advisory Council informed of the discharge of the powers vested in him in this respect.25 The Governor may also be requested by the House of Representatives to report on the conduct by the Bank of its monetary policy functions before a committee of the House appointed for this purpose, and to furnish the committee with any information deemed necessary. This parliamentary committee is empowered to question the Governor on any activities or decisions taken in the field of monetary policy, but it has no powers to order the Governor to change any decisions or to undertake a certain course of action. However, to ensure that such reporting does not constitute undue pressure, the Governor may not be requested to appear before the committee more often than once every six months.26 Finally, after each meeting of the Monetary Policy Advisory Council, the Bank is obliged to publish a statement of the monetary policy decisions taken by the Governor.27

Of course, the implementation of the concept of independence of the Central Bank of Malta within the CBM Act is not an end in itself but a necessary measure to allow the Bank to conduct its monetary policy and to participate in the ESCB. With the eventual adoption of the euro it is envisaged that the Bank will again have to shed its operational autonomy, in part to recognise the competence of the ECB in ESCB-related tasks. At this time it will have to be assessed whether this actually means handing over autonomy to the ECB, or rather sharing autonomy with other central banks and the ECB acting together within the Eurosystem.

23 Ibid., article 31.
24 Ibid., article 23.
25 Ibid., article 17A.
26 Ibid., article 17B.
27 Ibid., article 17D.
Národná banka Slovenska (the National Bank of Slovakia) is the independent central bank of the Slovak Republic as established by the National Bank of Slovakia Act No 566/1992 Coll., as amended (henceforth “the NBS Act”).

The principle of the independence of Národná banka Slovenska is also declared in the Constitution of the Slovak Republic.¹

As far as central bank independence is concerned, national legislation in the Member States has to be adapted to comply with the relevant provisions of the Treaty establishing the European Community (“the Treaty”) and the Protocol on the Statute of the European System of Central Banks and the European Central Bank (“the Statute”).

The Treaty in Article 108 and the Statute in Articles 7 and 14.2 identify central bank independence and require the compatibility of national legislation with these provisions, which has to be ensured at the latest upon joining the European System of Central Banks (ESCB).²

In 1997 the European Monetary Institute established a list of features that embody the concept of central bank independence. These form the basis for assessing the national legislation of the Member States, in particular of the statutes of the national central banks (NCBs).

The concept of central bank independence includes various types of independence that must be assessed separately; namely personal, institutional, financial and functional independence.

Over the past few years, these aspects of central bank independence have been further refined by the European Central Bank (ECB) and subsequently incorporated step by step into the statutes of the NCBs of the new Member States.

This is also the case for Národná banka Slovenska. The NBS Act has been amended several times since 1997, and the principle of central bank independence has been incorporated into Slovak legislation.

The following brief review is designed to cast some light on the way in which some of the key aspects of central bank independence are reflected in the current NBS Act.

² Article 109 of the Treaty and Article 14.1 of the Statute.
PERSONAL INDEPENDENCE

MINIMUM TERM OF OFFICE FOR GOVERNORS

The statutes of the NCBs must, in accordance with Article 14.2 of the Statute, contain a minimum term of office for a governor of five years, although this does not preclude a longer term of office.

The NBS Act lays down that the members of the Bank Board shall be appointed for a term of office of five years, and that the membership of the Bank Board shall be limited to a maximum of two consecutive terms of office.3

GROUNDS FOR DISMISSAL OF GOVERNORS AND SECURITY OF TENURE OF MEMBERS OF THE DECISION-MAKING BODIES OF NCBs INVOLVED IN THE PERFORMANCE OF ESCB-RELATED TASKS OTHER THAN GOVERNORS

NCBs’ statutes must ensure that their governors may not be dismissed for reasons other than those mentioned in Article 14.2 of the Statute (i.e. that they no longer fulfil the conditions required for the performance of their duties or that they have been guilty of serious misconduct).

Personal independence would be jeopardised if the same rules for the security of tenure of governors were not also applied to other members of the decision-making bodies of NCBs who are involved in the performance of ESCB-related tasks. This applies in particular where the governor is primus inter pares between colleagues with equivalent voting rights or where other members may deputise for the governor.

To prevent the dismissal of a governor being at the discretion of the authorities involved in his or her nomination and appointment, in this case the Government of the Slovak Republic and the Parliament of the Slovak Republic, and to declare the security of tenure of other members of the decision-making bodies, the NBS Act provides for the following, in line with the Statute:

Article 7 (9)

A member of the Bank Board may only be recalled from his function in the event that:

a) he has been legally sentenced by court for an intentional criminal offence,

b) he no longer fulfils the preconditions for the performance by him of the function of a member of the Bank Board pursuant to paragraph 4,

c) he has taken up a function, occupation, employment or activity that is incompatible with membership of the Bank Board or has otherwise violated the provisions of paragraph 6.

3 Article 7 (4) and (5) of the NBS Act.
RIGHT OF JUDICIAL REVIEW

The limitation of political discretion in the evaluation of grounds for dismissal justifies the fact that members of decision-making bodies have the right to have any dismissal decision reviewed by an independent judicial court. Article 14.2 of the Statute stipulates that an NCB governor who has been dismissed from his or her position may refer the decision to the Court of Justice. Moreover, national legislation should also grant national courts the right to review a decision to dismiss any other member of the decision-making body of the NCB who is involved in the performance of ESCB-related tasks.

The NBS Act declares that any disputes relating to the dismissal of a member of the Bank Board from his or her office shall be decided by a court in proceedings pursuant to a separate law. This shall however not apply in cases where, under an international treaty which is binding upon the Slovak Republic and which takes precedence over the law of the Slovak Republic, such a decision falls within the jurisdiction of the Court of Justice of the European Communities.4

SAFEGUARD AGAINST CONFLICTS OF INTEREST

Personal independence also entails ensuring that no conflicts of interest arise between the duties of members of decision-making bodies of NCBs vis-à-vis their respective NCB (and additionally of governors vis-à-vis the ECB) on the one hand, and any other functions which such members of decision-making bodies involved in the performance of ESCB-related tasks may have and which may jeopardise their personal independence on the other.

The problem of conflict of interest has been eliminated in the wording of the NBS Act, as follows:

Membership of the Bank Board shall be incompatible with the post of President of the Slovak Republic, Member of the Parliament of the Slovak Republic, Member of the Government of the Slovak Republic, judge, public prosecutor, and any other function, office of employment in state authorities, self-government bodies or any other public bodies, position in the management or supervisory body of a legal person doing business, performing entrepreneurial or other economic or income-earning activities which may create conflict of interest. A member of the Bank Board may not perform any other function or non-income-earning activity which may create a conflict of interest between duties of the member of the Bank Board and that function or activity. If, at the time of his/her appointment, a member of the Bank Board holds a position or pursues an occupation, employment or activity that is incompatible with membership of the Bank Board, he/she shall be obligated to take without delay a demonstrable legal action aimed at terminating such office, profession, employment or activity and shall be obligated without delay to give up such office, profession, employment or activity.

4 Article 7 (10) of the NBS Act.
INSTITUTIONAL INDEPENDENCE

Institutional independence is a feature of central bank independence that is expressly referred to in Article 108 of the Treaty as reproduced in Article 7 of the Statute. These Articles prohibit Member State NCBs and members of their decision-making bodies from seeking or taking instructions from Community institutions or bodies, from any Member State government, or from any other body. Some of the following rights of third parties were identified by the ECB as being incompatible with the Treaty and the Statute, and therefore needed to be amended in preparation for joining the ESCB:

– the right to issue instructions;
– the right to approve, suspend, annul or defer decisions;
– the right to participate in decision-making bodies of an NCB with a right to vote;
– the right to be consulted on an ex ante basis on an NCB’s decision;
– the right to censor decisions on legal grounds.

Taking into account the rights of third parties mentioned above, several more or less significant inconsistencies have been identified and subsequently dealt with in the NBS Act, with the following outcome:

– extension of the prohibition for the members of the decision-making bodies of Národná banka Slovenska of seeking or taking instructions not only from the Government of the Slovak Republic, but also from any other bodies,
– elimination of the advisory role of the representatives of the Government of the Slovak Republic in the decision-making process,
– elimination of the NBS reporting obligations towards the Government of the Slovak Republic and the Parliament of the Slovak Republic, which obligations could be understood as ex ante consultations on the NBS’s decisions,
– participation of the governor in the meetings of the Government of the Slovak Republic to be based on invitation rather than obligatory.

To cope with these issues, new provisions have been incorporated into the NBS Act. For example:

Article 7 (7)

In connection with the performance of their functions or with activities of the National Bank of Slovakia, members of the Bank Board may not seek or take instructions from state authorities, self-government bodies, any other public bodies, or any legal persons or natural persons. State authorities, self-government bodies, any other public bodies, or any legal persons or natural persons may not influence the National Bank of Slovakia or members of the Bank Board in connection with the performance of their function and the operations of the National Bank of Slovakia. The Governor of the National Bank of Slovakia may not seek or take instructions from the Bank Board in connection with the performance of his function in bodies of the European System of Central Banks and the European Central Bank. The same shall apply to a person acting for the Governor of the National Bank of Slovakia in these bodies.
Article 12 (2)

The National Bank of Slovakia shall fulfil its tasks pursuant to Article 2 hereof independently of instructions from state authorities, self-government bodies, any other public bodies and from legal persons and natural persons.

Article 8 (4)

Apart from its members, Bank Board meetings may be attended by a member of the Government of the Slovak Republic authorised by the Government of the Slovak Republic, persons designated in the Bank Board’s rules of procedure, and other persons invited by the Bank Board.

FINANCIAL INDEPENDENCE

In some countries third parties, particularly the government or parliament, were formerly in a position, either directly or indirectly, to influence the determination of an NCB’s budget or the distribution of profit. The submission of a draft NCB budget to the government or parliament either for approval or an opinion would clearly exceed the boundaries of financial independence. This was also the case for Národná banka Slovenska, albeit only to a limited extent.

The former NBS Act stated that Národná banka Slovenska should submit an Annual Statement on the results of its activities for approval to the Parliament of the Slovak Republic. There was some doubt as to whether the Parliament could be in a position to have either a direct or indirect influence on the determination of Národná banka Slovenska’s budget or the distribution of profit.

To avoid any confusion, the new NBS Act states that the competence of the Parliament of the Slovak Republic shall be purely limited to an ex post review which should be regarded as a reflection of the accountability of Národná banka Slovenska, without infringing its independence in any shape or form. Article 38.3 states that:

Within three months of the end of a calendar year, the National Bank of Slovakia shall submit to the Parliament of the Slovak Republic an annual report on the results of its operations; in addition to balance sheet data of the National Bank of Slovakia and an auditor’s opinion verifying it, this report shall specifically state the data concerning the costs of the National Bank of Slovakia.

FUNCTIONAL INDEPENDENCE

Article 2 of the former NBS Act stated that the primary task of Národná banka Slovenska should be to ensure the stability of the Slovak currency. In light of the ESCB Statute’s distinction between objectives and tasks, and in order to reflect more accurately the primacy of price stability, the wording was changed to “primary objective”, as follows:
Article 2.1

The primary objective of the National Bank of Slovakia shall be to maintain price stability.

In addition, the former Article 12 stipulated that Národná banka Slovenska should support the economic policy of the Government of the Slovak Republic. Because the ESCB’s secondary objective is to support the general economic policies of the Community, the NBS Act has been amended accordingly. Article 12 (1) states that:

While respecting its primary objective and tasks, the National Bank of Slovakia shall support the economic policy of the Government of the Slovak Republic.

Article 2 (2) additionally states that:

With a view to accomplishing its primary objective pursuant to paragraph 1, the National Bank of Slovakia shall also perform the authority, activities, tasks, rights and obligations following from its participation in the European System of Central Banks.

In becoming an independent central bank, Národná banka Slovenska has embarked on the process of becoming a member of the ESCB, with the aim of finally joining the Eurosystem as planned in 2009.
This paper has been written bearing particularly in mind the Member States that have not yet adopted the euro as their currency but that, should this be envisaged in the future, will face similar problems with regard to achieving legal convergence as Portugal did. In this context, its main purpose is to describe the “two in one” approach followed by the Portuguese legislative bodies when deciding to foresee, in one single legal act, the two possibilities of Portugal either adopting or not adopting the euro on 1 January 1999. This article is not intended to establish a model that should be followed by other Member States: obviously, each national legislator is free to choose its own approach. However, the European Monetary Institute (EMI) singled out the Portuguese approach for particular praise in its Opinion of 15 August 1997, noting “with particular satisfaction the comprehensive fashion in which the adaptation of the Bank’s statute is foreseen in the draft law, whilst at the same time the different situations are accommodated which may occur dependent on the moment at which Portugal adopts the single currency”.

INTRODUCTION

When the Treaty of Maastricht entered into force on 1 November 1993, rewording the provisions dedicated to Economic and Monetary Policy1 of the Treaty establishing the European Community (Treaty), the statutes of the Banco de Portugal (henceforth “the Bank”) were contained in an Organic Law (OL) which had been approved by Decree-Law 337/90 of 30 October 1990 (OL-90).

The new requirements of the Treaty conflicted with several provisions of OL-90, and the Portuguese authorities therefore decided to adapt the OL in two steps, the first in 1995 and the second in 1998.

I THE 1995 AMENDMENTS

1.1

Some of the provisions of OL-90 were clearly inconsistent with Articles 101 and 102.1 of the Treaty (the prohibition of monetary financing and of privileged access to financial institutions, respectively), and attention had to be paid to the fact that these Articles would be applicable as from the beginning of the second stage of Economic and Monetary Union (EMU), i.e. from 1 January 1994.2

More specifically, the Bank was allowed to “grant to the State, through the appropriate credit operations, the funds required by the latter to subscribe capital stock of international organisations operating chiefly in the monetary, financial

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1 Currently Articles 98 to 124, after the renumbering made by the Treaty of Amsterdam. This paper uses the numeration introduced by this Treaty.
2 Article 116.3, in conjunction with Article 116.1 of the Treaty.
and foreign exchange fields” (Article 25); the Autonomous Regions of Azores and Madeira were permitted to resort to an “account, free of charge” opened with the Bank (Article 26); and the Bank was allowed “to buy and sell securities issued by the Portuguese State” (Article 35.1.b).

It seems obvious that Articles 25 and 35.1.b were contrary to Article 101.1 of the Treaty, while Article 26 contradicted Article 102.1 of the same Treaty. Therefore, OL-90 was amended by Decree-Law 231/95 of 12 September 1995 with the main purpose of adapting it (although almost two years later…) to the said Articles of the Treaty.

1.2

Article 25 was reworded as follows: “(1) Overdraft facilities or any other type of credit facility with the Bank in favour of the State or other State-dependent services or bodies, other public-law legal persons and public undertakings, or any other bodies on which the State, the Autonomous Regions or local authorities may, directly or indirectly, have a dominant influence, shall be prohibited. (2) The Bank shall not guarantee any commitments of the State or any other body mentioned in the foregoing number, and shall not directly purchase debt instruments issued by the State or by the same bodies.”

The mechanism foreseen in Article 26 of OL-90 on the resort to a free-of-charge account by the Autonomous Regions was replaced in Decree-Law 231/95 by a transitional provision stating that “the Autonomous Regions may temporarily benefit from an interest-free credit facility with the Banco de Portugal”. This exception was in accordance with the Protocol on Portugal annexed to the Treaty. Later on, Article 48 of Law 13/98 of 24 February 1998 laid down that the Autonomous Regions’ interest-free accounts would be definitively closed no later than 31 December 2000 and that the respective debit balances would be paid on that date.

Finally, Article 35.1.b has been reworded to allow the Bank to buy and sell securities issued by the Portuguese State “on the secondary market” only.

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3 Under the original wording of Article 26 of OL-90, the State itself was also entitled to resort to a free-of-charge account opened with the Bank. However, such an account had already been closed in accordance with Article 58 of Law 2/92 of 9 March 1992 (the State budget for 1992). Therefore, at the entering into force of the Treaty of Maastricht, the part of Article 26 referring to the State’s account had been implicitly repealed.

4 “Overdraft facilities or any other type of credit facility with the ECB or with the central banks of the Member States (hereinafter referred to as ‘national central banks’) in favour of Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the ECB or national central banks of debt instruments.”

5 “Any measure, not based on prudential considerations, establishing privileged access by Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States to financial institutions, shall be prohibited.”

6 The prohibition of guaranteeing commitments of the State or other public bodies was linked to Article 103 of the Treaty.

7 “(1) Portugal is hereby authorised to maintain the facility afforded to the autonomous regions of Azores and Madeira to benefit from an interest-free credit facility with the Banco de Portugal under the terms established by existing Portuguese law. (2) Portugal commits itself to pursue its best endeavours in order to put an end to the above-mentioned facility as soon as possible.”
At the same time, the opportunity was taken to introduce, on a voluntary basis, other amendments with the aim of facilitating the path to EMU. In this context, the amendments to Articles 3, 18.1 and 63.2 deserve special mention.

According to Article 3 of OL-90, the objective of the Bank was, in its capacity as the central bank of Portugal, to “ensure the internal monetary equilibrium and the external solvency of the currency”; this provision came closer to the first and second sentences of Article 105.1, of the Treaty, insofar as it was rephrased as follows: “The primary objective of the Banco de Portugal, as the central bank of the Portuguese Republic, shall be to maintain price stability, taking into account the overall economic policy of the Government.”

Article 18.1 of OL-90 stated that only “taking into account the Government’s guidelines” was it incumbent on the Bank “to cooperate in the formulation of the monetary and foreign exchange policies and to execute such policies”; Decree-Law 231/95 eliminated the reference to the government’s guidelines and entrusted the Bank with the responsibility for conducting monetary policy, and no longer just cooperating in the formulation of this policy: “As [the] central bank, besides the conduct of monetary policy, under the terms of Article 3, it shall be particularly incumbent on the Bank […] to cooperate in the formulation and to implement the foreign exchange policy”.

Finally, while Article 63.2 of OL-90 on the distribution of profit for the fiscal year laid down that, after a deduction of 20% for legal and other reserves, 80% of such profit should be distributed to the State, the 1995 version reinforced the financial autonomy of the Bank since, after deducting 20% for reserves, the remainder would be distributed to the State as dividends, “or to other reserves proposed by the Board of Directors and approved by the Minister of Finance”.

2 REQUIREMENTS OF INDEPENDENCE OF NATIONAL CENTRAL BANKS (NCBs) AND OF THEIR INTEGRATION INTO THE EUROPEAN SYSTEM OF CENTRAL BANKS (ESCB)

2.1

According to Article 108 of the Treaty, applicable as from the beginning of the third stage of EMU, “when exercising the powers and carrying out the tasks and duties conferred upon them by this Treaty and the Statute of the ESCB, neither the ECB, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Community institutions or bodies, from any government of a Member State or from any other body. The Community institutions and bodies and the governments of the Member States undertake to respect this

8 “The primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2.”
9 The Banco de Portugal has been totally owned by the State since 15 September 1974 (Decree-Law 452/74 of 13 September 1974).
10 Article 116.3 of the Treaty.
principle and not to seek to influence the members of the decision-making bodies of the ECB or of the national central banks in the performance of their tasks.”

By virtue of Article 109 of the Treaty, “each Member State shall ensure, at the latest at the date of the establishment of the ESCB, that its national legislation including the statutes of its national central bank is compatible with this Treaty and the Statute of the ESCB.”

It was known that the Commission and the EMI would report to the ECOFIN Council on the progress made by the Member States in the fulfilment of their obligations regarding the achievement of EMU, and moreover that such reports would not only analyse the degree of sustainable economic convergence among Member States, but would also “include an examination of the compatibility between each Member State’s national legislation, including the statutes of its national central bank, and Articles 108 and 109 of this Treaty and the Statute of the ESCB”. Moreover, the Council of Heads of State or Government, taking into account the above-mentioned reports, would confirm before 1 July 1998 which Member States fulfilled the necessary conditions for the adoption of the single currency.

It derives from the above that, to be included in the group of those fulfilling the conditions for adopting the single currency, Member States should previously respect not only the economic convergence criteria, but also the legal convergence criteria.

In its essence, legal convergence means that (i) NCBs must be independent, either from the political authorities or from any other entities outside the ESCB; and (ii) not only the statutes of NCBs but all national legislation that has an impact on the NCBs’ performance of their ESCB-related tasks has to be compatible with the Treaty and with the Statute of the ESCB/ECB (the Statute), keeping namely in mind the integration of NCBs into the ESCB.

2.2

The independence of NCBs, to which Article 108 of the Treaty and Articles 7 and 14.2 of the Statute refer, is necessary for the performance of ESCB-related tasks and may be conceived as institutional, personal, functional and financial independence.

Institutional independence means that neither the NCBs nor any member of the respective decision-making bodies may seek or take instructions from any entity outside the ESCB.

11 Article 121.1 of the Treaty.
12 Article 121.4 of the Treaty. In fact, this would take place during the first quarter of 1998 because, according to Council Decision 96/736/EC of 13 December 1996, on entry into the third stage of Economic and Monetary Union (OJ L 335, 24.12.96, p. 48), the procedure foreseen in Article 121.4 of the Treaty would be applied “as soon as possible in 1998.”
13 With the natural exception of the judicial authorities.
14 Due to the limited scope of the present paper, reference shall only be made to aspects related to the statutes of NCBs.
Personal independence means that the term of office of a governor of an NCB shall be no less than five years, and that a governor may not be relieved from office unless he or she no longer fulfils the conditions required for the performance of his or her duties, or if he or she has been guilty of serious misconduct. Taking into account the spirit of the Treaty, the same rules for the security of tenure of office should also apply to the other members of decision-making bodies of NCBs involved in the performance of ESCB-related tasks.

Functional independence means that NCBs’ statutes must clearly reflect that in the third stage of EMU, they will perform their duties in an operational framework whose objectives are laid down in Article 105 of the Treaty, and no longer at national level.

Financial independence implies that NCBs must be in a position that allows them to avail themselves of the financial resources that are necessary to perform their functions.

2.3

As stated above, legal convergence also has the meaning of integration of NCBs into the ESCB. Articles 12.1 and 14.3 of the Statute are particularly devoted to this integration, which means that it has to be taken into account that NCBs are an integral part of the ESCB and must act in accordance with the guidelines and instructions of the European Central Bank (ECB). The ESCB is an independent and self-regulated system whose components are the NCBs and the ECB15, and where the NCBs must be able to comply with decisions taken by the ECB. Hence, national legislative provisions, including the statutes of NCBs, that create obstacles to compliance with such decisions or that do not respect the prerogatives of the ECB are incompatible with the full operation of the system.

To sum up, the full integration of NCBs into the ESCB implies the adoption of other measures beyond those aiming to ensure independence, particularly taking into account the need to allow NCBs to perform their functions in their capacity as members of the ESCB and in accordance with the decisions of the ECB.

3 THE 1998 AMENDMENTS

3.1

As mentioned before, each Member State had to ensure the compatibility of its national legislation, including the statutes of its NCB, with the Treaty and the Statute of the ESCB “at the latest at the date of the establishment of the ESCB”.16 Since the ESCB would be established “as soon as the Executive Board (of the ECB) is appointed”, this appointment being made “immediately after 1 July

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15 Article 107.1 of the Treaty.
16 Article 109 of the Treaty.
1998 \(^{17}\), the date of establishment of the ESCB would precede the beginning of the third stage of EMU. It should be noted that, regarding the application of Articles 108 and 109, the Treaty does not distinguish between Member States with a derogation and Member States without a derogation. Therefore, these Articles were binding for all Member States (with the sole exceptions of the United Kingdom and, to a lesser extent, Denmark)\(^{18}\), since a derogation, in the sense of Article 122 of the Treaty, only means that the respective NCB participates in the ESCB with reduced rights and obligations. Consequently, the time limit for all the necessary legislative adaptations would be the date of establishment of the ESCB, i.e. 1 July 1998.

Besides this, the Report on Progress towards Convergence, published by the EMI in November 1996, had highlighted\(^{19}\) that the adaptations to be introduced in the field of independence of the NCBs needed to be fully effective, at the latest, by the date of the establishment of the ESCB, while adaptations aiming to integrate NCBs into the ESCB, although possibly adopted before that date, only needed to become effective either at the start of the third stage (for Member States without a derogation) or at the start of their full participation in EMU (for Member States with a derogation).

This timing created a problem of legislative technique for the Portuguese legislative bodies. Considering that the compatibility of the statutes of the NCBs with the Treaty was one of the eligibility requirements for a Member State to adopt the single currency at the start of the third stage of EMU\(^{20}\), the amendments to the OL of the Banco de Portugal would need to be adopted before knowing whether or not Portugal would participate in that group of countries. Therefore, the problem was, in addition to the provisions on independence, how to determine which norms relative to integration into the ESCB needed to be adopted, before knowing what kind of integration (full or mitigated) would be required of the Bank.

It appeared that the easiest way to proceed would be to divide the law amending the OL into two main parts. The first was chiefly aimed at amending some Articles of the OL then in force, so as to guarantee the independence of the Bank, and should become effective immediately; the second would fully replace the OL with a new text containing both independence and full integration requirements, and would become effective at the start of the third stage or, should Portugal not be confirmed as fulfilling the necessary conditions for the adoption of the single currency on 1 January 1999, at a later date on which Portugal would adopt the single currency.

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17 Article 123.1 of the Treaty.
18 The United Kingdom, having notified the Council that it did not intend to move to the third stage, was exempted from the application of Articles 108 and 109 of the Treaty by virtue of paragraphs 2 and 5 of the Protocol on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland, annexed to the Treaty. Denmark, which had also notified that it would not participate in the third stage, was considered to be a Member State with a derogation and, as such, Danmarks Nationalbank had to fulfil the requirements of central bank independence, in accordance with Article 108 of the Treaty and with Articles 7 and 14.2 of the Statute.
19 See p. 99.
20 Articles 121.1 and 121.4.
It was however taken into account that even if Portugal were not to be in the first group of countries participating in the single currency, some mitigated integration requirements would nevertheless apply to all NCBs as from the start of the third stage\textsuperscript{21}, regardless of the full participation of the respective country at that stage. Consequently, it was also considered advisable to lay down for the provisions amending the OL which – should Portugal fail to participate in the single currency from the start – were designed to reconcile the OL with these mitigated integration requirements and would become effective at the start of the third stage.

Law 5/98 of 31 January thus contained simultaneously and successively the following: some changes to be introduced immediately in the OL with regard to the Bank’s independence (Article 1)\textsuperscript{22}; a new integral version of the OL, which envisaged not only the independence of the Bank but also its full integration into the ESCB, whose version would entirely replace the OL then in force as of the date of Portugal’s full participation in the third stage of EMU (Article 2)\textsuperscript{23}; and other amendments to the OL in the field of integration, which would only become effective at the start of the third stage if Portugal’s full participation were to occur only subsequently, and whose validity would be confined to the interim period between the start of the third stage and the day on which Portugal adopts the euro (Article 3).\textsuperscript{24}

In other words, without knowing, at the moment of legislating, whether or not Portugal would be confirmed as fulfilling the necessary conditions to be included in the group of Member States that would adopt the single currency on 1 January 1999, the Portuguese legislator considered two hypotheses, one being that Portugal would not adopt the single currency on 1 January 1999, and the other that it would. In the first hypothesis, the amendments to the OL would be those completing such independence, introduced by Article 1 of Law 5/98 (in force since 1 February 1998) plus those regarding (mitigated) integration, introduced by Article 3 of the same Law (in force as from 1 January 1999). In the second hypothesis, the amendments to the OL would be those regarding independence, introduced by Article 1 and in force since 1 February 1998, plus those reinforcing such independence and regarding also (full) integration, introduced by Article 2 of the same Law and in force as of the day of Portugal’s adoption of the euro as its currency.

\textsuperscript{21} With the possible exception of the Bank of England, pursuant to the Protocol on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland.

\textsuperscript{22} Article 1: “(1) As of the date of publication of this Law, Articles 1, 3, 16, 43, 44, 47, 51, 57, 58, 64, 66, 67, 69, 71 and 72 of the Organic Law of the Banco de Portugal, approved by Decree-Law No 337/90 of 30 October, as amended by Decree-Law No 231/95 of 12 September and by Law No 3/96 of 5 February, shall be reworded as follows: [...]. (2) As of the date mentioned in the foregoing paragraph, Articles 71-A and 71-B shall be added to the Organic Law of the Banco de Portugal in question, worded as follows: [...]”

\textsuperscript{23} Article 2: “As of the day on which Portugal adopts the euro as its currency, the Organic Law of the Banco de Portugal shall have the wording contained in the annex to the present Law, of which it forms an integral part. Simultaneously, the Organic Law approved by Decree-Law No 337/90 of 30 October, as amended by Decree-Law No 231/95, of 12 September, by Law No 3/96 of 5 February, and by Articles 1.1 and 1.2 and, should it come into force, by Article 3 as well of the present Law, shall be revoked”.

\textsuperscript{24} Article 3: “Should Portugal fail to adopt the euro as its currency on the day on which the third stage of Economic and Monetary Union will start, as of that date Articles 3, 19, 39 and 65 of the Organic Law of the Banco de Portugal, approved by Decree-Law No 337/90, of 30 October, as amended by Decree-Law No 231/95, of 12 September, by Law No 3/96, of 5 February and by Article 1.1 and 1.2 of the present Law, shall be reworded as follows: [...]”
Among other advantages, this legislative technique provided a full picture of Portugal’s intentions in this field, which was all the more important as both the EMI and the European Commission would have to produce reports containing studies on the compatibility of the national legislation of each Member State with the Treaty provisions, which would in turn be taken into account by the European Council when confirming which Member States had fulfilled the necessary conditions for the adoption of the single currency.  

Besides this, such a legislative technique would avoid a second consultation with the ECB on a future draft OL.

As Portugal was confirmed as one of the Member States that would adopt the euro as a single currency on 1 January 1999, the amendments on independence introduced in the OL by Article 1 of Law 5/98 were in force between 1 February and 31 December 1998; the amendments on independence and full integration introduced by Article 2 of Law 5/98 entered into force on 1 January 1999; whereas the amendments on independence and mitigated integration foreseen in Article 3 of the same Law never entered into force.

### 3.2 IT IS ILLUSTRATIVE TO COMPARE THE LEGAL REGIMES ON INDEPENDENCE AND ON INTEGRATION ENVISAGED FOR THE TWO IDENTIFIED HYPOTHESES

#### 3.2.1 PROVISIONS FOR THE HYPOTHESIS THAT PORTUGAL WOULD NOT ADOPT THE SINGLE CURRENCY ON 1 JANUARY 1999: ARTICLES 1 AND 3

We will start with the amendments laid down by Article 1 of Law 5/98 aiming to ensure the independence of the Bank.

#### 3.2.1.1 Article 43 of OL-90 stated that the Governor could “suspend the effectiveness of the decisions taken by the Board of Directors” on the grounds that, in his judgement, they were “contrary to the law, to the interests of the country or of the Bank”; the suspension should be reported to the Minister of Finance and would be considered waived if the government did not confirm it within 15 days.

This power to suspend the effectiveness of the decisions, insofar as it depended on confirmation by the Cabinet, was not compatible with the institutional independence of the Bank and, therefore, Law 5/98 changed it into the equivalent of a right of veto, although restricted to the issues concerning the participation of the Bank in the ESCB as well as the independence of the Governor as a member of the decision-making bodies of the ECB, to which he would inherently belong.

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25 Articles 121.1 and 121.4 of the Treaty.
26 The amendments on independence introduced by Article 1 of Law 5/98 had by then been subsumed within the more significant amendments brought about by Article 2.
27 Comparison is naturally limited to the essential features of these regimes.
28 Article 43.2, as amended by Article 1 of Law 5/98: “The vote in the affirmative of the Governor shall be required for all the decisions taken by the Board of Directors or by Executive Committees, which, in his motivated judgement, may affect either his decision-making autonomy in his position as member of the decision-making bodies of the European Central Bank, or the compliance with the obligations of the Bank as an integral part of the European System of Central Banks”.

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There was general consensus that the independence of NCBs could be jeopardised if the same rules for the security of tenure of office – which Article 14.2 of the Statute only expressly provides for central bank governors – were not also applied to other members of the decision-making bodies of NCBs involved in the performance of ESCB-related tasks.\textsuperscript{29} The Portuguese legislator therefore added two new paragraphs, 4 and 5, to Article 44 of OL-90\textsuperscript{30} to ensure the implementation of this principle. Paragraph 4 is self-explanatory, while paragraph 5 seeks to highlight the fact that, according to the Statute, only the Governor has the right to institute proceedings at the Court of Justice of the European Communities (the vice-governors and other members of the Board shall only have the right to institute proceedings at Portuguese courts, under general terms).

Three new paragraphs, 5, 6 and 7, were added by Law 5/98 to Article 64 of OL-90.\textsuperscript{31} Paragraphs 5 and 6 were justified because, in their absence, the Bank would be subject on the one hand to the financial system governing public administration services and bodies, like any other public body, and, on the other hand, to the control of the Portuguese Court of Auditors. This would hamper its management and, consequently, the successful performance of the Bank’s tasks as an integral part of the ESCB.

A new paragraph, number 2, was also added by Law 5/98 to Article 69 of the OL-90\textsuperscript{32} with the aim of putting an end to an old practice which required the Minister of Finance to sign the Notices of the Bank, since such a practice, in terms of the ESCB-related tasks, was not consistent with the Bank’s independence.\textsuperscript{33}

Turning now to the amendments foreseen by Article 3 of Law 5/98 aiming at the integration of the Bank into the ESCB, the first one worth noting is the rewording of Article 3 of the OL.

In contrast to the text then in force, as amended in 1995\textsuperscript{34}, Law 5/98 redrafted Article 3 of the OL as follows: “(1) The Bank, in its capacity as central bank

\textsuperscript{30} Paragraphs 4 and 5 of Article 44, as amended by Law 5/98: “(4) The Governor and the other members of the Board of Directors may only be relieved from office should any of the circumstances envisaged in Article 14.2 of the Statutes of the European System of Central Banks and of the European Central Bank occur. (5) The Governor may institute proceedings against such a decision, pursuant to the provisions laid down in Article 14.2 of the Statutes of the European System of Central Banks and of the European Central Bank.”

\textsuperscript{31} Paragraphs 5, 6 and 7 of Article 64, as amended by Law 5/98: “(5) The Bank shall not be subject to the financial system governing the autonomous funds and services of the public sector. (6) The Bank shall not be subject to the prior control of the Court of Auditors, nor to its successive control in the issues relating to its participation in the performance of the tasks entrusted to the European System of Central Banks. (7) The provisions of the foregoing paragraph shall be applicable to all Funds operating at the Bank or in whose management the Bank participates.”

\textsuperscript{32} “(2) The Notices of the Bank shall be signed by the Governor and published in Series I, B of the Official Gazette.”

\textsuperscript{33} In broad terms, the “notices” of the Bank are mainly the expression of its regulatory power (pouvoir réglementaire) to produce rules detailing the principles established by the law.

\textsuperscript{34} See supra, 1.2.
of the Portuguese Republic, shall be an integral part of the European System of Central Banks. (2) The Bank shall pursue the objectives and shall participate in the fulfilment of the tasks entrusted to the ESCB, pursuant to the provisions laid down in the Treaty establishing the European Community and in the statutes of the European System of Central Banks and of the European Central Bank.”

The reasons behind this amendment are certainly worth elucidating. The Portuguese legislative bodies were confronted with an apparent contradiction between the Treaty provisions and the provisions of the Statute as regards the degree of involvement in the objectives and tasks of the ESCB by the NCBs of the Member States that would not adopt the single currency from the start of the third stage (non-participating NCBs).

Resorting to a virtually identical wording, the objectives of the ESCB are defined in Article 105.1 of the Treaty and in Article 2 of the Statute, while its basic tasks are defined in Article 105.2 of the Treaty and in Article 3 of the Statute.

Article 122.3 of the Treaty states that Articles 105.1 and 105.2 would not apply to any Member States not joining the single currency from the start of the third stage, which leads to the assumption that the non-participating NCBs would neither be involved in the objectives nor in the tasks of the ESCB.

However, Article 43 of the Statute, which develops Article 122.3 of the Treaty, confirms the non-applicability of Article 3 (tasks) of this Statute, although not of Article 2 (objectives) of the same Statute. This indicates that, after all, the non-participating NCBs share the pursuance of the ESCB’s objectives, although they do not take part in the fulfilment of its tasks.

This contradiction, which resulted from the literal meaning conveyed by the texts, had to be solved by resorting to established techniques for interpreting the law. Along this line, the interpreter verified that the ESCB would be composed of all the NCBs, with no exception (Articles 107.1 of the Treaty and Article 1.2 of the Statute). For this reason, non-participating NCBs assist the ECB in the collection of statistical information in order to undertake the tasks of the ESCB (Article 5 of the Statute); they may be prevented from performing functions that interfere with the objectives and tasks of the ESCB (Article 14.4 of the Statute); they are prohibited from granting credit to public sector entities (Article 101 of the Treaty and Article 21 of the Statute); their assets and liabilities that fall within the ESCB are included in the consolidated balance sheet of the ESCB (Article 26.3 of the Statute); they subscribe their part to the capital of the ECB (Articles 28 and 29 of the Statute) and may be forced to pay up a minimal percentage as a contribution to the operational costs of the ECB, even though in principle the need to pay up their subscribed capital is waived as long as their country has a derogation (Article 48 of the Statute)\footnote{This in fact happened through Decision ECB/1998/14 of 1 December 1998, which laid down the measures necessary for the paying-up of the capital of the ECB by the non-participating NCBs (OJ L 110, 28.4.99, p. 33). This Decision was replaced by Decision ECB/2003/19 of 18 December 2003 (OJ L 9, 15.1.2004, p. 31), which, in turn, has itself been repealed and replaced by Decision ECB/2004/10 of 23 April 2004 (OJ L 205, 9.6.2004, p. 19).}; and the
respective governors are members (Article 45.2 of the Statute) of the General Council of the ECB, which is one of its decision-making bodies (Article 45.1 of the same Statute).

However, the non-participating NCBs retain their powers in the field of monetary policy according to national law (Article 43.2 of the Statute) and, namely, are not subject to the guidelines and instructions of the ECB (Articles 12.1 and 14.3 of the Statute of the ESCB, which do not apply to them pursuant to Article 43.1 of the Statute).

Based on the above, and also taking into account the fact that the provisions of the Statute as laid down in a Protocol annexed to the Treaty have the same legal force as this one, the Portuguese legislator concluded that Article 122.3 of the Treaty should be interpreted in light of the provisions of Article 43 of the Statute, which means that the non-participating NCBs also pursue the objectives of the ESCB and, albeit on a more limited basis, also take part in the performance of its tasks.

It may appear somewhat surprising that the enforcement of this new wording of Article 3 of the OL was proposed to become effective on 1 January 1999, although the ESCB and the ECB were to be established earlier, in accordance with Article 123.1 of the Treaty. This was on the one hand due to the fact that a different solution would have lead to a higher degree of complexity, in terms of transitory law. On the other hand, it was also felt that during such an interim period, the direct applicability of the relevant Articles of the Treaty and of the Statute would suffice to remove any doubts not only with regard to the participation of the Bank in the composition of the ESCB, but also as to the terms and conditions under which such participation should take place.

3.2.1.6
According to Article 19.1 of the OL, the Bank should “ensure the centralisation and compilation of the monetary, financial, foreign exchange and balance-of-payments statistics”. In order to reinforce the integration of the Bank into the ESCB, Article 19.1 was reworded by Law 5/98 as follows: “(1) The Bank shall ensure the collection and compilation of the monetary, financial, foreign exchange and balance of payments statistics, particularly within the scope of its cooperation with the European Central Bank”.

3.2.1.7
A new sub-paragraph a) was added to Article 39.1 of the OL, stating that it would be incumbent upon the Governor “to carry out the tasks of member of the General Council of the European Central Bank, pursuant to the provisions laid down in the Treaty establishing the European Community and in the Statute of the European System of Central Banks and of the European Central Bank”.

The reason for this amendment was that the function of member of the General Council of the ECB would not be performed on behalf of the Bank, in contradiction to what was prescribed in the subsequent two sub-paragraphs b)
and c) of the same Article.\textsuperscript{36} In fact, while the governors that compose the Council of the EMI were considered as “representatives of their institutions”, and the prohibition of instructions only covered “the Council of the EMI” (Article 8 of the EMI Statute), the situation is completely different in the third stage of EMU, as regards both the decision-making bodies of the ECB (one of which is the General Council, as laid down in Article 45.1 of the Statute) and the decision-making bodies of the NCBs: in the ECB, the aforementioned representation ceases and the prohibition of instructions include the “ECB, the NCBs or any member of their decision-making bodies” (Article 108 of the Treaty and Article 7 of the Statute).

\textbf{3.2.2 PROVISIONS FOR THE HYPOTHESIS THAT PORTUGAL WOULD ADOPT THE SINGLE CURRENCY ON 1 JANUARY 1999: ARTICLE 2}

For the hypothesis whereby Portugal would not adopt the single currency on 1 January 1999, Articles 1 and 3 of Law 5/98 merely introduced some adjustments in OL-90. But for the hypothesis that Portugal would adopt the single currency on 1 January 1999, the entirely reformed OL foreseen in Article 2 of Law 5/98 incorporated fundamental amendments to the same OL-90. Some examples that illustrate these amendments are provided below.

\textbf{3.2.2.1}

While, in the first hypothesis described above, Article 3.2 of the OL stated that “the Bank shall pursue the objectives and shall participate in the fulfilment of the tasks entrusted to the ESCB, pursuant to the provisions laid down in the Treaty establishing the European Community and in the statutes of the European System of Central Banks and of the European Central Bank”, for the second hypothesis it was added that, besides the above, the Bank “shall be subject to the provisions of the Statute of the ESCB and of the European Central Bank, acting in accordance with the guidelines and instructions of the European Central Bank pursuant to the same Statute.”

\textbf{3.2.2.2}

While, in the first hypothesis, Article 43.2 referred to the Governor as a member of “the decision-making bodies of the European Central Bank”\textsuperscript{37}, the equivalent Article 32.2 of the reformed OL mentions, more precisely, the Governor as a member of “the Governing Council and of the General Council of the ECB”.

\textbf{3.2.2.3}

The same applies to the competence of the Governor: while in the first hypothesis the new sub-paragraph a) added to Article 39.1 mentioned the Governor as a member of “the General Council” of the ECB\textsuperscript{38}, the corresponding Article 28.1 (a) mentions him/her as a member of “the Governing Council and of the General Council”.

\textsuperscript{36} Article 39.1 (b) of the OL: “To represent the Bank”; Article 39.1 (c) of the OL: “To act on behalf of the Bank with foreign or international institutions”.

\textsuperscript{37} See \textit{supra}, 3.2.1.1, 2nd paragraph.

\textsuperscript{38} See \textit{supra}, 3.2.1.7.
3.2.2.4

In the same vein, only on the assumption that Portugal would adopt the single currency was it possible to introduce in the OL, via Article 2 of Law 5/98, some other fundamental changes, namely the deletion of the provisions related to banknotes denominated in escudo; the deletion of references to the “currency issue of the bank and other sight escudo liabilities”; the deletion of the reference to the powers of the Bank to conduct monetary policy (which contradicted the provisions of Article 105.2 of the Treaty and of Articles 3.1, 12.1, 14.3, 18.2, 19.1 and 20 of the Statute)39; the deletion of the reference to the powers of the Bank not only to “cooperate in the formulation of the foreign exchange policy” but also to “implement such policy” (since, according to Article 4.2 of the Treaty, the Community has a single exchange rate policy whose types of definition and implementation as well as the sharing of responsibilities between the ECOFIN Council and the ECB are set forth in Article 111); the deletion of the reference to the powers of the Bank to determine the composition and the requirements of minimum reserves imposed on credit institutions (which was inconsistent with Article 19 of the Statute); and, finally, the specification, in the indicative list of operations available for monetary policy and foreign exchange purposes, that such operations are carried out “in order to meet the objectives and to perform the tasks of the ESCB”.

39 The participation of the Banco de Portugal in this area is at any rate subject to the general provisions of the new Article 3.2 (see supra, 3.2.1.1).
INTRODUCTION

Under Article 109 of the Treaty establishing the European Community (Treaty)\(^1\) each Member State of the European Community has a duty to ensure that its national legislation, including the articles of association of its national central bank, is, by the date of establishment of the European System of Central Banks (ESCB) at the latest, compatible with the Treaty and the Statute of the European System of Central Banks and of the European Central Bank (Statute of the ESCB). This was a direct instruction to revise the *Bankwet* (Bank Act) of 1948, the organic Act which laid down the duties, objectives, instruments and institutional provisions governing De Nederlandsche Bank N.V. before it was replaced by the current act, the 1998 Bank Act.\(^2\) This article examines, against a historical background, in what ways the organic Act governing De Nederlandsche Bank N.V. (the Bank) differs, in its current form, from its predecessors.

The requirement that national legislation be compatible with the Treaty is one of the provisions ensuring that the ESCB is able to conduct a uniform monetary policy. Were the laws, rules and regulations in force in the Member States to differ, implementation of the policy set by the European Central Bank (ECB) would be impossible or, at any rate, inadequate. Bringing national legislation into line with the Treaty requirements relating to Economic and Monetary Union (EMU) – in particular with the laws governing the powers of the national central banks – was thus of considerable importance. This is also evident from the fact that upon transition to Stage Three of EMU it was necessary to ascertain to what extent the Member States satisfied this legal criterion.\(^3\)

The establishment of EMU was agreed upon in the Treaty on European Union\(^4\), also known as the Treaty of Maastricht, the place where the Treaty was signed at the end of 1991.\(^5\) The Treaty of Maastricht amended the Treaty and provided that EMU should take place in three stages. The first stage, lasting from 1989 to 1994, was geared towards further coordination of economic and monetary policy. The second stage began with the establishment of the European Monetary Institute (EMI) on 1 January 1994 and was marked by further convergence of the economic and monetary policies of the Member States and preparations for the introduction of the euro. Stage Three, which began on 1 January 1999, is marked by the advent of Monetary Union among the participating Member States.\(^6\)

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1 Upon entry into effect of the Treaty of Amsterdam on 1 May 1999 the articles were renumbered; this was previously Article 108 of the Treaty. The Treaty of Amsterdam (OJ, 1997, C 340) was approved for the whole of the Kingdom of the Netherlands by way of the *Goedkeuringswet* (Act of Ratification) of 14 December 1998; (*Staatsblad* (Bulletin of Acts, Orders and Decrees) 1998, 737).

2 The *Bankwet* 1998 (1998 Bank Act), the *Statuten van De Nederlandsche Bank N.V.* (Articles of Association of De Nederlandsche Bank N.V.), and the Statute of the ESCB can be found on the Bank’s website at www.dnb.nl. The ECB’s website contains, inter alia, the Statute of the ESCB and the ECB’s legal instruments.

3 This obligation is laid down in Article 121 (1), (2) and (3) of the Treaty. It also applies to Member States which join at a later stage (see Article 122 (2) of the Treaty).


The transition to Stage Three of EMU was about implementing the monetary provisions of the Treaty; the economic leg of EMU had largely been implemented at the beginning of the second stage. The monetary provisions are geared towards the needs of the Community as a whole and not specifically to those of an individual Member State. The requirement of compatibility between national legislation and the Treaty was one of the reasons for completely revising the 1948 Bank Act. In the process of modifying the 1948 Bank Act, the starting point was to identify which of its provisions were in conflict with the Treaty and the Statute of the ESCB. Such provisions had to be either amended or repealed. Thereafter it was ascertained which provisions would have to be introduced as a consequence of the fact that the Bank was to be an integral part of the ESCB and would have to operate in line with the guidelines and instructions of the ECB. This not only meant having to introduce a number of new provisions; it was also decided that the Act’s provisions, structure and terminology should, as far as possible, be brought into line with those of the Treaty and the Statute of the ESCB, in order to ensure that there would be as few differences as possible with the agreed Community provisions. In addition, the revision of the 1948 Bank Act was used as an opportunity to adapt the Bank’s non-monetary duties to the requirements of the times, with the consequence that some of the provisions of the Bank Act disappeared altogether, while others were re-written. The break with history is considerable – much greater than in the case of previous revisions of the Bank Act.

**HISTORICAL BACKGROUND**

A large number of articles contained in the 1948 Bank Act have their origin in other bank acts, i.e. those of 1937, 1918, 1903, 1888 and 1863; some even go back to the Bank’s first Octrooi (Letter Patent) of 1814. This Letter Patent relates to the Koninklijk Besluit (Royal Decree) of 25 March 1814 whereby the Bank was established and, for a period of 25 years, licensed to carry out “only those activities conferred upon it”. Thus the Letter Patent of 1814 encapsulates three principles which can also be found in the 1948 Bank Act:

- the Bank was to limit itself to banking activities; trading in goods was forbidden, with the exception of trading in coin material;
- the Bank could perform only those banking activities detailed in the Letter Patent;
- the issuing of unsecured credit was expressly forbidden.

The first and the third of these principles can also be found in the 1998 Bank Act (Section 8); they stem not so much from the Dutch tradition, but rather from the fact that the Statute of the ESCB contains corresponding provisions. The principle that the Bank can perform only those banking activities expressly stipulated in the Bank Act – such as those transactions described in Section 15

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7 See Article 14.3 of the Statute of the ESCB.
8 Article 18 of the Statute of the ESCB.
of the 1948 Bank Act – was, in conformity with Article 18 of the Statute of the ECSC, abandoned. These amendments are already an indication of the extent of the break with the past. The break is also evident from the absence of provisions which are contained in the 1948 Bank Act and can be traced back to the 1863 Bank Act, such as the provision of cashier services to the State free of charge, the power to invest its capital and reserves, the publication of a summary balance sheet and the dropping of the function of Secretary on the Bank’s Governing Board. Section 10 of the 1948 Bank Act provides that the Bank is authorised, to the exclusion of any other party, to issue banknotes. This article, too, has its origin in the 1863 Bank Act, Section 1 of which provides that:

No bank of issue can be established and no foreign bank of issue can put its banknotes into circulation in this country other than by virtue of a special law and on the basis, and pursuant to the provisions, of such a law.

The article likewise provides that “Bank of issue refers to any institution whose purpose is to issue banknotes or put them into circulation”. In addition, Section 2 of the 1863 Bank Act grants the Bank the right to act as a bank of issue for a period of 25 years after the expiration of the existing Letter Patent. As a result, in successive Bank Acts up to that of 1948 the Bank was continually granted a licence to act as a bank of issue for a specific period of time. This Letter Patent was not granted to other financial institutions, meaning, de facto, that up to the entry into effect of the 1948 Bank Act the Bank had the exclusive right to issue banknotes. The licence construct was abandoned in the 1948 Bank Act, by way of which the Bank was granted the sole right to issue banknotes for an unlimited period. Under Section 6 of the 1998 Bank Act the Bank is also authorised to issue banknotes. However, the Bank’s right to do so is no longer exclusive; under Article 106 (1) of the Treaty and Article 16 of the Statute of the ESCB both the ECB and the national central banks have the right to issue banknotes as from the beginning of Stage Three of Economic and Monetary Union. This means, on the one hand, that alongside the banknotes issued by the Bank, banknotes issued by other central banks can circulate in the Netherlands, and, on the other, that the banknotes issued by the Bank can enter circulation throughout the euro area. Thus, the break with tradition is evident here too. On the other hand, an old tradition is maintained: the legal form of the Bank remains that of a naamloze vennootschap (public limited liability company), and the Governing Board and the Supervisory Board remain the Bank’s most important bodies.

However, the activities which the bank may carry out are clearly demarcated: only such activities as are necessary in order to carry out the tasks conferred upon it (Section 5) or those conferred upon it by Royal Decree (Section 9 c).

Section 19 (2), 1948 Bank Act.

Section 18, 1948 Bank Act.

Section 35, 1948 Bank Act.

Article 106 should be read in conjunction with Article 116 (3) and Article 122 (3) of the Treaty and Protocol No. 11 on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland. From this it emerges that the Treaty article relating to the issuing of banknotes is not applicable to Member States which have not yet adopted the euro, to Member States with a derogation and to the United Kingdom for as long as it makes use of its opt-out right. Thus, in the context of EMU, the term “Community” refers to the Member States belonging to the euro area.
The substantial nature of the revision of the Bank Act is evident from the new form of the “Gemeenschapseenlement” (public welfare component)\textsuperscript{14} in the Bank Act of 1998. From time immemorial there had always been a Royal Commissioner who was responsible for supervising the Bank’s activities.\textsuperscript{15} During discussions on the draft 1937 Bank Act in the Tweede Kamer (Lower House), various Members expressed the view that the relationship between the Government and the bank of issue was in need of revision. While not wishing to turn the Bank into a state bank, they were keen to ensure that its policies be geared towards promoting the public welfare. In their view the Bank should not only direct its own activities towards this objective, but also ensure that functions of the private banking sector be performed in a manner which best served the welfare of Dutch society. The State was to ensure that the Bank performed these duties properly and, if necessary, should issue an instruction to the Bank to act accordingly. Within the same framework the issue was raised of whether it would be appropriate and desirable for the Bank to conduct an active economic policy under the influence and supervision of the Government.\textsuperscript{16} Ultimately, however, this line of thinking did not find expression in the 1937 Bank Act. Only after World War Two was a process embarked upon of strengthening the Bank’s public welfare component alongside the function of the Royal Commissioner who supervised the Bank’s activities on behalf of government. An important reason for this was that the Bank’s monetary policy under the gold standard was more or less automatic in nature. Following the abandonment of the gold parity in 1936, it was repeatedly necessary to give substance to monetary policy, as the Bank’s room for manoeuvre had increased. The then Dutch Minster of Finance, Pieter Lieftinck, remarked that:

Before the war, under the system of the international gold standard, the Bank’s policy was to a large extent mechanical in character. The maintenance of the existing gold parity of the currency unit was the guiding objective, and monetary policy was subordinate to this objective, irrespective of the economic consequences. In the thirties we had learned what the consequences of such a policy can be. When the gold standard was abandoned the era of managed currencies began. The central bank faced a new task. I was of the opinion that its position and powers had to be brought into line therewith.\textsuperscript{17}

This occurred, in the first instance, by way of the Royal Decree of 1 October 1945\textsuperscript{18}, which not only stated that the 1937 Bank Act, which had been abrogated by the occupying powers, was once again declared effective, but also that, inter alia, the appointment of members of the Governing Board by the shareholders was to be subject to the approval of the government, that a Bankraad (Bank

\begin{footnotesize}
\begin{itemize}
\item[14] This is the term used historically in the Netherlands as a way of referring to the public element in the workings of the Bank. It should be distinguished from the term “Community element” (capital “C”), a concept referring to the European Community.
\item[15] First introduced in the 1863 Bank Act, Section 20.
\item[18] Bulletin of Acts, Orders and Decrees F204.
\end{itemize}
\end{footnotesize}
Council) – an advisory body for the Minister of Finance and for the Bank’s Governing Board – was to be established, and that the Minister of Finance could issue instructions to the Governing Board.

These public welfare components ultimately appeared, in somewhat modified form, in the 1948 Bank Act. In addition, in order to strengthen the Bank’s public welfare component, all shares were transferred to state ownership by way of the Naastingswet (Nationalisation Act) of 23 April 1948, which entered into effect on 15 May 1948. Private shareholders affected by the nationalisation process were compensated. Such compensation took the form of issuing those shareholders who surrendered their shares to the Bank with a declaration on the basis of which they could, per share of 1,000 guilders in the Bank, receive an entry of a nominal amount of 2,000 guilders in the national debt register, yielding interest at a rate of 2.5%. The last private shares were surrendered to the Bank in 1958. The Bank remained a vennootschap (public limited liability company), as this legal form guarantees independence and because there are a number of administrative advantages associated with such a form as compared with that of a public institution. For example, in the case of a public institution, by contrast with a public limited liability company, business is conducted solely through the budget. Moreover, Finance Minister Lieftinck considered it necessary to deviate from previous Bank Acts by incorporating a general description of an issuing bank’s duties in Section 9. Under Section 9 (1) of the 1948 Bank Act the Bank had:

... the duty to regulate the value of the Netherlands’ monetary unit in such a manner as will be most conducive to the nation’s prosperity and welfare, and in so doing to keep the value as stable as possible.

Thus it was established that the Bank’s (monetary) policy was to be geared to the public interest, i.e. to promoting the welfare of the Dutch state. In the Memorie van Toelichting (Explanatory Memorandum) to the Bill the Minister of Finance made it clear that the direction of monetary policy was to be determined by the Government. Accordingly, under Section 26 the Minister of Finance was granted the power to issue binding instructions with regard to the Bank’s monetary policy, where necessary. The final part of Section 9 (1), added during the reading in the Lower House by way of an amendment proposed by Member E. Sassen, provides that the country’s welfare is served by stabilising the value of the guilder to the greatest extent possible. This addition was striking in that it gave the Bank’s monetary policy a direction at a time when views on the issue still differed widely. Some expressed a preference for price stability, others for smoothing cyclical fluctuations, for pursuing a neutral monetary policy.

19 Wet op de naasting der aandelen in De Nederlandsche Bank N.V. (Act on the nationalisation of shares in De Nederlandsche Bank N.V.), (Bulletin of Acts, Orders and Decrees I 165).
20 By virtue of Section 2 of the Nationalisation Act and the enactment decree of 12 July 1948 (Bulletin of Acts, Orders and Decrees I 290).
21 Sections 3, 4 and 5 of the Nationalisation Act.
or for supporting an employment policy. Ultimately the addition proved to be a very propitious one; in the 1970s and 80s the pursuit of price stability became the prevailing doctrine for central banks. In the case of the ESCB this objective is laid down in the Treaty.

The public welfare elements laid down in the 1948 Bank Act were in part revised in the 1998 Bank. All shares remain – in conformity with the Nationalisation Act – in the hands of the State, and the President and Executive Directors of the Governing Board are appointed by the Government. The Bank Council also remains as an advisory body under the 1998 Bank Act, albeit in a modified composition and size. On account of the independence required by the Treaty, the Minister of Finance’s right to issue instructions, as laid down in Section 26 of the 1948 Bank Act, has expired, as has government supervision of the Bank’s activities by a Royal Commissioner. There is a weak allusion to the Royal Commissioner in Section 13 (2), in conjunction with Section 14, in the form of a Government-appointed Supervisor who is to provide the Minister of Finance with all information deemed necessary. In addition, the 1998 Bank Act also makes reference to a public welfare element. However, this no longer relates to the welfare of the country, but rather – as a result of the transfer of monetary policy to the European level – to that of the European Community; the Bank supports, without prejudice to the objective of price stability, the general economic policies in the European Community. In this context, the President of the ECB regularly appears before the European Parliament’s Committee on Economic and Monetary Affairs, where he accounts for the policy pursued by the ECB.

MOST IMPORTANT REVISIONS

DEMOCRATIC ACCOUNTABILITY

From the beginning of Stage Three of EMU, monetary policy (together with the other ESCB tasks) was conducted at the Community, and no longer national, level. For the Netherlands this means that responsibility for monetary policy no longer lies with the Dutch Minister of Finance and, accordingly, that the Minister is no longer accountable to the Dutch Parliament for such policy. Accountability now lies at the European level. The ECB compiles an Annual Report on the activities of the ESCB and on the monetary policy for the previous and current year for the European Parliament, the Council and the Commission, as well as for the European Council. The President of the ECB presents this report to the Council and the European Parliament, which may hold a general debate on the basis of thereof.

24 De Jong, p. 411.
25 Article 105; Article 2 Statute of the ESCB.
29 Article 113 Treaty; Article 15 Statute of the ESCB.
LAPSING OF THE RIGHT TO ISSUE INSTRUCTIONS

The principle that it is the Government of the Netherlands that has the last word on monetary policy in the Netherlands was already incorporated into the Royal Decree of 1 October 1945. Its inclusion in the 1948 Bank Act was justified as follows in the Explanatory Memorandum to the Bill:

In view of the fact that the direction of monetary policy should be determined by the Government, the Minister of Finance must be able to issue binding instructions to the Governing Board of the Bank on matters of principle regarding which the Bank’s policies might conflict with the monetary and financial policies of the Government.\(^\text{30}\)

It is ultimately the Dutch Government’s responsibility to safeguard the general welfare of the country. However, when the draft Act was being read in Parliament, Minister of Finance Lieftinck stated that in normal circumstances the coordination of the policies of the Bank and the Government should take place through regular consultation. The issuing of instructions should be considered an ultimum remedium.\(^\text{31}\) No Minister of Finance has made use of the right to issue instructions laid down in Section 26 (1) of the 1948 Bank Act. This was partly due to the inclusion by Lieftinck of a second sub-section in Section 26, which granted the Bank the right to appeal to the Government against instructions and the option, included in the fourth sub-section of Section 26, of making the instructions public. It is also worth noting here that the third sub-section determined that, contrary to the normal procedure, the Council of State, the highest advisory Government body, had no role to play in such appeals to the Government, the rationale being that the interests of the country would be best served by swift decision-making procedures in such matters. These provisions strengthened the Bank’s position to conduct an independent policy and forced the Minister and the Bank to find an internal solution to possible differences of opinion regarding the monetary policy to be conducted. De facto, therefore, the degree of independence enjoyed by the Bank under the 1948 Bank Act was high.

At the time when the 1948 Bank Act was being drafted, there was no unequivocal view on the monetary policy to be conducted by a central bank. As stated above, there were differing views on whether the aim should be to strive for price stability, to conduct a cyclical or employment policy, or to adopt a neutral policy stance. This was also one of the reasons behind granting the Minister of Finance the right to issue instructions to the Bank; however, charging the Bank with the task, in accordance with the wishes of Parliament, of keeping the value of the monetary unit as stable as possible gave a clear direction to the policy to be conducted by the Bank, thereby reducing the need to issue instructions. Since that period, the views on the monetary policy to be conducted by a central bank

have, however, evolved. Today the prevailing view is that a central bank’s monetary policy should be based on one primary objective. This is the view, developed by monetarists in the 1960s, that central banks must follow a fixed monetary growth rule based on trend growth of real national income. Monetary policy must be based on combating inflation, not on regulating the real economy by means of discreetly dampening cyclical fluctuations. According to these monetarists, the latter, in which the money supply is geared to the economic cycle, will in the longer term lead to greater cyclical fluctuations, as lag factors will cause monetary actions to have procyclical effects. In the mid-1970s several central banks, including the Deutsche Bundesbank, adopted a more or less fixed growth rate for the money supply, which was made public in advance. Through the pegging of the Dutch guilder to the Deutsche Mark in March 1983, Dutch monetary policy was indirectly (i.e. via German monetary policy) geared to a policy of fixed monetary growth up to the third stage of EMU.

Related to this is the preference for a central bank which is independent of the world of politics. When a central bank is in a position to conduct an independent monetary policy, this will ensure that monetary policy is protected from the (short-term) policies of Government. Thus, paradoxically, the responsibility for the common interest, which should, in the first instance, be that of Government, is partly withdrawn from the political domain. The primacy of politics in this area (and thus part of the democratic control exercised by Parliament) makes way for the advantages of an independent central bank. The solid reputation of a number of independent central banks (in particular the Deutsche Bundesbank) in the area of combating inflation has strongly contributed to acceptance of this view – a view which has had a great influence on the formulation of the Statute of the ECB and the national central banks participating in the ESCB.

As a result of the requirement for monetary policy to be independent, as laid down in the Treaty and the Statute of the ESCB, the Minister of Finance’s right to issue instructions under the Bank Act 1948 was not incorporated into the 1998 Bank Act. In this respect, the legal situation is thus the same as that prevailing at the time of the 1937 Bank Act. However, the actual situation has always, even under the 1948 Bank Act, been one in which the Bank has had a high degree of independence. As noted above, the Minister of Finance never made use of the right to issue instructions and the Bank has been able to conduct a completely independent monetary policy on the basis of its authority, in good cooperation with the Minister of Finance and within the broad frameworks established by the political domain. Even under the 1948 Bank Act the Bank enjoyed the reputation of being an independent central bank. Thus, the amendment introduced by the 1998 Bank Act is, in fact, smaller than it may seem in legal terms. The amendment is smaller than the above suggests in another respect too: although the Bank’s independence vis-à-vis the Minister of Finance may indeed

33 The Royal Decree of 1 October 1945 (Bulletin of Acts, Orders and Decrees F 204) already contained, before the 1948 Bank Act, the Minister of Finance’s power to issue instructions to the Bank.
have increased, this is balanced by the fact that the Bank is now obliged to follow the instructions issued by the ECB. 34

EXPIRATION OF THE OFFICE OF ROYAL COMMISSIONER

When extending the Letter Patent of 1838 the Government intended to institute a Royal Commissioner, but in the end it refrained from doing so as a result of the Bank’s resistance. Under the 1863 Bank Act, however, this wish on the part of Government was finally fulfilled. The institution of a Royal Commissioner was based on the rationale that the interests of the State and its citizens were greatly affected by the actions of the Bank and that the State had also entrusted the Bank with considerable financial interests. 35 Article 30 (1) of the 1948 Bank Act stated that the Royal Commissioner should supervise the Bank’s actions on behalf of Government. In addition, the article stipulated that the Royal Commissioner could attend the meetings of the Bank’s governing bodies and that he would be provided, by the Governing Board, with all information which he deemed necessary in order to adequately conduct his supervision. This extension of the powers of the Royal Commissioner was laid down by Royal Decree. 36 In addition to supervision of the Bank’s actions, Section 31 of the 1948 Bank Act also provided for the Royal Commissioner to supervise the Bank’s financial management.

The Royal Commissioner was no longer included in the 1998 Bank Act. A continuation of the Royal Commissioner’s right to supervise the Bank’s actions and financial management would have been incompatible with the requirement of independence laid down in Article 108 of the Treaty (Article 7 of the Statute of the ESCB). Government supervision of the Bank’s actions has been abandoned, while supervision of the Bank’s financial management under the 1998 Bank Act is, in accordance with company law, conducted by the Supervisory Board. Instead of the Royal Commissioner, there is now a Government-appointed member of the Supervisory Board. 37 In addition to the duties ensuing from his membership of the Supervisory Board, this Supervisor has a trait d’union function between Government and the Bank. 38 As can be seen from the extended powers of the Royal Commissioner, the latter’s duties also consisted largely of a trait d’union function: he acted as the “eyes and ears” of the Minister of Finance by informing the latter of the Bank’s actions and policies. Within the confines set by the Treaty, this function has been taken over by the Government-appointed member of the Supervisory Board.

INTEGRATION INTO THE ESCB

One of the most important changes compared with the 1948 Bank Act is that in the 1998 Bank Act the Bank’s objectives, tasks and activities are completely

34 See Section 3 (3) of the 1998 Bank Act.
36 Royal Decree of 27 October 1972, No. 82.
37 Section 13 (2) of the 1998 Bank Act.
38 Section 14 of the 1998 Bank Act.
modelled in accordance with the objectives, tasks and activities of the ESCB, and that the Bank’s rights and duties are formulated in such a way that the Bank is fully integrated into the European System of Central Banks. The Bank’s tasks are no longer exclusively national, but also European, insofar as they coincide with those of the ESCB. The European dimension is evident from several sections of the 1998 Bank Act. Section 1 (2) provides for the Bank to be an integral part of the European System of Central Banks as regards the tasks and duties conferred upon the ESCB under the Treaty. Section 2 (2) subsequently makes clear that the Bank, without prejudice to the objective of price stability, supports the general economic policies in the European Community. The European dimension is also apparent from the tasks assigned to the Bank in Section 3, which reflect the tasks of the ESCB, and from the provision included in this Section that, in implementing the Treaty, the Bank may seek and take instructions exclusively from the ECB. Finally, this European dimension is also clear from Section 12 (4), which states that, with a view to achieving the objective of maintaining price stability, the Governing Board shall respect the President’s position as a member of both the Governing Council and General Council of the ECB.

MODERNISATION

The revision of the 1948 Bank Act, which had become necessary in order to bring the Act into line with the Treaty, was used to adapt the Bank’s non-monetary tasks to the new requirements of the time. First, it was ascertained which provisions on the tasks and powers were still appropriate; outdated provisions were taken out. Subsequently, it was decided which provisions belonged in the Act and which provisions should be more appropriately included in either the Bank’s corporate Articles of Association or a ministerial regulation.

The Explanatory Memorandum provides two examples to illustrate the modernisation of the Bank Act. Articles 11 to 14 of the 1948 Bank Act dealt with the exchange, form, compensation and recall for exchange of banknotes issued by the Bank. In the 1998 Bank Act it was decided, on the basis of Section 27 (3), that these provisions should be laid down in a general administrative order. This decision was made because this concerned operational activities in respect of which it was important that the relevant rules may, if necessary, be amended through a simplified procedure. The rules issued applied to banknotes denominated in guilders. Upon the introduction of the euro banknotes and coins, this Royal Decree was amended, as was Section 27 of the 1998 Bank Act. The amendment is introduced on the basis of Section 27 (4) of the 1998 Bank Act, which states that the section or part thereof shall cease to have effect on a date to be determined by Royal Decree. In connection with the introduction of the euro banknotes and coins, the first sub-section of Section 27, which states that banknotes issued by the Bank denominated in guilders shall be legal tender, was amended.

The second example refers to the activities that the Bank was allowed to conduct to implement its tasks. Section 15 of the 1948 Bank Act included an exhaustive

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40 Royal Decree of 27 July 1998 concerning the institution of rules in relation to the exchange, withdrawal from circulation and signing of banknotes by De Nederlandsche Bank N.V. and to the information to be provided to the public in this respect (Bulletin of Acts, Orders and Decrees 519).
41 The amendment is introduced on the basis of Section 27 (4) of the 1998 Bank Act, which states that the section or part thereof shall cease to have effect on a date to be determined by Royal Decree. In connection with the introduction of the euro banknotes and coins, the first sub-section of Section 27, which states that banknotes issued by the Bank denominated in guilders shall be legal tender, was amended.
list of the activities which the Bank was allowed to conduct. Under the 1948 Bank Act, the greatly outdated provisions were interpreted as broadly as possible in order to allow the Bank to conduct those activities that were expected of a central bank at the time in question. Thus, it was concluded in the past that the Bank would be allowed to participate in bridging loans provided to countries by the Bank of International Settlements (BIS), in anticipation of a promised loan from the International Monetary Fund (IMF) or the World Bank.\footnote{The Bank’s participation in such loans boils down to the Bank concluding a so-called “substition agreement” with the BIS, whereby the Bank, at the request of the BIS, enters into the BIS’s obligations. This is basically a guarantee by the Bank to the BIS, authorised on the basis of Article 15 (6) of the 1948 Bank Act.} In addition, in the mid-1980s it was judged that the Bank would be allowed to accept “certificates of deposit” (CDs) en “commercial paper” (CP) as collateral.\footnote{It was concluded that these instruments should be considered promissory notes to the bearer, which the Bank was permitted to accept as collateral on the basis of Article 15, (3) and (6) of the 1948 Bank Act.} In the 1998 Bank Act this provision was replaced by one which granted the Bank broad powers to conduct transactions in the financial markets.\footnote{Section 8 (1) of the 1998 Bank Act.} This provision, stripped of outdated concepts, was formulated in an open (non-exhaustive) way and was derived from Article 18 of the Statute of the ESCB.

A final example refers to activities, not specified in the Bank Act itself, conducted by the Bank pursuant to Royal Decrees issued on the basis of Section 21 of the 1948 Bank Act. It was ascertained for which of these activities under the 1998 Bank Act a separate Royal Decree was still necessary. A number of these decrees were repealed because they were outdated or because the activities in question were carried out in accordance with the 1998 Bank Act or the Treaty. The activities assigned to the Bank by Royal Decree under the 1998 Bank Act have a dual legal basis. This is due to the strict distinction between tasks and activities under the new Act. Thus, under Section 4 (4), it is permitted, by Royal Decree, to conduct other tasks and, under Section 9, sub-section c, to perform other activities.

**STRUCTURE OF THE 1998 BANK ACT**

**CONTENTS OF THE ACT**

The 1998 Bank Act consists of various chapters dealing with the following subjects: Chapter I: Definitions; Chapter II: Objectives, tasks and activities of the Bank; Chapter III: Provisions on the management of the company; Chapter IV: Information and confidentiality; Chapter V: Amendment of other acts; and Chapter VI: Transitional and final provisions.\footnote{By the Act of 11 November 1999, amending the 1998 Bank Act (Bulletin of Acts, Orders and Decrees, p. 507), Chapters VII and VIII were renumbered Chapters V and VI.}

**TERMINOLOGY AND STRUCTURE**

The 1998 Bank Act refers to objectives, tasks and activities, in accordance with the subdivision in the Treaty and the Statute of the ESCB. The 1948 Bank Act
referred only to *activities* and *tasks*, where the concept of *activities* was broadly defined and comprised both tasks and activities that the Bank was legally entitled to undertake. The 1948 Bank Act did not contain the concept of *objective*. The objectives of the Bank under this Act and also under earlier Bank Acts were implicit in the tasks assigned to the Bank. In line with the Treaty and the Statute of the ESCB, the interrelationship between the three above-mentioned concepts is as follows in the 1998 Bank Act: the Bank uses the activities which it is entitled to undertake to perform a task aimed at achieving an objective.46

As indicated above, the Bank is integrated in the ESCB under the 1998 Bank Act. Accordingly, it contributes to a number of tasks and activities assigned to the ESCB. When reference is made to ESCB activities, this is indicated in the text of the Act with the words: “*In implementation of the Treaty*”. However, in addition to the tasks and activities that arise from its integration into the ESCB, the Bank also performs activities that ensue from the national tasks assigned to it. A clear distinction is made in the Bank Act between ESCB and non-ESCB activities. This distinction comes to the fore in Sections 2, 3 and 4. As with ESCB activities, the 1998 Bank Act subdivides non-ESCB activities into *objectives*, *tasks* and *activities*. In Section 2, the first two sub-sections set out the ESCB objectives, while sub-section 4 sets out the non-ESCB objective. Section 3 specifies the ESCB tasks and Section 4 the non-ESCB tasks. From the structure of the Act it follows that the objectives aimed at achieving ESCB tasks and objectives (the monetary objectives) and the non-ESCB objectives (the non-monetary objectives) are on a par: the first objectives are of the same order as the last objective, which ensures that when the Bank performs a task related to a particular objective, this task is not subordinate to a task performed under another objective. This is also reflected in Section 1 (2), which stipulates that, in implementation of the Treaty, the Bank’s *objective* is to maintain price stability, whereas in the Treaty (Article 105(1)) reference is made to *primary objective*. The Treaty thus indicates that maintaining price stability is the main objective of the ESCB. Were this terminology to have been adopted in the 1998 Bank Act, however, this would have meant subordinating the non-ESCB objective to the maintenance of price stability. It should be borne in mind, however, that the national central banks of the euro area can only perform other functions if these do not interfere with the objectives and tasks of the ESCB (including the primary objective of price stability).47 Thus, despite the fact that in the 1998 Bank Act the ESCB and non-ESCB activities are on a par, the latter activities must never interfere with the objective of price stability.

**TRANSITIONAL PROVISIONS**

Until the start of Stage Three of EMU, monetary policy was a national prerogative. Pursuant to Article 109 of the Treaty, however, each Member State had to ensure that, at the latest by the date of the establishment of the ESCB, its national legislation, including the statute of its national central bank, was

47 Article 14.4 of the Statute of the ESCB.
compatible with the Treaty and the Statute of the ESCB. This Treaty obligation aimed to ensure that all central banks would be independent by the time the ESCB was established.\(^4\) Its purpose was to create the necessary distance between the ESCB and the political domain in the important preparatory phase leading up to the transfer of monetary policy authority to the European level. That is why the 1998 Bank Act had to contain at least two transitional regimes: a regime applicable as from the establishment of the ESCB until the Netherlands’ accession to Monetary Union (the Bank is independent and monetary policy is a Dutch prerogative) and a regime applicable as from the moment of the Netherlands’ accession to Monetary Union (the Bank is independent and monetary policy is a prerogative of the ESCB). In addition, the 1998 Bank Act provides for a third regime, whereby the possibility is taken into account that the 1998 Bank Act would come into force prior to the establishment of the ESCB (the Minister of Finance can give the Bank instructions and monetary policy is a Dutch prerogative). The latter regime has never applied, because the 1998 Bank Act came into force simultaneously with the establishment of the ESCB.

**CONCLUSION**

The organic Act of the Nederlandsche Bank has been amended many times in the past two centuries, albeit that such amendments to the Act always followed in the footsteps of earlier Acts. The 1998 Bank Act, however, follows a completely new pattern: this time not a Dutch, but a European one. It is for this reason that the 1998 Bank Act in many ways constitutes a significant break with the past.

\(^4\) On the basis of Protocol No. 11 (Article 5), the United Kingdom was exempted from this obligation.
FINANCIAL LAW
TAX BARRIERS ON THE WAY TOWARDS AN INTEGRATED EUROPEAN CAPITAL MARKET: THE EU SAVINGS DIRECTIVE AS A CHALLENGE FOR CLEARING AND SETTLEMENT SYSTEMS

Joseph De Wolf

ABSTRACT

La creazione di un mercato finanziario europeo integrato, efficiente, liquido e sicuro è uno dei programmi più ambiziosi della UE. Tuttavia, i trasferimenti internazionali di titoli incontrano una così ampia divergenza di trattamento fiscale in seno alla UE, e in pratica le questioni di tipo fiscale rimangono un ostacolo reale alle transazioni internazionali ed allo sviluppo di un mercato finanziario europeo. Il Rapporto Giovannini ha già evidenziato le principali barriere fiscali esistenti.

Il contributo riflette sull’impatto della Direttiva UE sul Risparmio sulle barriere fiscali esistenti. Se, da un lato, la procedura adottata di scambio di informazioni può considerarsi un approccio positivo per il reddito riveniente dai conti di deposito presso gli istituti di credito, dall’altro, l’autore si chiede se non sia più adeguato un approccio diverso per i proventi da titoli a reddito fisso, negoziabili sui mercati mobiliari.

In particolare, l’organizzazione di un meccanismo di ritenuta fiscale a livello delle infrastrutture di compensazione e regolamento tramite meccanismi come quello belga X/N potrebbe aver incrementato i proventi fiscali degli Stati membri, dirottato l’importante onere amministrativo della raccolta dei dati su operatori più adeguati, affidato le responsabilità per la raccolta e lo scambio delle informazioni alle autorità competenti e infine essere riuscito pienamente a rispettare la sovranità fiscale degli Stati membri.
A BRIEF OVERVIEW OF THE GENERAL DEBATE

The Commission’s Communication on clearing and settlement\(^1\) to the Council and the European Parliament calls the creation of an integrated and efficient European capital market the most important and ambitious economic project currently under way in the European Union (EU).

Such a European capital market should be safe, liquid and offer facilities for the cross-border issuing, trading and holding of EU securities. The project is supported by a multitude of players, such as the European institutions, the European Central Bank (ECB); regulators and supervisors from the European System of Central Banks (ESCB)/the Committee of European Securities Regulators (CESR); the specialised committees, in particular the Giovannini Group; and, last but not least, the public and private sector, the clearing and settlement systems, national capital markets and the banking sector. All have a proper interest in the project and jointly contribute in their respective fields of competence.

The European capital market is to be the final link in a long chain of developments, starting with the liberalisation of capital movements, the single passport for financial institutions (e.g. credit institutions, investment firms, insurance companies, etc.), the creation of the ESCB, the single currency and a safe environment for financial transactions through EU projects such as Directive 98/26/EC of the European Parliament and the Council of 19 May 1998 on settlement finality in payment and securities settlement systems (OJ L 166, 11.6.98, p. 45) and Directive 2002/47/EC of the European Parliament and the Council of 6 June 2002 on financial collateral arrangements (OJ L 168, 27.6.2002, p. 43).

The clearing and settlement systems clearly play a significant role in this project. Their role is currently the subject of intensive debate\(^2\), as a process of integration and consolidation is underway, and it is not certain that the political debate about their role can keep up with the pace of change in the industry. The debate is about the optimal degree of regulation that may enhance private initiative and competition, while meeting the need for a secure, balanced and institutional level playing-field for all operators. Clearing and settlement has a natural tendency to improve efficiency via economies of scale and to seek to consolidate markets. Member States, on the contrary, have a tendency to segment markets and to maintain boundaries, monopolies and sets of local rules in order to respond efficiently to their overall responsibility for the proper functioning of their own markets.

The Commission has given indications as to the way forward to improve the Community environment for cross-border securities clearing and settlement.

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Priority points on the agenda will be the elimination of existing barriers and of possible restrictive market practices, as well as the adoption of a common regulatory and supervisory framework, accompanied by appropriate governance structures.

The Commission also made it clear that it will respect the principles of subsidiarity and proportionality and the diversity of approaches in the different Member States with regard to market structures. Any further consolidation should be mainly market-driven, but only to the extent that this meets legitimate public policy concerns. The Commission adopts the approach suggested by the Giovannini group to remove existing barriers through a combined effort by the private and public sectors, and according to an appropriate sequence of actions. The Commission therefore envisages the creation of advisory and monitoring groups, the drafting of a Directive on clearing and settlement, and the organising of expert groups to tackle legal and tax issues.

The fiscal treatment of transactions in securities still diverges widely within the EU. As a consequence, tax issues remain in practice a fundamental obstacle for cross-border transactions. While legal insecurity regarding the settlement of financial transactions has to a considerable extent been removed through the implementation of relevant Community directives in all EU Member States, no such progress has yet been realised in the field of direct taxation.

The Giovannini Report identifies these tax barriers. It suggests that one solution might be to allow investors to choose the preferred location of the holding of their securities. Such a solution, which would imply that exclusivity of taxation is given to the Member State where the security is located, would make sound competition possible between Member States in order to attract investors. However, it would also be contrary to the EU principle of fiscal sovereignty, which allows Member States to tax the income of securities held by their tax residents, irrespective of the location of the asset, as well as to levy a withholding tax upon the streams of income from securities passing through or originating in their jurisdiction. The Giovannini Report correctly observes that even such a solution would not solve all potential problems, as some investors might prefer to hold their securities in the local market so that national differences in the relevant tax regime would remain.

National differences in withholding taxes, capital gain taxation and transaction taxes are of a general nature, and are not specific to the securities and settlement systems environment. The Giovannini Report also stresses the negative impact of tax barriers resulting from disadvantageous domestic withholding tax regulations for foreign intermediaries, or from functionalities integrated into local settlement systems that reduce the possible recourse to alternative settlement systems and therefore reduce competition and weaken the optimal allocation of resources.

Fiscal barriers fully appear in the processing of cross-border transactions. There are numerous causes of inconsistencies, such as:

- the differences in the tax treatment of income derived from equity or fixed-income securities, such as domestic withholding taxes, taxation of capital gains, permanent establishment exemptions, etc.;
- the fiscal treatment of securities lending, swaps or repurchase transactions;
- the definition of “beneficial ownership”;
- the formalities and documentation duties to obtain tax exemptions, tax vouchers or tax relief via other forms (e.g. affidavits, certificates);
- the scope of the tax reporting by the SSSs (securities settlement system) or (I)CSDs (international) central securities depository);
- the fiscal status of intermediaries (e.g. US qualified intermediary status);
- the particular clauses of the bilateral treaties to avoid double taxation.

The position of the Commission towards the taxation of interests from fixed-income securities and dividends may for this reason have an important impact upon the further progress towards a European capital market.

THE FUNCTIONALITIES OF CLEARING AND SETTLEMENT

We shall first briefly describe the functionalities of clearing and settlement.

Transactions in securities generally go through four phases: trade, confirmation, clearing and settlement. As there is no common legal definition for these operations, concepts are often used rather interchangeably, which does not simplify matters.

The first two parts of these transactions, trade and confirmation, allow the securities transaction to be legally constituted (which means the creation of a valid legal agreement for the securities transaction, whatever its type) and, preferably, also confirmed, in order to avoid errors or later disputes. These parts are handled by the traders’ front and back offices.

The third phase of the execution of a securities transaction is neither obligatory nor absolutely necessary, but is extremely useful. In the clearing phase, parties to securities transactions set off all mutual transactions through a process of compensation. The intention is to arrive at a single claim of securities and cash which must be settled by the respective debtors. The transactions are generally cleared through a so-called clearing house. The clearing of securities transactions may moreover be accompanied by legal novation of the obligations: the seller’s obligation to deliver the securities is taken over by a central counterparty (in principle the same as the clearing house), and the same is true for the buyer’s obligation to pay the price.

Finally, the securities transaction is settled: the securities are delivered and the price is paid. This can be performed on a gross settlement basis, in which case the obligations of the parties are executed individually and separately for each transaction, often in a so-called real time gross settlement process. If the securities transactions are cleared prior to settlement, then only the net balances are settled. The advantage of clearing is precisely that it drastically reduces the settlement process, and more particularly the need for settlement assets. However, even if the securities transactions are not cleared beforehand, the securities settlement systems can still net the settlement transactions (i.e. the so-called payment netting) rather than settling all instructions individually on a gross basis. The settlement can be arranged either by delivery versus payment (DVP) or by delivery free of payment.

In practice, the settlement, and more particularly the delivery, of securities is arranged through bookings on securities accounts. No physical security is handled or transferred between parties, unless this is expressly demanded, as may be the case in some jurisdictions where investors still prefer to receive physical bearer securities. In such cases, physical delivery will only appear in the last phase of the chain. Normally the transfer of property is organised through the debiting and crediting of book entries of fungible or dematerialised securities on securities accounts. Physical securities in bearer form are gradually disappearing in the Member States as they are costly, contain a high risk of loss, and may facilitate tax fraud and money laundering.

In a cross-border environment investors have a variety of possibilities to settle a transaction, depending on the market organisation, their position and the possibilities of access to the different market structures. They may address themselves directly to a local agent abroad, which will arrange the transaction with the foreign central security depositary (CSD). If the investors are professional ones, they will normally operate through an ICSD, a custodian bank or global custodian specialised in custody of securities, or through a local CSD, if a link exists with the foreign CSD. The settlement of such cross-border transactions is more expensive than local transactions for a number of reasons, mainly because all markets are still functioning in a national environment as far as operational, regulatory, supervision and tax features are concerned, which makes the cost structure multi-layered.

As the Giovannini Report points out, the fragmentation of the markets with their integrated local tax functionalities might constitute an obstacle to the development of a functioning European capital market. However, one must also take into account the fact that most ordinary investors need to be able to address their local intermediaries, and expect simple, safe and transparent treatment. For this reason, it is also necessary to maintain local infrastructures at the lowest possible cost.

Fragmentation as such should therefore not necessarily be seen as a threat. The threat consists rather in the absence of low-cost, efficient links, that allow smooth interactions between the local infrastructures, which overrides the local
functionalities. The problem should not be the independence or proper functionality of the local infrastructure, but rather the absence or inefficiency of links or suprastructures interconnecting the local infrastructures.\textsuperscript{5} And then again, tax obstacles may be at the heart of connection problems.

**THE BREAKTHROUGH REPRESENTED BY THE EU SAVINGS DIRECTIVE**

Direct taxation is not subject to the European harmonisation process but remains a sovereign Member State competence. It is clear that taxation issues have an immediate and far-reaching impact on the architecture of the European capital market and on the functioning of clearing and settlement systems in the EU.

The EU Savings Directive\textsuperscript{6} ("the Directive") seems to mark a significant breakthrough and may accelerate the development of an integrated market.

Therefore, we should examine some aspects of the Directive and its possible impact on the European clearing and settlement systems in more detail.

Although the principle of the exclusive sovereignty of Member States in the area of direct taxation is in principle not questioned, the Directive indicates the need for further action at the EU level.

Some major achievements have already been made. In the field of company taxation, the Parent-Subsidiary Directive\textsuperscript{7} stopped the cumulative taxation of company gains within a group structure, while the Code of Conduct, presented by the Tax Harmonisation Group chaired by Dawn Primarollo, was aimed at avoiding harmful tax competition between Member States. Today, the Commission is following a two-track strategy, addressing specific tax obstacles on the one hand, and working on a more long-term solution for a single EU-wide company tax base for EU cross-border activities on the other. The adoption of International Financial Reporting Standards (IFRS) shall boost this process.

The Directive originates in the adoption of the Council Directive of 24 June 1988\textsuperscript{8}, which liberalised the free movement of savings. On this occasion a political agreement was reached between Member States to adopt in parallel another directive that would counter the tax avoidance that the liberalisation of the cross-border opening of savings accounts had made possible. While the first directive passed, however, the second failed and was quietly abandoned.

Tentative measures to impose a common EU withholding tax also failed, among other reasons because of the objections of the United Kingdom due to concerns about the impact on the Eurobond market.

Finally, consensus was reached upon an EU legislative instrument at the Santa Maria da Feira European Council of 19 and 20 June 2000. The ultimate aim of the EU Savings Directive is to enable the effective taxation of interest payments in the beneficial owner’s home Member State. The exchange of information between Member States is accepted as a substitute for a common withholding tax. The entry into force of this Directive was made dependant on the simultaneous introduction of equivalent measures in the major competitive financial centres. Three Member States negotiated a transitory regime, whereby they will not share information, but will instead levy a withholding tax, starting at 15% and progressively reaching 35% in 2011. The revenue of this withholding tax will be shared between the withholding state (25%) and the home state (75%).

The Directive contains a significant implicit message, namely the recognition of the failure of Member States to organise and coordinate an appropriate tax information exchange. The EU Savings Directive admits this deficiency and justifies on the basis of the subsidiarity principle the need for action to be taken on the Community level to adopt a minimum framework for the automatic exchange of information.

The European Court of Justice (ECJ) did consider that possible deficiencies in the exchange of information on tax matters might not justify restriction of the free movement of capital by Member States. In the Commission v. Kingdom of Belgium, the ECJ examined whether a provision in the prospectus of a Eurobond loan issued by Belgium in the German market was compatible with the free movement of capital. This provision prevented Belgian residents from acquiring securities of this loan. Normally, Belgian residents would be liable to withholding taxes on interest income from Belgian government loans issued on the Belgian market, whereas this would not be the case with a Belgian Eurobond loan issued on the German market. The Belgian government invoked the arguments of fiscal coherence, the effectiveness of fiscal supervision and the need to prevent tax evasion. However, the Court tested these arguments against the required appropriateness and proportionality of such restriction. Taking into account the fact that nothing stops Belgian residents from acquiring hundreds of other Eurobond loans issued by other entities, these arguments did not pass the proportionality test. Still, a rather problematic issue remained in

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9 As originally to be found in the so-called Scrivener proposal.
10 Recital 14.
11 The entry into force had to be postponed until an agreement for equivalent measures between the EU and the Swiss Confederation was reached. These measures have now been adopted and the term for a public call for a Swiss referendum will expire on 31 March 2005.
12 Recital 10.
13 See Recitals 10 and 16 of the EU Saving Directive.
14 Case C-478/98 of 26 September 2000, Commission v Kingdom of Belgium.
15 While no Belgian withholding tax will apply on interest received abroad, Belgian residents will have to declare this interest income in their yearly tax returns.
16 An argument that was accepted in case C-204/90, Bachmann v. Belgian State, 1992, ECR I-249.
that the Court did not take any account of the major difficulties faced by Member States to organise an effective mutual exchange of information, which would certainly apply to those hundreds of other Eurobond loans.

On this point the Directive represents a clear breakthrough and answers a genuine need of the EU. The questions that have been raised as to its compatibility with the freedom of movement of capital and payments, as provided for by Articles 50 to 60 of the Treaty establishing the European Community, do not seem to undermine the legitimate motivation and grounds of the Directive concerning the need to legislate on the basis of the subsidiarity principle. The existing possibilities for the exchange of information among EU Member States certainly appear less than ideal for the EU.

Although Article 26 of the OECD’s Model Tax Convention on the exchange of information on tax matters was updated in July 2004 and may over the coming years affect more than 2,000 existing bilateral tax agreements, it can no longer satisfy the needs of the EU. After having realised the free flow of capital in the EU, an efficient information exchange has become a necessity in order to maintain the Member States’ taxation competences. An approach that only relies on the framework of conventions to avoid double taxation would require the current 25 EU Member States to conclude or modify among them a total of 320 bilateral tax agreements. Moreover, bilateral agreements are not satisfactory instruments on the EU level, taking into account the competency of Member States to interpret the terms of the agreements according to the definitions under the national legislation. While the OECD Model Tax Convention may remain a useful bilateral instrument for settling several types of taxation matters between Member States, it seems it can no longer be regarded as a workable instrument to organise the information on flows of interest and dividends in the EU.

Neither has the existing Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation (OJ L 336, 27.12.1977, p. 15) been able to satisfy the pressing need for automatic information exchange on interest and dividend income after the liberalisation of the capital markets.

The Directive puts all required tax data with respect to the fixed income of individual tax residents at the disposal of the Member States. The investment decisions of residents with regard to fixed-income securities or deposits in the...
EU will no longer be adversely affected by considerations of tax evasion, but will instead be the result of an objective comparison between the financial conditions on offer. Therefore the Directive might represent the tipping point towards the emergence an EU capital market for fixed-income securities.

Nevertheless, the question remains whether the easiest road has been chosen.

**THE EU SAVINGS DIRECTIVE AND THE CLEARING AND SETTLEMENT SYSTEMS**

This contribution does not enter into the details of the Directive. For the purpose of this paper, it is sufficient to know that the EU Savings Directive puts an obligation upon *paying agents* to inform their national tax authorities on the payment of fixed-income savings income in the form of interest payments to individuals who are identified as the beneficial owners and residents of another EU Member State. The information is then forwarded by the tax authority of the involved Member State to the relevant tax-resident EU Member State.

Some of the definitions in the Directive, such as ‘beneficial owner’, ‘interest payment’ and ‘paying agent’, have raised many questions, and the explanatory note of the Commission will hopefully provide the required clarification. It has also already been observed that some operators may be tempted to look for loopholes. The Commission has foreseen this problem and has arranged for a three-yearly review to remedy any such deficiencies.

However, it cannot be ignored that the banking industry, financial intermediaries and any operator qualifying as a paying agent under the Directive are all confronted with the nightmare of qualifying, interpreting, implementing and processing complex information at their own responsibility, and must then justify their actions towards their client base.

No distinction is made in the Directive on the basis of the nature of the right created by the financial instrument, be it an *intuitae personae* contractual right (e.g. cash deposit accounts) or a right *in rem* (e.g. bearer securities). Income from deposit accounts held in the books of financial institutions from Eurobonds in bearer form deposited with a financial intermediary, or from registered bonds, all become subject to identical measures of information exchange. Unlike deposits, where the financial institution has an overall oversight on a yearly basis of the client’s accounts, tradable securities may be actively managed on a daily or short-term basis, or be transferred, sold or subject to specific financial transactions, such as securities lending, repos, swaps, etc. And all these data, which may be dispersed over a wide variety of operators and intermediaries, will finally have to be collected, interpreted and classified.

19 The notion of a paying agent used in the EU Directive differs completely from the ordinary concept of a paying agent in the capital markets.
21 Article 18.
This implies that the Directive not only places reporting duties on the most obvious intermediaries, namely the financial institutions, which are after all properly organised to manage the client’s data flow, but also on any operator in the industry processing an interest payment and qualified as paying agent by the Directive. The Directive does not distinguish between different types of intermediaries and instruments, with the consequence that all sectors and types of intermediaries will be affected by reporting duties and tax data processing, which might eventually damage the efficiency of the exchange of information and boost the cost of market transactions. In a global European capital market, investors should be able to operate directly in the different market segments through competitive intermediaries. One might therefore fear that further market unification will be mirrored by a further fragmentation of data over the different market segments that may be involved in a securities transaction. This could multiply the number of involved paying agents for securities transactions.

The Directive’s automatic exchange only addresses one type of savings income, namely interest payments, and excludes income from pension schemes, insurance policies or shares. 22 On several occasions, when no accurate information can be obtained, the Directive introduces legal presumptions, so that income may be qualified as an interest payment for the application of the Directive. 23 Information will therefore not always be accurate and will need to be treated very carefully by the tax authorities.

While the data exchange for income from deposit accounts is manageable, it is less certain that the same applies to the data on securities transactions on the EU markets.

Remarkably, for Member States falling under the Directive’s derogation and applying the withholding tax, the Directive acknowledges that the period of holding of a security might not be known by the paying agent. Therefore, it allows the withholding tax to be levied without regarding the period of holding of the securities. 24 This may seem a practical solution, but in reality it means the end of cross-border access to such a market. This decision will make such a market segment unworkable for cross-border transactions, as the withholding tax burden will become extremely severe. The following example demonstrates the consequences.

Say that an Italian resident holds a Belgian government bearer bond with a yearly coupon of 5%. Under the Belgian tax regime, Belgian government bearer bonds do not qualify for any exemption of withholding tax unless they are registered and held for the whole interest period. Our Italian resident sells the bond on the secondary market. There will be no possibility of establishing the period of

22 The legal borderline between the different savings products is vague. Insurance products may qualify as fixed income instruments. But what about subordinated loans, profit-sharing bonds, discount bonds, index-linked bonds, convertibles, etc.? As the Directive takes priority over national legislation, the paying agents will have to look beyond the fiscal qualification of the type of income given in national legislation and will have to check the applicability and qualification as defined by the Directive.
23 For example Articles 6.2. - 6.4.
24 Article 11.3 of the Directive.
holding of the security unless the individual serial number of each security is registered at each transaction. This is in practice unfeasible. As a consequence, the Italian resident will first have to pay the pro rata compensatory indemnity for withholding tax, which is ordinarily applied between the seller and buyer, and will then once again suffer the Directive withholding tax. However, this will not be the pro rata withholding tax for the period of holding, as this unfortunately cannot be established, so that the Directive’s legal fiction applies and the withholding tax is calculated as if the Italian resident had held the security from the beginning of the interest period. This results in double taxation in Belgium, without the possibility of reimbursement, as this is unavailable under Belgian tax law. The story is not even over at this point, as the taxation power of Italy as the tax resident’s home state fully remains. We do not wish in this paper to further elaborate this example, but the least that can be said is that the Directive does not seem in this regard to improve the unification of the EU capital market.

Although the Directive does represent a breakthrough, it is also an extremely burdensome administrative instrument that shifts an important amount of work from the fiscal authorities to the industry, yet still entails substantial efforts on the part of the fiscal authorities to channel, process, verify and redress all the collected data.

Therefore, it is questionable whether the option of introducing a generalised reporting duty for all types of interest payments, independent of the type of instrument, is overall the most effective one. For negotiable securities, the withholding tax mechanism would offer numerous advantages, while the tax sovereignty of the Member States to choose between a withholding tax system or a globalisation of income need not be affected. A possible model for such alternative is described below.

**THE BELGIAN X/N MODEL: AN INTERESTING MODEL?**

There is little doubt that a common withholding tax could make life easier and constitutes an efficient instrument for market integration. This was the original idea of the Commission, but no unanimous vote could be reached.

Member States have resisted the idea of a common withholding tax. Even if the alternative of a massive information exchange system may have frightened the Member States, a common withholding tax system on interest payments seems to have been seen as a greater threat, creating the fear of a possible EU withholding tax, to be redistributed among the Member States on macroeconomic parameters. This would then have signified a major breach of tax sovereignty. The system of data exchange seems to protect against such an evolution.

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25 Article 11.3 of the Directive. The Directive introduces the principle of withholding tax on income paid not by the debtor, but between parties on the occasion of transactions during the interest period.

26 Article 11 of the Convention between Belgium and Italy to avoid double taxation.
While this resistance seems reasonable for income from deposits held with financial institutions on a contractual basis, the argument is less valid for income from securities transactions operated on the markets.

The Belgian X/N withholding tax system, which is applied in the so-called X/N clearing and settlement system of the Nationale Bank van België/Banque Nationale de Belgique (NBB), introduces a very simple system to organise a differentiated and anonymous withholding tax that can be directly settled with the Belgian Treasury or with any EU Member State other than Belgium, provided that a link has been created between both national securities markets. This system should not affect the final tax sovereignty of Member States in any way, but should avoid the immense administrative burden on the paying agents.

How would such an EU withholding tax system work? Let us first examine the existing Belgian X/N model.

In the Belgian X/N system, the participants, as the financial intermediaries, keep two categories of securities accounts at the top level of the CSD/SSS, held in the accounts of the NBB: accounts for persons or entities exempted from withholding tax, and accounts for non-exempted persons or entities. These accounts are global accounts, and the individual accounts are held on the lower levels in the books of the participants or sub-participants of the CSD/SSS. The identification and administrative attestation for tax purposes remain at the level of the immediate contractual relationship with the final client.

Taxation is organised at the level of the global accounts, and then cascades to the lower levels, without an additional need to exchange data on the individual account holders.

Securities transactions executed on “X” accounts (“exempted accounts”) are performed on a “gross” basis (meaning that no withholding tax applies on the payment of interest income). On “N” accounts (“non-exempted accounts”) the withholding tax applies and only net interest is paid or received by the account holder (either on coupon date or when buying or selling during the interest period). This withholding tax is calculated by the clearing system, which disposes of all required data (type of security, interest income and period of interest). To create a global market that allows transactions between exempted and non-exempted persons, a transitory account needs to be held by the Belgian Treasury, which functions as a valve to enable possible transactions between persons of different tax categories. The Belgian Treasury immediately receives the withholding tax pro rata temporis when an N account is debited and, conversely, advances the pro rata temporis withholding tax each time an N account is credited. A particular mechanism of debiting or crediting pro rata withholding is also put into place for the holders of X accounts to allow them to enter or withdraw securities from the common tax system environment into

27 Law of 6 August 1993 concerning transactions on certain securities.
28 Technically, these accounts are generally known as omnibus accounts.
the X/N clearing system, and vice versa. In this way, transactions between X and N accounts are made possible, one on a gross basis and the other on a net basis.

The advantages of such a system are clear: a global securities market is created with broad access to all types of issuers and investors, which can heighten the degree of market liquidity and efficiency. Withholding tax is collected and transferred by the clearing system to the Treasury in real time on all global transactions, without the need to identify or individualise, as all identification data exist on the lower levels and are subject to tax controls. This simplifies and improves tax collection. However, most importantly, this system avoids placing an administrative burden on the financial intermediaries, which do not have to exchange data or calculate withholding tax, but only have to pass on to the account holders the withholding tax debt, which is established on the global top accounts of the X/N system. Of course, the financial intermediaries remain subject to tax controls on their correct classification of the security accounts into X or N accounts. This requires identification of the client, and the intermediaries bear a proper tax liability for errors. The tax authorities are in a position to receive all global data from the X/N system so that local controls can be efficiently organised and information can still be transmitted to the resident Member States according to the arrangements between the Member States’ tax authorities. In this way Member States can rely upon a performant information exchange and maintain a sovereign choice as to the national fiscal regime applied to interest and dividend income and the methods to avoid double taxation on this type of income.

In this way the burden of processing the withholding tax, data handling and tax supervision is allocated to the most suitable levels with the most competent persons in charge. The processing of withholding tax is assigned to the clearing system at the top of the pyramid, so that it can work on the level of the global accounts, which allows a cost-efficient approach and advantages of scale. The exchange of information remains a primary task of the fiscal authorities.

This system can comply with any desired tax policy. It can provide exemptions on withholding tax for any type of income (Eurobonds, etc.), or for any type of tax entity or persons, depending on the tax policy.

Such a system can be linked to local systems of other Member States and could take into account the tax policy and withholding tax rate of these Member States. The system will even be directly operational for the tax collection of any Member State when its national Treasury holds an account with the system to be debited or credited according to the mechanism, described above and adjusted to satisfy the national tax regime’s particularities.

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29 In some Member States interest and dividend income is taxed in a global income scheme; in other States this type of income is taxed distinctly.
30 Different methods are applied by Member States to avoid double taxation, like tax exemption, tax credit, tax imputation, etc.
If national CSD systems in the EU all had a transition account with the different national Treasuries, withholding tax on income paid to tax residents of each Member State would in real time\(^{31}\) be processed by the Treasury of the tax-resident Member State at the common EU withholding tax rate of 15\%, or even directly at the national rate determined by each resident Member State. In parallel, an information exchange on income from residents, resulting from local controls on the lower level accounts held with the participants, would apply, allowing resident Member States to receive regular and systematic data information on their national tax residents that hold accounts abroad. This data exchange would not be as complete as the data exchange organised by the Directive, but it would be sufficiently systematic and thorough\(^{32}\) to dissuade beneficiaries from tax evasion. Such a system would therefore entirely respect the Member States’ sovereign taxation policies.

Could this taxation model improve the development of a European capital market? The essential characteristics of the X/N withholding tax mechanism certainly seem to offer some interesting perspectives, two of which stand out.

Firstly, the mechanism of levying and collecting withholding tax is situated on the top level of the suprastructure. Withholding tax levying and collecting is linked to the functioning of the global accounts and is disconnected from the individual holders of the accounts on the lower level. This characteristic minimises the administrative tax procedures while still providing permanent access to all relevant individual information.

Secondly, on the level of the global accounts, it becomes possible to multiply unlimitedly the number of types of X or N accounts based on the requirements of each Member State. A common EU withholding tax would no longer be necessary. A local SSS could easily keep 25 different global types of account, each one designed to apply the required withholding tax for a specific category as determined by each particular Member State, and connecting the global account to the transitory account of the relevant Treasury of each Member State, thereby enabling transactions between the holders of different types of accounts.

Such a mechanism can only be operational on the level of the suprastructures.

Progress towards achieving an EU capital market would require the creation of certain links. In a first phase, links will only be required between the national systems\(^{33}\) and the different Treasuries. Links with the latter would allow the withholding tax to be immediately redistributed without any further

\(^{31}\) One of the advantages of the transition account with the national Treasury is that withholding taxes are immediately collected by the State on the transaction day itself without the loss of interest due to the administrative delays in the tax collection.

\(^{32}\) As the tax authorities of the Member States should all receive access to global data at the highest level, since this information is required to justify the debiting of each national Treasury’s accounts, they can also immediately identify the origin of the global amounts of taxable income of their national residents in each other’s jurisdiction, and can agree with the relevant Member State’s tax authority on focused controls.

\(^{33}\) The system is already known and partially applied by Clearstream and Euroclear. In addition, some foreign tax systems – for example, the Italian Treasury – apply variants of the X/N model.
administrative burden. In a subsequent phase, direct cross-border access for issuers and investors would require further development of the links between the SSSs, (I)CSDs and Treasuries. This would be made easier with an X/N type taxation model, which could simplify tax administration, collection and redistribution.

Of course, administrative changes to the links between the SSSs and (I)CSDs would need to be implemented. The Member States’ Treasuries and tax administrations would have to be involved in this process, which would represent a major European operation.

However, the burden of such an operation would rest upon the suprastructures and national authorities, and not on the thousands of intermediaries who are currently confronted with the encumbrances of complex data processing even though they are not necessarily organised to accomplish this task, or capable of perceiving whether any real progress towards a more efficient cross-border EU capital market has been made.

It seems that such a tax system might kill several birds with one stone. Member States’ collection of fiscal revenues would be highly facilitated, while a significant step towards a single global EU capital market would have been taken. The competitiveness of national securities markets and clearing and settlement systems would improve. Responsibility for data collection, verification and exchange would remain essentially with the competent authorities, while correspondingly avoiding placing an administrative burden on the industry. All this might contribute to optimal capital allocation and to the creation and redistribution of welfare in the EU.
ABSTRACT


La seconda parte mira a descrivere succintamente il quadro legale dell’UE, che è stato costituito in pochi anni, con il fine di accrescere l’efficienza e la solidità legale della prestazione di garanzie, a beneficio del mercato finanziario integrato e della politica monetaria unica. In particolare, vengono in considerazione le Direttive sulla definitività degli ordini di trasferimento, sulle procedure di risanamento e liquidazione degli enti creditizi e sulle garanzie finanziarie. Il quadro giuridico dell’UE non è ancora definitivo, tuttavia è stato conseguito un consistente miglioramento.
I  THE PRINCIPLE OF ADEQUATE COLLATERAL UNDER THE STATUTE OF THE
ESCB AND THE ECB

1.1 REQUIREMENT OF COLLATERAL

Article 18.1 2nd indent of the Statute of the European Central Bank (ECB) and
of the European System of Central Banks (ESCB) states that, in order to achieve
the objectives of the ESCB and to carry out its tasks, the ECB and the national
central banks (NCBs) may conduct credit operations with credit institutions and
other market participants, with lending based on adequate collateral.1 To be more
precise, Article 18 applies only to the ECB and the NCBs of those Member States
that have adopted the single currency2 (the “Eurosystem”3). The Eurosystem
enters into credit operations when carrying out its tasks, i.e. the implementation
of monetary policy, the conduct of foreign exchange operations, the holding and
management of the official foreign reserves of the Member States, and the
promotion of the smooth operation of payment systems.4

In the course of preparatory work on the Statute, the Committee of Governors
did not reach any consensus on the requirement of adequate collateral. The
proposal to the Intergovernmental Conference which drafted the Maastricht
Treaty5 put the relevant text in square brackets. In fact, although most NCBs used
to take collateral in order to limit credit risk in the context of their transactions,
their statutes did not always expressly require it.6 The absence of an express
obligation allows more flexibility, for instance in the context of abnormal
operational situations, or the adoption of alternative risk control measures, such
as the levying of fees.7 However, the legislator finally decided that a prudent
approach would be justified due to the role of the Eurosystem as manager of
the European currency and of the official foreign reserves, and with regard to
the responsibilities which are given to the individual NCBs and to the ESCB as
a whole concerning the prudential supervision of credit institutions and the
overall stability of the financial system.

Although the final text of Article 18 has put a certain constraint on the
operational capacity of the Eurosystem, the same provision has conferred on the
ECB quite broad powers of definition with regard to the notion of adequate

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1 Article 18.1 lists open market and credit operations in two separate indents, and the requirement of adequate
collateral is only mentioned in the latter. However, it goes without saying that collateral must also be taken
when the Eurosystem conducts credit operations through open market interventions.
2 See Article 43 of the Statute of the ESCB and the ECB (the “Statute”).
3 The Governing Council of the ECB has adopted the term “Eurosystem” to denote the composition in which
the ESCB performs its basic tasks (see Article 3.1 of the Statute).
4 The Eurosystem may also enter into credit operations when the market needs financial assistance due to the
malfunctioning of market infrastructures or liquidity shocks affecting financial stability. Interventions in favour
of a single illiquid bank should remain within the national competences of NCBs, with regard to their links
with prudential supervision. See on this issue R. Smits, The European Central Bank (The Hague: Kluwer Law
5 See Smits, op. cit., p. 272. On Article 18, see also J. V. Louis, “L’Union économique et monétaire”, in
6 For instance, the statutes of the Banco de España, the Central Bank and Financial Services Authority of Ireland,
and Suomen Pankki did not contemplate collateral.
7 The Federal Reserve charges fees in the context of its intraday credit operations. See H. W. Richards, “Daylight
Overdraft Fees and Federal Reserve Payment System Risk Policy”, Federal Reserve Bulletin (December 1995),
collateral. In fact, according to Article 18.2, the ECB may establish general principles for open market and credit operations entered into by the Eurosystem, including principles governing the announcement of conditions under which it stands ready to enter into such transactions.

Therefore market-oriented instruments remain in the full domain of the Eurosystem, which can “regulate indirectly – and without recourse to administrative control and or restrictions – money and market conditions”. On the other hand, mandatory instruments used to implement monetary policy (minimum reserve requirements under Article 19 and other instruments of monetary control under Article 20) are subject to the regulatory power of the Council.

In accordance with Article 108 of the Treaty, Member States have adapted the statutes of NCBs in order to make them compatible with the Treaty and the Statute. In some cases, the principle of “adequate collateral” has been embodied expressly in the NCBs’ statutes. In other cases, legislation has entrusted NCBs with a broad range of operational capacity within the limits set out by the Statute and by the ECB’s regulatory acts; those national provisions that restricted the categories of eligible collateral were repealed.

1.2 THE ADEQUACY OF COLLATERAL FROM A LEGAL PERSPECTIVE

The Eurosystem has assessed the adequacy of collateral for its own operations on the basis of two different perspectives. Firstly, eligible assets must be financially sound and ensure operational efficiency. Secondly, collateral must be legally enforceable, i.e. it must be valid and realisable to the benefit of the creditor under the relevant jurisdictions.

This legal analysis requires the assessment of two elements which are strictly linked to each other: the nature of the collateral arrangements, and the legal framework that regulates the collateral.

With regard to market-oriented instruments, the Eurosystem acts in accordance with applicable national law. The ECB has organised the Eurosystem’s credit operations on the basis of the principle of decentralisation (Article 9 of the Statute): each NCB may, acting in its own name, enter into contractual relationships with counterparties established in its own territory, on the basis of standard terms and conditions of a contractual or regulatory nature, which are harmonised by way of regulatory acts issued by the ECB. Therefore,

8 See the introductory report to the Draft Statute, published in Europe, Document No 1669/1670, 8 December 1990, p. 25.
9 For more information, see the reports of the European Monetary Institute (EMI) and the ECB’s Convergence Report of 1998, available on the ECB’s website (www.ecb.int).
12 See Chapter 2.3 of this paper.
collateral is established in accordance with the relevant national law and in the legal form adopted by each NCB, on the basis of its common practice.\textsuperscript{13}

Harmonisation of the regulatory and operational regime has had a material impact on existing NCB practices with regard to risk control measures.\textsuperscript{14} Keeping the principle of an open market economy with free competition in mind (Article 2 of the Statute), the collateral framework takes market standards into account.\textsuperscript{15} In line with the needs of a single money market, the Eurosystem accepts collateral located abroad.

In this context the Eurosystem has to deal, on the same footing as all market participants, with a variety of legal risks\textsuperscript{16} in relation to its own refinancing operations. Risks arise from national jurisdictions which traditionally impose formal and procedural requirements on the perfection and realisation of collateral in order to make it valid and opposable to third parties, with the objective of limitation of derogation to the general principle of \textit{pari passu}. In addition, the existence of a cross-border component in credit operations adds further complexity and uncertainty due to the application of foreign law.

With regard to collateral, legal risks may be grouped into four categories\textsuperscript{17}: a) establishment risks, b) realisation risks, c) custodian risks, and d) conflict of law risks.

a) \textit{Establishment risks} arise when the formalities for perfection of collateral are not respected. The outcome may be that collateral is invalid, either due to an operational failure (which is very likely if the formalities for perfection are very burdensome) or to an incorrect interpretation of the law. One peculiar case of establishment risk is the so-called recharacterisation risk. This risk arises in jurisdictions where repo arrangements are not legally recognised and may be recharacterised by courts as security interests: if the formalities for the perfection of pledges are not carried out, the collateral may not be valid.\textsuperscript{18}

b) \textit{Realisation risks} occur in the event of default of the collateral provider. In such cases, the civil law (or, in the event of insolvency, the bankruptcy law) may limit the rights of the creditor of enforcement on assets in different ways. Waiting periods, reduction of the claim, special procedures for sale and judicial authorisations may

\textsuperscript{13} See Smits, op. cit., p. 263.
\textsuperscript{14} According to Article 32.4 of the Statute, the Governing Council of the ECB may decide that NCBs should be indemnified for losses arising from monetary policy operations. The existence of a harmonised risk control framework may give grounds for the application of this provision.
\textsuperscript{15} It is worth noting that upon the entry into force of Article 102 (the former 104 A) of the Treaty on 1 January 1994 (the start of the second stage of Economic and Monetary Union), Member States had to repeal any provisions which considered only public debt instruments eligible as collateral for NCBs’ credit operations to the detriment of private issuers.
\textsuperscript{16} Legal risk is broadly defined as “the risk of loss because of the unexpected application of law or regulation or because a contract cannot be enforced” (quoted from Bank for International Settlements (BIS), “Cross-border Securities Settlements” (1995), report prepared by the Committee on Payment and Settlement Systems of the central banks of the Group of Ten countries (CPSS), available at www.bis.org).
all delay or hinder the realisation of collateral. Any such delay, however, could cause market risks due to the loss of value of collateral on the market. Legal obstacles to the recognition of close-out netting techniques also fall within this category of risk.

c) **Custodian risks** arise because financial instruments eligible as collateral are issued with central securities depositaries (CSDs) which are subject to operational and, at worst, insolvency risk. This risk requires the legal features of these depositaries to be identified in order to assess the degree of protection of the rights of the collateral taker, acting as the pledgee or owner of securities.

d) **Conflict of law risks** arise from the cross-border use of collateral and from the access of a foreign entity to credit operations. In a complex but not exceptional case, the validity of collateral may be subject to three different jurisdictions: the *lex contractus*, which regulates credit operations and collateral arrangement; the *lex rei sitae*, the law of the place where the collateral is located, which determines the conditions for perfection and realisation of collateral; and the *lex concursus*, which in the event of insolvency of the collateral provider affects the realisation of collateral. The *lex contractus* may be agreed by the parties according to the Rome Convention, whereas the *lex rei sitae* and the *lex concursus* are determined by mandatory law.

The single monetary policy brought with it the cross-border use of collateral: banks may offer assets which are located in a foreign jurisdiction as collateral. According to general principles of private international law, the *lex rei sitae* regulates the exercise of a right *in rem*. However, this rule was intended for moveable things, in particular physical securities, but was not applicable to book-entry securities, which have however fully replaced physical securities on financial markets. Given that investors may maintain their interest on securities through a constellation of accounts located in different jurisdictions, a special international private law rule was needed to clearly determine the law applicable to collateral established on such instruments.

The interference of the *lex concursus* on the realisation of collateral was already an element of concern before the introduction of the single currency: according

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20 In fact, the borderline between the *lex contractus* and the *lex rei sitae* is vague, and inconsistencies between the relevant jurisdictions may cause uncertainty on the validity of collateral. See M. Perassi, “I sistemi di pagamento internazionali”, in *Banca, Borsa e Titoli di credito* (2000), I, p. 507; and Benjamin, op. cit., p. 516.

21 Book-entry securities are issued in immobilised or dematerialised form through a CSD (see R. Goode, “The Nature and Transfer of Rights in Dematerialised and Immobilised Securities”, in *Journal of International Banking and Financial Law* (1996), No 4, p. 167; and C. Bernasconi, “The Law Applicable to Disposition of Securities Held through Indirect Holding Systems”, Hague Conference on Private International Law, Preliminary Document No 1 of November 2000, available at http://hcch-e-vision.nl/upload/sec_pd01e.pdf). In both cases, interest on securities is identified and transferred by means of book entry onto an account. In some countries the investor may keep this account directly with the issuer or its agent (direct holding system), but in most countries the investor’s interest on securities is recorded on the books of an intermediary which, in turn, may have its interest recorded with another intermediary, and so on until the last intermediary of the chain which holds an account with the issuer (indirect holding system).

to European Community (EC) law, branches of banks incorporated in another
country are subject to the monetary policy of the host country and must enter
into monetary policy operations with the host central bank. The lex concursus
tends to override the lex contractus and the lex rei sitae. However, in the absence
of a harmonised European regime for the conduct of bank insolvency
proceedings, uncertainty as to the applicable lex concursus could arise. As this
paper will show, in some countries the principle of universality was in force;
while other countries followed the principle of territoriality, with several
nuances. This implied that in the event of insolvency of a multi-branch bank,
local proceedings could open in tandem with the main proceeding, each one
subject to its own lex concursus.

2 THE EUROSYSTEM'S LEGAL FRAMEWORK ON CREDIT OPERATIONS

2.1 THE ECB'S GUIDELINES

In most cases the legal risks examined above could only be solved through
legislative reforms, as explained below in Chapter 3. In the meantime, the
Eurosystem has managed such risks by setting out its own legal framework for
credit operations, within the limits allowed by national laws.

Article 18, as already noted, gives to the ECB the power to regulate the open
market and credit operations of the Eurosystem. On this basis, the ECB has enacted
several legal acts in the different field of competence of the Eurosystem: the
“Guideline on monetary policy instruments and procedure of the Eurosystem
which regulates monetary policy credit operations”; the “Guideline on a Trans-
European Automated Real-time Gross Settlement Express Transfer System
(TARGET)”, which regulates intraday credit operations; and the “Guideline on
the foreign reserve management of the ECB by NCBs and the legal documentation
for operations involving the foreign assets of the ECB”. Such Guidelines are
binding for the Eurosystem (Articles 12.1 and 14.3 of the Statute), but do not have
a direct effect on market participants. NCBs are obliged to implement them in their
legal frameworks in accordance with the powers conferred on them by national
statutes and to execute their operations accordingly.

The Guideline on monetary policy may be considered a sort of framework legal
act. It is basically composed of two annexes: the General Documentation on

24 The following quotations refer to the legal acts currently in force.
27 ECB/2001/1 published in OJ L 207, 17.8.2000, p. 24; ECB/2001/5 published in OJ L 190, 12.7.01,
28 With regard to the eligibility criteria for assets accepted as collateral for intraday credit operations, the
Guideline on TARGET makes reference to the same criteria that are valid for monetary policy operations
(Article 3 (f)). Foreign reserve assets transferred by the NCBs to the ECB, which the above-mentioned
Guidelines refer to, are managed by the NCBs acting as agents of the ECB on the basis of standard market
documentation. Foreign reserve assets that remain with the NCBs are managed exclusively by the NCBs within
the limits set by Article 31 of the Statute.
Eurosysterm Monetary Policy Instruments and Procedures (the “General Documentation”), and the Additional Minimum Common Features (AMCF).

The General Documentation\(^{29}\) describes the operational framework\(^{30}\) chosen by the Eurosystem, providing accurate information on eligible counterparties, open market and bilateral operations, procedures, eligible assets and minimum reserves. The AMCF aims at harmonising the contractual or regulatory arrangements which NCBs adopt for monetary policy operations.

2.2 THE LEGAL FORM OF COLLATERAL

The General Documentation (Chapters 3.1 and 4.1) states that NCBs have the option to execute credit transactions either in the form of repurchase agreements\(^{32}\) or as collateralised loans, where the collateral has the nature of a pledge or charge. The power of NCBs to select their preferred collateralisation technique is a result of the principle of decentralisation\(^{33}\), and is also one of the ways through which the Eurosystem may limit legal risks relating to collateral: each NCB should adopt a safe legal technique in its own jurisdiction, on the basis of its consolidated practice. However, this approach may not be fully effective in a cross-border context: if assets are located in a foreign country, requirements for the perfection and realisation of collateral are subject to the rule of that foreign country. If the foreign country’s legislation does not provide safe mechanisms for the collateral technique generally adopted by the financing NCB, or if the assets provided as collateral are subject to special legal features, then the collateral practice and contractual arrangements of the financing NCB are also affected and must be adapted, with the cooperation of the NCB in which the collateral is located.\(^{34}\)

2.3 THE LOCATION OF COLLATERAL

Chapter 6 of the General Documentation sets out the criteria which assets must fulfil to be eligible for monetary policy operations. These criteria aim to protect

\(^{29}\) The Governing Council of the ECB has just adopted the last version of the General Documentation, which shall enter into force on 30 May 2005 and is already available on the ECB’s website.


\(^{31}\) Supervised credit institutions are the only eligible counterparties for monetary policy operations (General Documentation, Chapter 2.1). Banks and other entities that participate in TARGET (investment firms, clearing and settlement agents, and some public entities) may access the Eurosystem’s intraday credit facility; it is worth noting that public entities may be exempted from collateral requirements, see Article 3 (f) of the Guideline on TARGET. In the absence of any restrictions in the Guidelines of the ECB (see footnote 27), operations on foreign assets may be conducted with banks and other market participant in accordance with Article 18 of the Statute.

\(^{32}\) On the use of repo transactions for monetary policy purposes, see BIS, “Implications of Repo Markets for Central Banks” (1999), available on the BIS’s website.

\(^{33}\) Chapter 2 of the General Documentation implements such a principle, whereby it specifies that eligible counterparties may access the Eurosystem’s standing facilities and open market operations based on standard tenders only through the NCB of the Member State in which they are established. The ECB may only conduct fine-tuning bilateral operations on its own under exceptional circumstances, subject to the decision of the Governing Council (Chapter 1.3.1).

\(^{34}\) In this respect, see the legal documentation adopted by the Banca d’Italia for the acceptance of some foreign collateral in “Strumenti di politica monetaria dell’Eurosistema: Guida per gli operatori” (2004), pp. 101-30, available on the Banca d’Italia’s website (www.bancaditalia.it).
the Eurosystem from incurring losses, ensuring the equal treatment of counterparties and enhancing operational efficiency.\textsuperscript{35}

It is worth examining the eligibility criteria\textsuperscript{36} concerning the location of eligible assets, since location determines the \textit{lex rei sitae}, i.e. the law applicable to the perfection and realisation of collateral. Article 17 of the Statute allows the Eurosystem to accept book-entry securities as collateral. Since the drafting of the Treaty, book-entry securities have fully replaced physical securities on financial markets: accordingly, the General Documentation requires that eligible assets must be as a rule transferable in book-entry form. The legal uncertainties relating to the application of the \textit{lex rei sitae} rule to book-entry securities have already been mentioned. The European legislation has agreed on the principle – as will be seen below – that the perfection and realisation of book-entry securities collateral are regulated by the law of the place of location of the relevant account where the rights of the collateral taker are legally recorded. On this basis, the General Documentation states (Chapter 6.2) that assets must be held in the euro area\textsuperscript{37} through an account with the Eurosystem or with a securities settlement system (SSS) which fulfils the standards established by the ECB, “so that perfection and realisation are subject to the law of a euro area country”. Therefore this criterion is based not only on operational efficiency (i.e. the need to ensure immediate access of the Eurosystem to the settlement accounts), but also on legal reasons, since it allows the Eurosystem to check that formalities relating to the perfection and, if needed, realisation of collateral are properly executed in a well-known jurisdiction.

The Eurosystem has adopted standards which SSSs must comply with to be eligible for the settlement of monetary policy operations.\textsuperscript{38} As already mentioned, one of the risks that the collateral taker bears is custody risk, i.e. the risk that due to insolvency or operational failure of the custodian, the interest of the collateral taker may be affected. One of these standards (Standard 1) concerns the legal soundness of the SSSs. It prescribes that SSSs must have a sound legal basis under the jurisdiction of incorporation and must provide for adequate

\textsuperscript{35} The General Documentation distinguishes between tier one assets and tier two assets. The former consist of marketable debt instruments fulfilling uniform euro area-wide eligibility criteria specified by the ECB; the latter consist of additional marketable and non-marketable assets which are of particular importance to national financial markets and banking systems and for which eligibility criteria are established by the NCBs, with the approval of the ECB and subject to minimum eligibility criteria established by the ECB. However, there is no distinction between the two tiers with regard to the quality of the assets and their eligibility for various types of operations. The Eurosystem intends to replace the current two-tier system with a single list of eligible collateral (see the last version of the General Documentation, footnote 29). In order to organise a smooth transition to a single list, the following measures are envisaged. Firstly (as from May 2005), euro-denominated debt instruments issued by entities established in G10 countries that are not part of the European Economic Area (EEA) will be introduced in tier one; equities will be withdrawn from the tier two lists of those countries that currently have them eligible. In a second stage, bank loans and non-marketable retail mortgage-backed debt instruments will be included in the single list.

\textsuperscript{36} The other eligibility criteria for tier one assets are that they must be debt instruments, should meet high credit standards, must be denominated in euro and issued (or alternatively guaranteed) by entities established in the EEA, and must be listed or quoted on a regulated market or on certain non-regulated markets as specified by the ECB.

\textsuperscript{37} However, assets may be deposited/registered (issued) in the EEA with a central bank or with a CSD that fulfils the minimum standards established by the ECB.

\textsuperscript{38} See EMI, “Standards for the Use of EU Securities Settlement Systems in ESCB Credit Operations”, op. cit.
protection for the rights of the NCBs and the ECB in respect of securities held in their accounts in such systems. The legal framework which regulates the SSS must ensure that the holder of securities is entitled with a proprietary right as distinct from a mere contractual claim, in order to be protected in the event of insolvency of the system operator or the depository.

2.4 CROSS-BORDER USE OF COLLATERAL

The cross-border use of collateral is an essential feature of the operational framework of the Eurosystem. It ensures equal treatment of counterparties in the euro area, and fosters integration of financial markets. Counterparties may obtain funds from their refinancing NCB (the “home NCB”) by providing assets issued or held in another Member State of the euro area as collateral. The General Documentation (Chapter 6.6) states that cross-border transfer of securities may take place in accordance with two alternative options: the correspondent central banking model (CCBM), or the links between SSSs.39

The CCBM is based upon a correspondent agreement between the Eurosystem members under which they act as custodians for each other in respect of assets issued or held in their local depository or settlement system. A counterparty which intends to obtain credit from its home NCB instructs its correspondent in the country where its securities are held to transfer them to the central bank of that country (the “correspondent NCB”) for the account of the home NCB. The collateral is managed by the correspondent NCB on behalf of the home NCB: formalities for its perfection and realisation are subject to the law of the state of the correspondent NCB, since the account where the collateral is registered is located there. The correspondent NCB ensures the legal soundness of collateral on the basis of its expertise in the local jurisdiction.40

Links between SSSs allow a participant in one SSS (the “investor SSS”) to hold securities issued in a foreign SSS (the “issuer SSS”) without being a participant in the latter. The investor SSS enters into a depository agreement and opens an account with the issuer SSS on which the global position of its participants is recorded (the “omnibus account”). When a counterparty intends to transfer to the home NCB foreign assets which have been issued in the country of the issuer SSS, the transfer takes place on the books of the investor SSS where both the NCB and the counterparty have their own accounts. The omnibus account held by the investor SSS in the issuer SSS is not affected by the transaction. The collateral is established according to the law of the state of the home NCB, since that is where the relevant account is located. The eligibility of links for their use in monetary policy operations is subject to assessment by the Eurosystem according to the same standards that apply to domestic SSSs.

39 See Perassi, op. cit., p. 510.
40 At the time of the launch of the single monetary policy, the CCBM model was envisaged as a transitional arrangement, since links between SSSs were very limited at that time. The situation has now changed, as the Eurosystem has assessed the eligibility of many links. However, the General Documentation (see footnote 25) no longer refers to the transitional nature of the model. Counterparties may freely decide between one of the two alternative models.
From the perspective of collateral management, the advantage of the correspondent model is that NCBs may benefit from the expertise of their correspondents. This could prove worthwhile, especially if the counterparty is subject to an insolvency proceeding in a foreign state. However, transfer through a link undeniably limits the cross-border dimension of the transactions, since the lex rei sitae and the lex contractus coincide.

2.5 HARMONISATION OF LEGAL DOCUMENTATION

The AMCF are designed to achieve a minimum level of harmonisation with regard to the terms and conditions adopted by the Eurosystem for monetary policy operations. In compliance with the principle of decentralisation, NCBs retain a certain discretion in tailoring legal documentation on the basis of their practice and legal environment. However, harmonisation is also needed to ensure equal treatment among all participants in the euro area as well as to manage credit risk properly. In actual fact, most of the individual AMCF deal with the treatment of counterparty default and the realisation of collateral. The AMCF list the individual instances of counterparty default (AMCF I.6) and the following remedies which should be at the disposal of NCBs. In particular, they should be “in a legal position to realise all assets provided as collateral without undue delay” (AMCF I.7), and “without there being prior claim over the assets concerned” (AMCF II.23). The basic features of repurchase transactions, including mark-to-market arrangements, substitution of assets and the mechanics of close-out netting (II. 17-22), are also part of this minimum harmonisation.

NCBs have implemented such principles in their legal documentation to the extent possible given the legal constraints imposed by national legislation. As already noted, Community legislation was needed to modernise national legislation on collateral as well as to regulate complex cross-border issues and to create legal certainty.

3 EUROPEAN UNION LEGISLATION ON COLLATERAL

3.1 THE BACKGROUND AND THE OVERALL LEGAL FRAMEWORK

Over the last fifteen years, collateralisation has become an essential feature for the proper functioning of monetary and financial markets, payments and securities settlement systems. The increasing volume of financial activity generates credit risks which may have systemic implications, as recognised by the monetary authorities. Measures like collateral, netting and exposure limits (caps) all limit such risks. The derivative markets are based upon the payment of margins to

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41 On the reasons behind the development of collateralisation, see J. Benjamin, Interests in Securities: A Proprietary Law Analysis of the International Securities Markets (Oxford: OUP, 2000), p. 80. Benjamin particularly draws attention to the “need to achieve new regulatory capital efficiencies in an increasingly competitive market”.

clearing houses; other markets and SSSs have put in place guarantee funds to ensure that transactions can be performed. In the secondary money market, transactions with terms longer than one month are mostly collateralised.\textsuperscript{43} Central banks have developed gross settlement systems in order to reduce systemic risks in their national payment systems: intraday liquidity granted against collateral is an essential feature that ensures the proper functioning of these systems.

A common legal framework was needed to reduce legal risks and make collateralisation effective, in particular in a cross-border context. The legislative initiative was spurred by the introduction of the single currency, the establishment of the Eurosystem legal framework and the need to complete the single financial market.


The Eurosystem has contributed to this process through the opinions released by the EMI and the ECB and the participation of its representatives in the drafting working parties, with regard to its twofold function as both a market player and a guarantor of financial stability.

The Settlement Finality Directive (SFD), the Winding-up Directive (WUD) and the Collateral Directive have a special relevance for the collateral activities of the Eurosystem and more generally of monetary and financial markets, and are accordingly individually examined in detail below in sub-sections 3.2-3.4.

3.2 THE SETTLEMENT FINALITY DIRECTIVE

The SFD\textsuperscript{45} aims at eliminating legal risks which affect payment and securities settlement systems in the event of insolvency of their participants. Legal protection of collateral provided to participants in the systems is one of the measures envisaged for this purpose. The SFD also applies to collateral provided in connection with operations of the ESCB, including monetary policy operations, and thereby contributes to the development of the Eurosystem legal framework (Recital No 10). Therefore, the ESCB may be subject to the rules of

\textsuperscript{43} See the ECB report on “The Euro Money Market” (2001), available on the ECB’s website.
\textsuperscript{44} The Insolvency Regulation applies to the insolvency of institutions other than banks, insurance undertakings and investment firms; it has special relevance since its provisions have been partially transposed in the Winding-up Directive. See D. Devos, “The European Directive of 19 May 1998 on Settlement Finality in Payment and Securities Settlement Systems”, in Capital Markets in the Age of the Euro, op. cit., p. 366.
\textsuperscript{45} On the SFD, see Devos, op. cit., p. 361.
this Directive as collateral taker either in intraday credit operations in TARGET, or in other central banking operations.

The definition of collateral (“collateral security”, Article 2 (m)) encompasses “all realisable assets” provided in whatever legal form, including the expressly mentioned pledge and repurchase agreements. The SFD derogates to insolvency law in order to ensure satisfaction of the rights of the collateral taker. Then it sets out the rule of private international law which determines the law applicable to book-entry securities provided as collateral.

The rights of holders of collateral security are “insulated” from the effects of the insolvency of the provider 46 (Article 9): insolvency law is not applicable to collateral takers in so far as it: a) imposes procedural constraints on the right of realisation of collateral (such as waiting periods, judicial authorisation, filing of creditors’ claims, etc.); b) limits the right of the collateral taker to satisfy its claim on the secured assets, by admitting the concurrence or preference of other creditors. Therefore, the general rules applicable to collateral, i.e. the lex rei sitae, should regulate the procedures for realisation. 47 Article 9 applies irrespective of whether one (the main proceeding in the Member State of incorporation) or more proceedings (local proceedings in the Member States with regard to the establishment of branches) are being opened within the European Union (EU); it may also be relevant in the event of proceedings opened in third countries (Article 2 (j)). 48 The Collateral Directive has broadened, as shown below, the scope of application of the principle set out by Article 9.

As already noted, the rule of lex rei sitae required adaptation to the peculiar nature of book-entry securities. Article 10 of the Directive is based upon the so-called place of the relevant intermediary approach (PRIMA), according to which the rights of collateral holders on securities which are legally recorded on a register, account or centralised deposit system located in a Member State shall be governed by the law of that Member State. The PRIMA has been broadly considered as a qualification of the lex rei sitae rule, although one distinguished scholar has drawn attention to its peculiarity 49, since in the absence of a paper form, it is no longer possible to identify the physical location of the security.

3.3 THE WINDING-UP DIRECTIVE

The WUD 50 has further contributed to legal certainty with regard to the enforceability of collateral in the context of insolvency proceedings of banks.

46 Devos, op. cit., p. 385, notes that this provision takes inspiration from Article 5 (1) of the Insolvency Regulation, but goes further than it since “insulation” also takes effect when the assets provided as collateral are located in the same Member State as the one where the insolvency proceedings have been opened, whereas Article 5 applies the same principle only in the event that assets are located in another Member State. See also Chapter 3.2, footnote 55.
47 See Devos, op. cit., p. 386.
48 In this case, the receiver may not challenge Article 9 on the grounds of its incompatibility with the local insolvency law, since the Directive should be considered part of the international public policy of Member States. See Devos, op. cit., pp. 377-78.
It has introduced a regime of mutual recognition of measures for bank crises. A clear legal framework is now in place with regard to the authorities entrusted with crisis management and the national law which comes into play. The WUD applies to the crisis (reorganisation measures or winding-up proceedings) of banks in the European Community with at least one branch in a Member State other than the one in which they have their headquarters, and only to the crisis of branches of non-EC banks when such banks have branches in at least two Member States. It is based upon the principles of unity and universality. The principle of unity provides for the exclusive jurisdiction of the home Member State’s administrative or judicial authorities regarding the decision to implement a crisis management measure in a specific bank, including in branches established in another Member State (Articles 3.1 and 9.1). The Community legislator does not intend to depart from the “home country control” rule in case of difficulties, and will grant equal treatment to all creditors in case of liquidation. The principle of universality implies that a single insolvency proceeding, established and regulated by the home Member State’s law, shall be effective with the consequent prohibition of any secondary proceeding being opened by the host authorities. The decisions taken within the proceeding shall be recognised and capable of producing effects in all Member States, without need of any formality or *exequatur* procedure.

The application of the principle of universality is mitigated by the introduction of some exceptions which provide for the application of the *lex rei sitae* or the *lex contractus* instead of the *lex concursus*. It is worth noting that a number of these exceptions relate to financial transactions and collateral arrangements. In such cases, the forum concursus shall apply foreign insolvency law to determine the treatment of these rights and contracts.

The derogation in favour of the *lex rei sitae* is justified by the fact that the location of the assets to which the rights refer creates an objective connection with another jurisdiction. These exceptions relate, inter alia, to rights on dematerialised or immobilised financial instruments where the register, account or centralised deposit system is held or located in a Member State (Article 24). In this case, in line with the PRIMA, the law of the Member State where the relevant account is located, i.e. its insolvency law, shall regulate the enforcement of proprietary rights.

The location of assets is also relevant regarding rights in rem in respect of tangible or intangible, movable or immovable assets belonging to the credit

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51 This derogation is also contained in the Insolvency Regulation (Articles 5 to 15).
52 Galanti, op. cit., p. 51, explains this outcome as a compromise adopted in the course of preparatory works between the supporters of a paramount application of the universality principles, and the advocates of a “softened” universality which would have allowed secondary proceedings. In particular, the latter were concerned about the treatment of local creditors, whereas the former considered the opening of secondary proceedings inconsistent with a system based on home country control. The compromise solution gives some protection to creditors in host Member States, while at the same time ensuring that there is no possibility of a further set of legal proceedings being initiated (see also Campbell, op. cit., p. 11).
53 However, Recital No 17 states that the exceptions in favour of the *lex loci* or the *lex contractus* have to be literally interpreted, while other issues, “such as the lodging, verification, admission and ranking of claims concerning those contracts and rights and the rules governing the distribution of the proceeds of the realisation of the assets […] are governed by the law of the Member States”.
54 The other derogation concerns rights in respect of immovable property, a ship or an aircraft subject to registration (Article 20 (b) (c)).
institutions, or rights based on a reservation of title on assets which are situated within the territory of another Member State at the time of adoption of the insolvency proceeding (Articles 21 and 22). Such rights, according to the provision, are not “affected by the insolvency proceedings”.

Netting agreements, repurchase agreements and transactions carried out in the context of regulated markets (Articles 25 to 27) remain subject to the lex contractus, whose application is justified by Recitals 23 and 24. The conflict of the lex concursus with the rules normally applicable in the context of the economic and financial activity of the credit institution and its branches must be regulated, in particular to ensure the security of transactions and the protection of the integrity of regulated markets. This approach follows the same direction adopted by the SFD, whereby the law regulating the system (the lex contractus), rather than the lex concursus, determines the rights and obligations of a participant regarding the system. In this way, both Directives encompass not only the settlement of transactions, but also dealing on financial markets and bilateral netting agreements, on the basis of the same principle of the lex contractus. It has been noted that these rules allow not only free choice in terms of the law applicable to this legal relationship, but also the chance to choose an applicable law taken from outside the EU. This may lead to a tendency to select the most favourable legal jurisdiction (“choice of law shopping”), and may even cause disintermediation in the European markets.

This remark leads us to some concluding considerations on the objective and effects of the provisions set out by the WUD. This Directive dictates rules which permit the solution of conflicts of law. This approach is of great value in terms of legal certainty: in the banking sector, the opening of potentially conflicting insolvency proceedings is no longer admitted; a financial market or a central bank that has contractual relationships with a number of operators may establish ex ante that only one single law, i.e. either the lex contractus or the lex rei sitae, will apply to its transactions, irrespective of the place of incorporation of counterparties. However, in some cases the determination of the applicable law may indeed be unclear, especially taking into account the recalled principle of literal interpretation of derogations to the lex concursus.

55 This rule repeats the content of Article 5 of the Insolvency Regulation and is also similar to Article 9 of the SFD. However, under the Insolvency Regulation “the insulation” does not take place when secondary insolvency proceedings are opened: in such an event, the rights of the collateral taker shall be subject to the insolvency law of those proceedings. With regard to banks, secondary proceedings are not contemplated by the Directive. According to Devos, op. cit., p. 373, Article 21 means that the holder of the right in rem “should be exempted from any restrictive rules intending to avoid abuses to the detriment of other creditors”. Galanti, op. cit., p. 62, holds that a narrower interpretation of Article 21 may be that rights in rem “do not straightaway escape from the proceeding but that they are not voided as a simple effect of its opening”. This latter position may be supported by the fact that rights in rem as defined by Article 21 cannot benefit from more favourable treatment than rights on book-entry securities, which would be subject to the lex rei sitae as defined by Article 24. In any case, Article 21 is without prejudice to the application of the special regime regulated by the SFD with regard to collateral given to central banks and participants, with the insulation of the rights of collateral holders from insolvency law (Recital No 26).

56 However, even the provision on set-off (Article 23) contains a derogation to the lex contractus which is based upon the contract law applicable to the claim of the credit institution subject to set-off.

57 See Galanti, op. cit., p. 61, who reports that the advocates of derogation put forward this argument in the course of preparatory work.

58 Galanti, op. cit., p. 61.
The WUD did not aim at harmonising substantive rules on insolvency in the EU. In the context of this Directive, harmonisation was not a realistic objective (see Recital No 6). Further progress toward a reduction of legal risks called for greater harmonisation of the European insolvency law with regard to the treatment of collateral arrangements, taking the objective of ensuring the competitiveness of the European financial market into account.

### 3.4 THE COLLATERAL DIRECTIVE

The Collateral Directive is the last and the most ambitious piece of EU legislation on collateral issues. It complements the other legal acts considered above (Recital No 4), but in fact goes well beyond their limited scope in this field. The Commission announced its intention to proceed further with legislation on collateral in its Financial Services Action Plan (FSAP) after the adoption of the SFD. The preamble of the Collateral Directive explains its objective: “A Community regime [...] for the provision of securities and cash as collateral [...] will contribute to the integration and cost-efficiency of the financial markets as well as to the stability of the financial system” (Recital No 3). This Directive also aims at improving the efficiency and legal soundness of the cross-border operations of the Eurosystem, which are necessary for the implementation of monetary policy, and at improving collateralised transactions entered into the secondary money market (Recital No 12).

The Collateral Directive concentrates on the profile of harmonisation: only one provision is devoted to conflict of law issues (Article 9, on the law applicable to book-entry securities collateral). It touches upon aspects regulated by the *lex contractus* (the recognition of title transfer arrangements and right of use), the *lex rei sitae* (perfection and enforcement) and the *lex concursus* (close-out netting and avoidance rules). Harmonisation has requested material amendments to the basic rules of civil law, which are all extremely ancient. However, the Council adopted the Collateral Directive in a very short timeframe, one year after the proposal of the Commission. This apparent contradiction may be explained by the fact that this Directive takes its inspiration from consolidated market practice, as embodied in the master agreements adopted by the financial market associations. Moreover, past case laws have often recognised legal arrangements such as repo contracts, close-out netting and marking to market, even though they were not expressly regulated by national civil law. Finally, the previous Directives paved the way for this comprehensive legislative intervention.

### 3.4.1 SCOPE OF APPLICATION AND PERFECTION REQUIREMENTS

The Collateral Directive applies to public authorities, central banks, financial institutions subject to prudential supervision and central counterparties,
settlement agents and clearing houses; it also applies to non-financial entities other than natural persons, provided that the other party of the collateral arrangement is a public or financial institution as listed above (Article 1.2). The issue of its subjective scope proved very controversial in the course of preparatory work. The Commission had originally submitted that only large-sized legal persons other than financial institutions would be encompassed by the Directive, as the proposed legislation was addressed to the needs of the monetary and financial markets. Some delegations, by contrast, were in favour of extending the subjective scope to all undertakings, or even to natural persons, in order to avoid any disparity of treatment or segmentation of the credit market. Others supported instead a restrictive approach, since the Collateral Directive sets out a derogation to the insolvency law. Final agreement was reached with the inclusion of an opt-out clause: Member States may decide to exclude non-financial entities from the scope of the Directive. To our knowledge, only a few countries have exercised this opt-out clause.

Regarding its objective scope, the Directive applies to financial collateral, i.e. cash and financial instruments, taken for the purpose of securing financial obligations, namely obligations which give right to cash settlement and/or delivery of securities (Article 2.1 (d-f)). The ECB suggested extending the notion of financial collateral in order to cover all types of assets that are eligible for Eurosystem credit operations, including credit claims in the form of bank loans. However, this proposal was not accepted, probably for procedural reasons.

The definition of collateral arrangements (Article 2.1 (a-c)) encompasses title transfer arrangements (i.e. arrangements, including repurchase agreements, under which a collateral provider transfers full ownership of the collateral to the collateral taker); and security arrangements (i.e. arrangements under which a collateral provider provides collateral by way of security to, or in favour of, a collateral taker, and under which the full ownership of the collateral remains with the collateral provider).

The Collateral Directive takes its inspiration from the “functional approach” typical of common law, which is based upon the underlying economic function of the collateral arrangements. Continental civil law, on the other hand, is based on the “formal approach”, i.e. the provision of a specific form devoted to security (pledges). The ECB has welcomed the functional approach, since it

62 The ECB (in its Opinion of 13 June 2001, OJ C 48, 12.7.2001, p. 10, paragraphs 7-8) expressed concern that the application of thresholds would create uncertainty and as a compromise proposed that the provisions that do not deal with protection against insolvency, but with substantive law or the conflict of law rule, could be made generally applicable.
63 Namely Austria, Malta, Slovakia, Sweden, France and Germany (in the latter three cases to a very limited extent). This implies that most states have solved the trade-off between a broader derogation to the civil and insolvency law regime and the risk of segmentation of the credit market and of choice of law shopping in favour of the first option.
64 Opinion of the ECB, op. cit., paragraph 10.
encompasses and protects all the collateral techniques adopted by the Eurosystem. The functional approach implies the legal recognition of security based on title transfer arrangements (see Article 6) and, in particular, of repurchase agreements, which some jurisdictions did not consider valid yet or did not expressly regulate. In fact, the Collateral Directive goes even further than this by extending rights of use, of appropriation and close-out netting, which are normally linked to title transfer arrangements, to security collateral. It follows that the differences between the two legal forms of collateral are becoming increasingly indistinct.

For the purpose of its application, the Collateral Directive requires that financial collateral “has been provided” and that “provision can be evidenced in writing” (Article 1.5). Provision is defined (Article 2.2) as collateral “being delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of the collateral taker”. Evidencing the provision requires the identification of the financial collateral. Recital No 9 explains that “provision” not only defines the scope of application of the Collateral Directive, but also sets out the “only perfection requirement that national law may impose in respect of collateral” (see also Article 3). The objective is to limit the “administrative burden for parties using financial collateral”. The perfection or enforceability of collateral may not be subject to any other formal acts, such as those listed by Recital No 10. The Collateral Directive considers that this solution provides a balance between market efficiency and the safety of parties to the arrangement and third parties, thereby avoiding inter alia the risk of fraud. However, a distinguished scholar has criticised the dismissal of any system of publication, since even the functional approach broadly recognises the need for publicity, which would also be easy to implement with modern technology, in order to protect the interests of third parties to obtain information on the assets of their debtors.

3.4.2 ENFORCEMENT

The Collateral Directive extends the privileged treatment on the enforcement of collateral recognised by the SFD for the benefit of central banks and systems to collateral arrangements entered into by the other parties covered by the Collateral Directive. Moreover, the derogation is not limited to disapplication of the lex concursus, as set out by the SFD, but also impinges on the lex rei sitae, since the special enforcement rules are also relevant upon the occurrence of events of default not related to insolvency.

The Collateral Directive is designed to introduce rapid and non-formalistic enforcement procedures with the aim of safeguarding financial stability and

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66 See the Opinion of the ECB, op. cit., paragraph 6.
67 The recognition of the right of use is somewhat anomalous since it goes against the general principle of nemo plus ius transferre potest quam ipse habet, although the right is subject to the agreement of the collateral provider. On the right of use, see Morton, op. cit., p. 18. The Collateral Directive holds that the right of use will increase liquidity in financial markets (Recital No 19).
68 The collateral arrangements under which Morton has been provided must be also evidenced in writing or in an equivalent manner (Article 1.5, 3rd sub-paragraph).
69 For the purpose of book-entry securities collateral and cash, it is sufficient to prove that provision has been registered in the proper account (Article 1.5, 2nd sub-paragraph).
limiting contagion effects in case of a default of a party (Recital No 17). For this purpose, it leaves parties considerable freedom in the definition of enforcement mechanisms. However, discretion creates risks of abuse that may have a material impact on financial stability as well. The Collateral Directive only partially contrasts these side-effect risks, as this paper demonstrates below.

Collateral may take effect in accordance with the terms agreed in the financial arrangements, notwithstanding the commencement of winding-up or reorganisation measures (Article 4.4). The definition of reorganisation measures also includes cases in which authorities decide to suspend payments (Article 2.1 (k)). In such cases, rapid realisation may conflict with the interest of prudential supervisors in effective reorganisation measures and the stability of the financial system, as the ECB has also pointed out.71 The same risk exists with regard to the definition of “enforcement events”, i.e. events of default or similar events agreed between parties which may trigger the right of enforcement (Article 2.1 (l)). The provision seems to leave full discretion to the parties on the definition of what is “similar” to an event of default72: courts can hardly control the material relevance of such events on this basis.

Articles 4.1 and 4.2 define the enforcement procedures for security collateral arrangements. Financial instruments may be realised by sale or appropriation73 (the latter only if parties have agreed and have determined the valuation of the financial instruments). Cash collateral may be realised by set-off. Article 4.4 specifies the principle of the rapid and non-formalistic enforcement procedure by clarifying that, subject to the terms agreed by the parties, realisation of collateral should not be subject to formal procedures as listed in the article (prior notice, approval of courts, public sale and waiting periods).

Article 7 provides for the full recognition of close-out netting clauses: these may take effect in accordance with their terms, and prevail on mandatory insolvency rules and on legal set-off mechanisms.74 It is worth noting that the definition of close-out netting (Article 2.1 (n)) aims to include all the possible variants which the practice elaborates. Close-out netting provisions of derivative arrangements, such as the International Swaps and Derivatives Association (ISDA) master agreement or the European Master Agreement (EMA), should also be included in the scope of the definition to the extent that a financial collateral arrangement should form part of the derivative arrangement.75

The provisions briefly examined above (Articles 4 to 7) are subject, according to Article 4.6, to any requirement under national law to the effect that the

71 See the Opinion of the ECB, op. cit., paragraph 13.
72 The approach of the Directive reflects the current market practice embodied in the standard contractual documentation, which usually contains a detailed list of events of default or termination events.
73 Member States that did not allow appropriation on 27 June 2002 are not obliged to recognise it. To our knowledge, no state has yet exercised its right to opt out.
74 For more on netting, see P. R. Wood, Title Finance, Derivatives, Securitisations, Set-off and Netting (London: Sweet & Maxwell, 1995).
75 According to Article 6.2 (on the recognition of title transfer collateral) and Article 5.5 (on the right of use), the obligation of the collateral taker to transfer equivalent collateral may also be subject to a close-out netting provision.
realisation or valuation of financial collateral and the calculation of the relevant financial obligations must be conducted in a commercially reasonable manner. The Community legislator has therefore left it up to Member States to decide whether the collateral provider or third parties, including receivers or liquidators, should have any right to challenge the realisation procedure or the relevant clauses agreed by parties. This approach can be criticised, since a principle of harmonisation on this very sensitive issue would have been appropriate in order to avoid the risk of competing legal jurisdictions. However, it is acknowledged that the risk of abuse is substantially reduced when parties adhere to standard market documentation which sets out criteria for the realisation and valuation of financial collateral and the calculation of financial obligations.

3.4.3 DISAPPLICATION OF INSOLVENCY LAW

Article 8 of the Collateral Directive provides for a minimum harmonisation of national insolvency rules which, in order to ensure compliance with the *pari passu* principle, regulates the validity of collateral arrangements entered into in a prescribed period prior to the commencement of the insolvency proceeding or on the same day of commencement. These rules are peculiar in every jurisdiction: in some cases, automatic avoidance rules based only on the timing of transactions are in place, whereas in other cases the voidness of an act is subject to further or different circumstances, such as the detrimental nature of the act to the estate and the creditors or the bad faith of the counterparty. The Directive is intended to repeal just the national provisions that belong to the first category.

Article 8.1 states that financial collateral arrangements and the provision of collateral under such arrangements cannot be declared void *on the sole basis* that they have come into existence or have been provided on the day of the commencement of the proceeding, but prior to the issuance of the decree (the “zero hour rule”), or in a prescribed period prior to the commencement of the proceeding (“the suspect period”). Article 8.2 ensures the validity of any collateral activity arising on the same day of the proceeding but after its commencement, if the collateral taker proves its good faith.

The Collateral Directive further repeals the “zero-hour rule” with regard to collateral arrangements that lie outside the scope of the SFD. The protection of collateral provided after the commencement of proceedings is entirely new, as the SFD contains a similar provision to be used only “exceptionally” in the case of transfer orders (Article 3.1, 2nd paragraph).

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76 See also the Opinion of the ECB, op. cit., paragraph 13.
77 In the wake of this, the Italian legislator (Article 8.1 of the Legislative Decree of 21 May 2004, No 170, in *Gazzetta Ufficiale della Repubblica Italiana*, No 164, 15 July 2004, p. 11), has stated that contractual clauses on realisation and valuation are presumed to be commercially reasonable if they are in line with contractual arrangements determined by the Banca d’Italia, in agreement with the *Commissione Nazionale per la Società e per la Borsa* (the Italian supervisor for the stock exchange and financial markets), taking into account market practices on collateral arrangements.
78 Subject to the contents of Article 8, the Directive leaves the general rules of national law unchanged in relation to the avoidance of transactions (Article 8.4).
79 The provision applies where on such a day and after the commencement of the proceeding, a financial collateral arrangement or a relevant financial obligation has come into existence, or financial collateral has been provided.
Article 8.3 provides for special regulation of top-up collateral and substitution clauses. These clauses regulate very common market practices in the financial markets, and are normally included in the standard market documentation. They are considered by regulators and supervisory authorities as a sound system for managing credit risk. It is worth noting that the definition of top-up collateral does not cover collateral provided as a consequence of a deterioration in the financial soundness of the debtor: this is not accidental, as national insolvency law does not generally recognise protection to disposition of assets in favour of creditors that are aware of a deterioration in the financial position of their debtors.

The Collateral Directive requires the repeal of national rules which provide for invalidity of provision of top-up or substitute collateral on the sole basis of the timing of the provision, as defined by Article 8.1, and/or on the basis that relevant financial obligations were incurred prior to the date of the provision of the top-up or substitute collateral. As for Article 8.1, the wording “on the sole basis” implies that whenever national legislation makes the avoidance rule subject to requirements other than those set by Article 8.3, such as bad faith on the part of the collateral taker, there is no need for implementation in national legislation.

3.4.4 THE EXTENSION OF THE PRIMA APPROACH

The Collateral Directive has extended the scope of application of the PRIMA to cases where the relevant account is located outside the EU. Article 9 of the Collateral Directive lists those matters that are regulated by the law of the location of the relevant account in relation to book-entry securities collateral (legal nature and proprietary effects, perfection and realisation, competing titles, etc.).

4 CONCLUDING REMARKS

The establishment of a EU legal framework on collateral has clearly substantially reduced the legal risks encountered by the Eurosystem and financial operators in financing operations. However, there are three main reasons why this process is far from complete.

80 Article 8.3 (a) defines top-up collateral as an obligation to provide financial collateral or additional financial collateral in order to take account of changes in the value of the financial collateral or in the amount of the relevant financial obligations. A substitution clause (Article 8.3 (b)) entrusts the collateral provider with a right to withdraw financial collateral upon providing, by way of substitution or exchange, financial collateral with substantially the same value.

81 In this respect, the Opinion of the ECB (op. cit., paragraphs 17 and 18) supports the protection of such clauses as a way of fostering the effectiveness of risk control management systems, including the risk control framework of the Eurosystem. In particular, the recognition of substitution of assets would allow financial operators to increase the effectiveness of collateral management, as well as to contribute to the smooth functioning of securities settlement systems by reducing settlement failures and thus enhancing financial stability.

82 See Recital No 11 of the Commission’s proposal.

83 In fact, the existence of a time-lag between the existence of the financial obligation and the provision of collateral is often considered by insolvency law as evidence of an absence of consideration or of the existence of fraud.

84 See Morton, op. cit., p. 35.
Firstly, the WUD and the Collateral Directive have not yet been implemented by all Member States, notwithstanding the expiry of the envisaged deadlines. The assessment of consistent implementation among Member States will be crucial in order to ensure a level playing-field in the markets and the proper functioning of the adopted rules in a cross-border context.

Secondly, the Eurosystem’s legal framework on collateral is subject to adaptation prompted by the process of consolidation of the regulatory and operational framework. A notable example is the recent decision85 to include credit claims in the form of bank loans in the prospective single list of eligible collateral. Credit claims have not been regulated by the examined EU Directives. Some harmonisation of national legislation concerning this kind of collateral might be warranted, as recalled by the ECB in its Opinion on the Collateral Directive.

Thirdly, regulation on book-entry securities remains at the top of the agenda of the Community legislator in the field of financial law. As far as international private law is concerned, the possible ratification of the recent Hague Convention would require amendments to the Directives at hand.86 In the meantime, the Commission has announced that it intends to propose harmonising substantive law on interest in securities with an intermediary, as the absence of such a law is now considered to be the most important source of legal risk in cross-border transactions.87

85 See the last version of the General Documentation, footnote 29.
87 On this project, see the Communication of the Commission of 28 April 2004 on “Clearing and Settlement in the European Union – The Way Forward” (COM (2004) 312). The International Institute for the Unification of Private Law (UNIDROIT) has been working on the same project and has already produced a preliminary draft convention (available at www.unidroit.org).
THE HAGUE CONVENTION ON THE LAW APPLICABLE TO BOOK-ENTRY SECURITIES – THE RELEVANCE FOR THE EUROPEAN SYSTEM OF CENTRAL BANKS

Diego Devos

ABSTRACT

Finora si è osservato un considerevole grado di incertezza giuridica a livello internazionale, in relazione alla determinazione di una precisa legislazione nazionale relativa ai titoli accreditati su un conto presso un intermediario in una dimensione internazionale, dovuta alla varietà dei possibili sistemi legislativi (legge dell’emittente, legge del luogo in cui i certificati sottostanti - certificati cartacei del tipo al portatore - possono essere fisicamente depositati o detenuti, legge di registro, legge dell’emittente CSD - Central Security Depository, legge di un altro intermediario a livello superiore o inferiore, etc.). Tale incertezza genera a sua volta rischi giuridici per l’industria dei valori mobiliari e gli investitori nella misura in cui la legge che regola i titoli smaterializzati determinerà la protezione offerta al possessore in caso di insolvenza dell’intermediario, nonché le formalità da adempiere per creare, perfezionare e attuare i contratti di garanzia finanziaria su tali titoli. L’applicazione di un’altra legge, diversa da quella attesa dalle parti, al rapporto di custodia potrebbe in realtà compromettere i diritti di proprietà dell’investitore, o invalidare le sue operazioni di garanzia finanziaria qualora i requisiti di quest’altra legge non fossero stati soddisfatti.

A livello UE, le Direttive sulla Definitività del Regolamento, la Riorganizzazione e la Liquidazione degli istituti di credito e il Collaterale hanno notevolmente elevato il livello di certezza giuridica, ma rimangono limitate alla UE, senza rivolgersi al resto del mondo e tener conto di tutti gli aspetti rilevanti per i possessori di titoli e tutti gli operatori di mercato. E’ proprio questo che la Convenzione dell’Aia sta ora realizzando, determinando la legge applicabile ai titoli smaterializzati con particolare riferimento alla legge scelta per regolare l’accordo relativo al conto titoli. Lo studio commenta la Convenzione dell’Aia incentrandosi sui suoi principali risultati in vista delle suddette incertezze giuridiche. E in conclusione spiega anche perché tale Convenzione dovrebbe essere particolarmente rilevante in una prospettiva SEBC.
INTRODUCTION

1. The need for legal certainty when dealing with securities held through intermediaries on a cross-border basis is undisputed among market players, law practitioners and public authorities. This need is at the heart of multiple law reforms introduced at national level over the last 20 years as well as at international or at European level, with the adoption by the European Union (EU) of the Settlement Finality Directive (SFD)\(^1\), the Directive on the Reorganisation and Winding-up of Credit Institutions\(^2\) (WUD) and, more recently, the Collateral Directive\(^3\). These legal reforms were aimed at improving the substantive legal regimes of collateral transactions and of transfer of securities (and cash) in general, particularly against insolvency risk of the counterpart, the intermediary holding the securities itself, or of any third party (creditors, etc.) interested in the securities transaction.

2. It is however pointless to achieve the best possible legal protection of securities transactions in a national environment if, on the other hand, uncertainties remain about the determination of the applicable national law governing a particular securities transaction in a cross-border dimension. Of course, this question is less of an issue when for example two domestic banks exchange domestic securities on behalf of domestic clients in a domestic central securities depository (CSD), which will naturally take place under the law of the domestic jurisdiction in question. However, financial transactions nowadays are often substantially more complicated with many international aspects to consider, such as the involvement of foreign market players conducting transactions from abroad on a remote basis with a domestic player or through a domestic branch. Domestic players also deal with foreign securities, either in the domestic CSD that holds such foreign securities via a link with another CSD, or with a custodian in the jurisdiction where these securities were issued and are primarily deposited, or even directly in the local market. Additionally, they may themselves hold securities on behalf of domestic or foreign customers, and so on. Central banks that are members of the European System of Central Banks (ESCB) have since 1998 adopted rules on the eligibility of assets for monetary policy purposes and on the

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cross-border use of collateral (correspondent central banking model (CCBM) arrangements and the use of eligible links between eligible securities settlement systems (SSSs)). This represents a departure from long-standing monetary policy traditions, which classically limited the range of securities eligible as collateral for refinancing purposes to domestic assets.

3. In the above context, the specific need for legal certainty with respect to determining which law will govern the holding of securities has been stressed many times in the legal literature, as well as in the preparatory Report prepared by the Permanent Bureau of the Hague Conference on Private International Law, which seeks to justify the adoption of what has become the “Convention on the law applicable to certain rights in respect of securities held with an intermediary” (“the Hague Convention”), adopted by the Nineteenth Session of the Hague Conference on 13 December 2002. The Hague Convention is the subject of this paper. The reader is referred to the rationale explained in this preparatory report as well as in the Explanatory Report of the Hague Convention prepared by three professors of law (Roy Goode, Hideki Kanda and Karl Kreuzer) with the assistance of Christophe Bernasconi (henceforth “the Report”), which can be found on the website of the Hague Conference.

2 THE ISSUES

4. In seeking to assess the important and complex issues addressed by the Hague Convention, it is necessary to revisit the overall situation as a whole, since it is probably in this field that some misunderstandings may have arisen in the past – misunderstandings which are currently influencing the debate about the need to have the Hague Convention adopted at EU level. This is why it is worth recalling some basic principles of conflict of laws in relation to securities. This paper will subsequently address the issues at stake in the context of indirect holding of securities and the correlative criteria that have to be taken into account as part of the commentary on the Hague Convention itself.

The key principles to take into account when looking at the determination of the law governing indirectly held securities are as follows:

a) It is generally admitted that the law applicable to securities in the direct relationship between the end-investor and the issuer is the domestic law under which these securities were issued. This is the domestic company law, or *lex societatis*, of the domestic issuer for domestic issues in the form of equities

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4 See “The Oxford Colloquium on Collateral and Conflict of Laws” held at St John’s College, Oxford University, in Butterworths Journal of International Banking and Financial Law, special supplement September 1998.
6 http://www.hcch.net; see also the rationale indicated in the Proposal for a Council Decision concerning the signing of the Hague Convention on the law applicable to certain rights in respect of securities held with an intermediary, presented by the EU Commission on 15 December 2003 (COM (2003), 783 final).
or bonds, which is in common law countries determined by reference to the place of incorporation of the company; and in continental law systems, by reference to the place of the main seat of the company. Alternatively, for international bonds, the applicable law is determined by reference to the *lex contractus*, the law governing the issue of such international bonds (as selected in applicable contractual issuing documentation, e.g. the prospectus, etc.).

b) It is also generally recognised that the law applicable to the listing and trading of securities listed on a particular stock exchange is indeed the law of that stock exchange; the law applicable to the netting process in case of intervention by a central counterpart (clearing) is the law chosen to govern such contractual netting (generally by way of novation).

c) Again, it is not disputed that the law applicable to over-the-counter (OTC) securities transactions between the two relevant counterparts is the law governing the particular OTC transaction (forward sale, repo, transfer of title, loan, sale and buy-back, securities swap, etc.) as *lex contractus* (see Article 3 (1) of the Rome Convention of 19 June 1980 on the law applicable to contractual obligations in the EU).

d) Categories a) to c) above are however restricted to the institutional and contractual aspects of the issuance and transfer of securities vis-à-vis the issuer or the counterpart. As such, they do not concern third parties with respect to either the enforceability of the possible transfer of ownership that the securities transaction may entail, or the enforceability of the collateral transaction, especially in case of insolvency or any other form of competition between creditors. Nor do they address the law governing the rights of the holder of the securities account in case of insolvency of the intermediary maintaining the account. In other words, the above categories do not address the proprietary aspects of securities holdings, which are usually governed under private international law by the so-called *lex rei sitae* rule, which refers to the law of the place where the relevant assets are located.

e) The *lex rei sitae* (or “*lex situs*”) rule is relatively easy to apply in the case of direct holdings (and related transactions) of bearer securities in paper (“physical”) form, as these are indeed governed by the law of the place where such paper certificates are physically located or held, as is the case for any

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9 Van Houtte, op. cit., 4.22–4.24; see also Article 9 of Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, OJ No L160 of 30.06.2000, pp. 1-13, which states that “the effects of insolvency proceedings on the rights and obligations of the parties to […] a financial market, shall be governed solely by the law of the Member State applicable to that […] market”.
other moveable asset.\textsuperscript{13} Under the same \textit{lex rei sitae} rule, registered securities are governed by the law of the place where the register, which constitutes the rights of the holder, is located or maintained\textsuperscript{14}, as such securities are represented by entries on the register maintained by the issuer or its agent (the so-called registrar).

f) Difficulties started to emerge when securities became largely held through intermediaries, which felt the need to dispense with physical paper certificates or the requirement to generate entries in the issuer’s register every time registered securities were transferred between their clients. Financial intermediaries in every country decided to “immobilise” their securities with a common agent (the CSD or any other central custodian) so that the only way to exchange securities was by way of book-entry transfers between themselves. This eliminated the need to physically move pieces of paper or make entries in the register (through the use, where possible, of a nominee of the CSD or of its affiliates to hold on a pooled basis registered securities on behalf of ultimate beneficial owners). In some systems, a new form of securities – so-called dematerialised securities – was created. This last type of securities is only represented by book-entries on accounts held with authorised account-keepers in the books of a CSD in direct relation to the issuer. Even just at the domestic level, this trend created a strong need for legal protection of securities \textit{held in book-entry form}. Certain key issues distinct from the rules applied to the underlying securities as such needed to be addressed, such as: what would happen in case of insolvency of the CSD/central custodian with respect to the underlying paper certificates held in bearer form by the latter? What would happen in case of insolvency of the custodian/account-keeper? The same also applied to collateral transactions on such book-entry securities, since pledging of a securities account per se may represent a more efficient and adequate solution in view of the book-entry character of the securities immobilised in this fashion, compared with a physical delivery of securities to the pledgee or with special segregated physical storage in the hands of a common agent.

g) The intervention of foreign market players also willing to offer to their own customers the benefits of immobilising securities issued in different domestic jurisdictions through book-entry holdings\textsuperscript{15} logically led intermediaries to centralise in their own books, again in book-entry form, all the entitlements of their clients with respect to the underlying securities already held at local level in book-entry form on behalf of their clients. By doing so, intermediaries were able to offer their customers a centralised pool of assets governed by the same rules irrespective of where the underlying certificates were ultimately held or deposited. These securities could then be transferred or pledged centrally without necessarily physically moving either the paper

\textsuperscript{13} Van der Elst, op. cit., No 78; Dicey and Morris, op. cit., No 22-040.
\textsuperscript{14} Van Houtte, op. cit., No 1.10, p. 15; Dicey and Morris, op. cit., No 22-044.
certificate or the local book-entry corresponding to the holding (except for deliveries with another local recipient). This is the so-called intermediated or indirect holding system, which basically implies a chain of intermediaries (registrar, CSD, CSD participants, custodians at various levels) between the ultimate beneficiary and the issuer. It is also on this basis that links between CSDs have been established, even though some features of such links may differ from standard custody relationships and practices.

h) The protection of investors that own foreign securities held on such an intermediated basis may vary, depending on the jurisdictions and the legal regime organised for such indirect holding systems16 (e.g. ownership or co-ownership in a pool composed of the securities of the same issue credited on the books of the intermediary, which reflects the holding of underlying securities held ultimately by the intermediary). Such an ownership right may either be regarded as directly traceable to the underlying securities – as far as the law of the intermediary is concerned – or only be enforceable against the intermediary (as evidenced by the book-entries in its records) with, however, enforceable recovery rights (including in case of insolvency of the latter). In this last regime, the intermediary must have in turn the enforceable right to obtain restitution in kind (for bearer certificates, through physical delivery; for registered securities, through the re-registration of the ultimate owner in the issuer register; or for dematerialised securities, through their transfer to another account keeper of the investor’s choice) of the underlying securities for the benefit of the account holders up to the amount recorded in their respective securities accounts.

i) In view of the intermediated/indirect holding structure as described in points (f) to (h) above, it is crucial to make sure that when holding securities through a chain of intermediaries, the law governing the custody relationship at each level of the chain is also the only law applicable between the relevant intermediary at that level in the chain and its respective account holder (or between different account holders of the same intermediary), with respect to the holding of book-entry securities as such and to their transfer, whether outright or for collateral purposes, and not the law of the jurisdiction where the underlying securities are primarily issued and deposited (nor the law of another intermediary one level above or below the relevant level in the multi-tiered custodial chain). This risk that a foreign court could decide to apply not the law of the custodian, but instead the law of the place where the underlying securities are deposited or registered to determine under which conditions a transfer of ownership can be enforceable or a pledge be perfected (i.e. made good against third parties) is known as the “look-through” approach (so named because the Court would in this instance look through the book-

entry intermediated holding to apply only the law of the place where the underlying securities are physically located or, alternatively, the law of the issuance).\(^{17}\) This approach probably constitutes one of the major legal risks in the cross-border securities business, since it could potentially jeopardise the legal certainty required for a securities account relationship with an SSS or a custodian by disregarding the law of the custodian expected to be applied by the parties, and on the basis of which they designed the account structure, its rules and protection, in favour of another law that the account holder does not know. This last solution can in practice only work properly if the end-investor has its securities account directly opened with the issuer CSD in a segregated position. It certainly will not work if the underlying securities are held on a fungible pooled basis in the name of an intermediary by means of an omnibus account representing the total amount of clients’ positions, or on a nominee registration basis for registered securities in the books of the issuer or of its registrar. In such a case, which is standard practice in almost all indirect holding schemes, the law of the place of the underlying certificates will of course continue to govern the property aspects of the custody relationship between the intermediary (holding for the account of its clients) and its custodian at local level (the issuer CSD, another custodian, the registrar or the issuer directly). However, it will not determine the rights of the clients of such an intermediary that have no direct contractual or property rights on the underlying securities. The property rights and related collateral rights of clients holding through their intermediary will be determined by the law of the place where their assets are “located”, which is the law of the jurisdiction in which their rights in the securities are recorded on the accounts of their intermediary, i.e. the law governing the book-entry securities held with such an intermediary.\(^{18}\)

\(^{18}\) The right relating to book-entry securities held indirectly with an intermediary is generally called in Anglo-Saxon terminology “interests in securities”. In the US it is also known as a “securities entitlement” (Article 8 of the Uniform Commercial Code), and in some EU legal instruments as “rights in securities” (see Article 9.2 of the SFD and Article 24 of the WUD (“other rights in such instruments”)). On this terminology, see J. Benjamin, Interests in Securities (Oxford: OUP 2000), No 1.05 and 2.21 et seq.; J. Benjamin, “Conflicts of Law and Interests in Securities”, in K. Tyson-Quah, Cross-border Securities: Repo, Lending and Collateralisation (London: Sweet & Maxwell, 1997), No 2.3 et seq., p. 16; J. Benjamin and M. Yates, The Law of Global Custody, 2nd edition (London: Butterworths, 2002), No 2.17 and 5.30-5.31; in the context of Belgian Royal Decree No 62 of 1967 relating to the book-entry circulation of securities and governing the rights of participants in the Euroclear system, see L. De Ghenghi and B. Servaes, “Collateral Held in the Euroclear System: A Legal Overview”, Journal of International Banking and Financial Law (March 1999), pp. 85-87; B. Servaes, “Het immobiliseren van effecten: Het Belgisch juridisch kader”, in Nieuw vennootschap-financieel recht 1999 (Jan Roose Instituut-KU Leuven), p. 513. This distinction between interests in securities as evidenced by book-entries in the accounts of the intermediary and underlying securities has led to the creation of ownership rights on assets (a pool of fungible book-entry securities) that are distinct from the underlying certificates. What is then transferred or pledged in the books of the relevant intermediary is not the underlying securities but the co-ownership rights of the collateral provider in the pool of book-entry fungible securities vis-à-vis the intermediary holding the securities account. Of course, “economically, and also for balance sheet, taxation and regulatory purposes, [such an] asset is indistinguishable from the underlying certificates” (Benjamin and Yates, op. cit., No 5.30, on the basis of which corporate actions will be exercised vis-à-vis the issuer (collection of interests and cash proceeds, redemption and exchange, put and call options, tax withholding and reclaiming services, voting at a general assembly, etc.), either by the intermediary on behalf of the investor, or directly by the latter, through different techniques depending on the features of the local issuer market (proxy voting, registration in the name of the end-investor for the limited purposes of voting, etc.). Similarly, when the client exercises its rights to restitution in kind for the securities (in the event of a change to or insolvency of the intermediary), the underlying securities held locally will of course be returned by way of physical delivery (shipment) for bearer paper certificates, re-registration in the issuer records of the registered securities in the name of the clients or of its new intermediary, or transfer of the dematerialised securities to a new account keeper designated by the client owing the securities.
j) The application of the law of the book-entry securities held with such intermediaries, which has been recommended for many years now by several international financial market associations\(^\text{19}\), has already been recognised at European level by Article 9.2 of the SFD in 1998, which governs collateral transactions in the scope of designated systems.\(^\text{20}\) This is also the approach chosen in Article 24 of the WUD in 2001\(^\text{21}\), and is furthermore also the rule defined by the Collateral Directive in 2002 (Article 9.1) regarding book-entry securities collateral.\(^\text{22}\)

k) The main purpose of the Hague Convention is to confirm this solution at international level and to make it more precise, without however preventing investors and securities intermediaries from holding their securities directly at local level under the law of the issuer or of the issuer CSD, if they still prefer to do so.

This paper provides below a rapid survey of the key features of the Hague Convention, focusing on its main achievements in terms of scope, connecting factors, collateral requirements and impact of insolvency (as opposed to detailed comments on all the various provisions of the Convention, for which the reader is referred to the comprehensive Explanatory Report of the Convention). As part of the conclusions of this paper, this Convention is put into perspective with the aim of demonstrating why the ESCB and the European Central Bank (ECB) should, in our opinion, support this initiative.

3 THE HAGUE CONVENTION: KEY FEATURES\(^\text{23}\)

5. Scope- The Hague Convention is applicable to “securities held with an intermediary” (see Article 1.1), which means:
   – Securities in the broad sense (equities, bonds, etc.) including “any interest therein”. This naturally also covers interests in securities (see footnote 18

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\(^{20}\) “Where securities (including rights in securities) are provided as collateral security to participants and/or central banks of the Member States or the future European Central Bank as described in paragraph 1, and their right (or that of any nominee, agent or third party acting on their behalf) with respect to the securities is legally recorded on a register, account or centralised deposit system located in a Member State, the determination of the rights of such entities as holders of collateral security in relation to those securities shall be governed by the law of that Member State”; see also C. Keller, “Die EG-Richtlinie 98/26 vom 19.5.1998 über die Wirksamkeit von Abrechnungen in Zahlungs- sowie Wertpapierliefer- und -abrechnungssystemen und ihre Umsetzung in Deutschland” in Zeitschrift für Wirtschafts- und Bankrecht, 26 (2000), pp. 1269 ff, which refers to the concept of lex conto sitae (however, we do not share the restrictive view suggested by the author for the application of Article 9.2 of the SFD; see p. 1274).

\(^{21}\) “The enforcement of proprietary rights in instruments, or other rights in such instruments the existence or transfer of which presupposes their recording in a register, an account or a centralised deposit system held or located in a Member State, shall be governed by the law of the Member State where the register, account or centralised deposit system in which those rights are recorded, is held or located”.

\(^{22}\) “Any question with respect to any of the matters specified in paragraph 2 [property and collateral rights] arising in relation to book-entry securities collateral shall be governed by the law of the country in which the relevant account is maintained”, which is “in relation to book-entry securities collateral which is subject to a financial collateral arrangement, the register or account – which may be maintained by the collateral taker – in which the entries are made by which that book-entry securities collateral is provided to the collateral taker” (Article 2.1.g).
above), since the main objective of the Hague Convention is to protect indirect holdings of securities through intermediaries. *Cash holdings are excluded* as such from the scope of the Convention.

- **Intermediaries in the broad sense**, meaning any person whose business is to maintain securities accounts for others. This refers to banks, investment firms, other securities intermediaries entitled to maintain securities accounts under the law of the country in which they operate, central banks, CSDs, etc., but not to pure registrars or transfer agents (see Article 1.3 (a));

- Securities must be in *book-entry form*, which means securities credited to a securities account with an intermediary. This is again a consequence of the fact that the Hague Convention is designed to address primarily indirect holdings of securities, although it can also protect direct holdings systems as such (see Article 1.4 of the Convention: CSDs are expressly regarded as intermediaries under the Convention, especially at the request of the Scandinavian countries, which wanted to benefit from the protection of the Convention with regard to their own domestic securities held in book-entry form in the domestic CSD, even though direct holding system/CSD accounts were generally regarded as obviously governed by the law of the country where the underlying domestic securities are issued and deposited with the local CSD). As an exception, a contracting state under whose law registered (or even dematerialised) securities are constituted may declare that the operator of an SSS holding such securities directly (in such a way that its securities accounts are assimilated to the issuer records and as such directly constitute the primary record of entitlement as against the issuer) should not be treated as an intermediary for the purposes of this Convention (Article 1.5). Opt-out mechanisms have been proposed by the UK and Irish delegations to avoid treating the CREST System, which is operated by CREST Co in the UK not just for UK securities, but also for Irish equities (and is designated as a separate “Irish” system for the purposes of the SFD), as an intermediary under the Convention in respect of those Irish-registered securities, as this could lead to the application of English law instead of Irish law. This would thus be contrary to what is currently applied for the settlement of Irish securities in CREST, as CREST does not have a qualifying office in Ireland which could justify under the Convention the application of Irish laws to Irish holdings entries. This opt-out mechanism could even apply to CREST in respect of UK securities that it directly holds and for which CREST books are assimilated to issuer records, even though here the reason for not applying the Convention’s protective regime might appear less immediate.

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6. The Convention is aimed at determining the applicable law that should govern the following aspects relating to book-entry securities, as defined under Article 2.1:

- the legal nature of the rights of the account holder resulting from the book-entry holding (ownership, contractual claims, etc.) and the effect of such rights as against the intermediary and third parties;

- In case of a “disposition” of securities, meaning any transfer of book-entry securities whether outright (a sale) or for securities purposes (transfer of title, repo) as well as any granting of security interest (a pledge) on such book-entry securities, including a lien by operation of law in favour of the relevant intermediary to secure any claim in connection with the maintenance of the securities account (see Article 1.2):
  - the perfection requirements or steps to make a disposition (as defined above) effective against third parties;
  - priorities between conflicting interests (e.g. good faith protection in case of multiple dispositions, but not the ranking between creditors’ claims in case of insolvency, which is not affected by the rules of the Convention pursuant to Article 8.2 (a); see below Section 12);
  - the duties of an intermediary to third parties in competition with the account holder or with other persons in relation to the book-entry securities (attachment proceedings, etc.);
  - the realisation requirements to enforce the rights of the collateral taker on the book-entry securities (sale of pledged assets, etc.);
  - the extent to which a disposition of securities may include an entitlement to cash proceeds relating to such securities (even though cash accounts as such are not covered by the Convention).

7. The Convention shall not apply (see Article 2.3) to determine either the law governing the pure contractual aspects of the custody relationship between the intermediary and the account holder (duties of the intermediary, definition of contractual services, liability, statute of limitation, etc.), or between the parties to a disposition (contractual aspects of a pledge or of a repo transaction, e.g. netting, currency, interests for late payment, etc.), which continue to be governed by the lex contractus or the law governing the rights and duties of an issuer of securities (or of its registrar or transfer agent) – see above, Section 4 a.

8. Determination of the applicable law. The main rule of the Hague Convention is laid down in Article 4.1:

I. The law applicable to “proprietary” aspects (classified as “Article 2.1 issues”; see above Section 6 and also footnote 25) of book-entry securities is the law expressly agreed between the relevant intermediary and the

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24 This applies when an international situation involving a possible choice between the laws of at least two different States is involved (see Article 3).

25 The fact that the law as determined in accordance with the Convention would qualify the rights of the account holder on book-entry securities as mere contractual claims, and not rights of ownership, does not prevent the application of the Convention to what still constitutes “securities held with an intermediary” under the meaning of the Convention: see Article 2.2 and the Explanatory Report, No 2-30 to 2-35. For the sake of simplification, in the rest of this study the expression “proprietary (or “property”) aspects” is used to illustrate those issues specified in Article 2.1.
account holder to govern the account agreement; in this case, the lex contractus will govern the entirety of the custody relationship, both pure contractual aspects and proprietary aspects linked to a securities account;

II. The relevant intermediary and the account holder may however agree expressly in the account agreement that the proprietary aspects of the holding and disposition of securities in book-entry form (“Article 2.1 issues”) will be governed by a different law than the law governing the account agreement; in that case, the contractual aspects of the custody relationship will be governed by the lex contractus, while the property aspects will be governed by another law specifically selected for that purpose by the intermediary and its client;

III. The Convention does not permit property aspects to be split between multiple laws in the same securities account: only one law must apply to the entirety of the issues mentioned under Article 2.1;

IV. The choice of applicable law to property aspects under points I and II is however only admitted under the Convention provided that the relevant intermediary has at the time of the account agreement an office in the state whose law is chosen, and that it is either:

a) engaged in a business of maintaining securities accounts by effecting or monitoring securities entries, or by administering payments or corporate actions in relation to book-entry securities, or is otherwise considered as engaged in such a business (see Article 4.1 (a iii); see below, point VI), or

b) alternatively, is identified by a specific means of identification as maintaining securities account in that state (through a bank code, account number, etc.) (see Articles 4.1 (a and b)).

V. The office in question under point IV must be a non-temporary place of business of the intermediary itself (see Article 1.1 (j)): a branch obviously qualifies in principle but not a subsidiary, as a subsidiary is a distinct legal person, nor a representative office, which has no power to enter into account agreements (see Article 4.2 (d)), but does not necessarily have to be the entity with which the relevant securities account is in fact maintained. For the purposes of the securities account business criteria defined under point IV (a) above, the assessment can also take into account not only the office in the state whose law is applicable but also other offices (e.g. branches) of the relevant intermediary as well as the business of “other persons acting for the relevant intermediary” (for example, service providers to which securities account activities may have been outsourced) which, as far as the latter are concerned, may or may not be acting in that state.

VI. Are not considered per se as evidence of a securities accounts business in the state whose law is declared applicable (meaning that the following elements are not sufficient to demonstrate per se a business of maintaining securities account under the catch-all “otherwise” residual provision of Article 4.1 (a iii); however, they may well further confirm the “securities account business” test if taken together with other elements under Article 4.1 (a): see Explanatory report, No 4-32 and 4-40):

– the location in that state of information technology (computer processing) which supports bookkeeping for securities accounts;
– the location of *call centres* for communication with account holders; or
– the location of mailing, filing or archiving centres.

9. **The current debate on the Hague Convention.** The main criterion of Article 4.1 for the determination of the law governing property aspects of book-entry securities is currently at the centre of intense discussions at EU level, where some voices have been raised urging Member States not to sign the Hague Convention, at least not without a comprehensive prior impact analysis. This is the view expressed by the European Banking Federation (EBF) in two letters dated 29 June and 18 November 2004 that were circulated to Permanent Representatives of Member States to the EU and to other banking federations. The main argument underlying the EBF’s opposition is that the Hague Convention, by departing from a pure *lex rei sitae* approach (the “application of the law of the place where the securities account is maintained”) to favour the law chosen by the parties to the account agreement, would introduce legal risks and politically adverse effects. Supporters of this approach argue that the authors of the Hague Convention did not consider the full implications of moving from *lex rex sitae* to *lex contractus*, and that this would therefore justify a prior impact analysis at EU level on numerous aspects such as the implications for all parties in the securities chain, as well as for securities systems and regulators, on the potential effect on tax regimes, money laundering and fraud prevention, and on various other economic aspects, such as costs, tariffs and risks. This is also now the advice expressed by the European Central Bank in its recent Opinion of 17 March 2005\(^\text{26}\) in relation to the possible signing of the Hague Convention by the European Union (“the ECB Opinion”).

In the light of the above, it must be emphasised that during the negotiations of the Hague Convention between 2000 and end-2002, there was actually right from the outset a clear debate between the European approach, focusing on the place where the account is maintained (as mentioned in some EU Directives), and the US position (derived from Article 8 of the Uniform Commercial Code), which refers to the law governing the account agreement. In the end, the latter was ultimately adopted in the final text of the Hague Convention. However, this choice was finally supported by all representatives including the EU Member States\(^\text{27}\) after thorough discussions that took place during the whole negotiation process. The debate also benefited greatly from the intensive involvement of the securities industry (including the EBF) as well as from the participation of authorities, regulators, central banks, academics and law practitioners. In the period between June and October 2002, the criterion of the law of the account agreement to govern property aspects of book-entry securities was presented by the Hague Permanent

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27 A formal COREPER meeting was even held on 10 December 2002, three days before the final text was signed by delegates, to confirm the common position of EU Member States and the Commission in order to proceed on the basis of the draft text on the table at the time, which already contained the debated article (No 4).
Bureau as a possible option (“Option A+”) during regional workshops conducted with banking representatives around the world, particularly in Europe (France, Germany and the UK). The topic therefore came as no surprise at the end of the Convention negotiations, as it had been assessed ex ante by all interested financial sectors, and was finally adopted by the Hague Convention as the main rule.

This paper submits28 that the Hague Convention represents a unique opportunity to achieve in the near future the highest possible degree of legal certainty on a worldwide basis for all intermediaries active in the securities industry. This is because the Hague Convention:

a) Ensures the prevailing application of the law governing securities accounts as agreed between an account holder and its intermediary over other possible conflicting laws such as the law(s) of the place(s) where the underlying physical certificates may be located abroad, or the law(s) of the foreign CSD(s) that primarily hold(s) the securities, or the law of the local custodian(s) that hold(s) the securities on behalf of the relevant intermediary, or the law of the place where IT processing takes place, and so on (see above, Section 4). As a result, the holding, transferring and pledging of several securities primarily issued and deposited in various issuers’ jurisdictions may be centralised in one single account under one governing law with one intermediary in a legally robust fashion (see also below, point d).

b) Complements the existing EU legal framework, since the EU solution was either limited to collateral transactions in connection with payment and settlement systems designated as such by Member States (Article 9.2 of the 1998 SFD), or applicable to financial intermediaries, but only for collateral transactions (Article 9 of the 2002 Collateral Directive), or to a certain extent applicable to securities holdings as such, although only in case of insolvency of a credit institution (Article 24 of the 2001 WUD).

c) Provides a harmonised conflict of law regime which, in contrast to the above EU current regime, is:
- general (covering all aspects of book-entry securities: holding, outright transfer, collateral),
- universal (aiming at covering not only the EU but also the US, Japan, Canada, Switzerland, China, emerging markets, etc.),
- truly uniform (since the EU solution could not be exported outside the EU’s boundaries, as demonstrated by the preparatory work of the Hague Convention),
- of benefit to all securities intermediaries (and not just system operators as in the SFD or just financial institutions as in the Collateral Directive), and
- workable for all intermediaries in view of the legal and practical difficulties to determine (even within the EU) what a securities account

28 See the letter of the author dated 29 November 2004 to the EBF; see also the letter dated 26 November 2004 from the Permanent Bureau of the Hague Conference to Mr Schaub, Director General of the European Commission (see Hague Conference website: http://www.hcch.net); see also the ISDA letter to the European Commission, DG Internal Market, dated 26 July 2004.
really is\textsuperscript{29}, and more fundamentally, where such an account may \textit{in fact} be "located", especially for multi-branches custodians operating on a cross-border basis through a large network that is decentralised or in which services relating to securities accounts are outsourced (steps such as opening a custody relationship, sending statements of account, IT processing, accounts monitoring, operating call centres, processing corporate actions instructions, etc., may indeed nowadays be each located in a different jurisdiction).

d) \textit{Offers the ideal solution for intermediated indirect holding systems}. This is indeed the specific aim of the Hague Convention: a key objective of an intermediary and its customers in using such a scheme is to have one law governing the entirety of the various securities holdings recorded on the securities account, irrespective of where the underlying papers may be located, while still preserving latitude, for those intermediaries and clients willing to do so, to continue to hold their securities directly with the issuer CSD(s) or via a local branch of the intermediary under local “issuer law”(s) through separate deposits.

In this respect, the criticism expressed in the EBF’s letters, or now in the new ECB Opinion to the EU Council of 17 March 2005, does not seem convincing, and should in no way justify the withdrawal of the support granted so far by the EU to the Convention. To illustrate this\textsuperscript{30}, this paper discusses below the implications of the three main objections raised in the letters and in the ECB Opinion:

- “The Hague convention would lead to “delocate” EU assets in favour of USA by having the major US banks imposing New-York laws to EU custodians” (EBF letter of 18 November 2004). This argument is hard to understand. To take a practical case, assume a French bank has been requested by a US bank to open an account recording French domestic securities under New York (NY) law. There are only two possibilities: either the French bank does not have a qualifying office (as defined by the Hague Convention) in New York – in which case NY laws cannot be selected under Hague rules, or there is such an office, in which case – assuming the French bank finally agrees to open an account under NY law (or, to follow the logic of the critics, is forced to for reasons of competition) – the French dematerialised securities will be then held under the US regime, specifically Article 8 of the Uniform Commercial Code\textsuperscript{31} (meaning under a securities entitlement representing co-ownership

\textsuperscript{29} It is submitted that the debate on the “subjective criterion: law of the agreement” vs. “objective criterion: location of the account” is in reality theoretical, since an “account” (including a securities account) is essentially an agreement between the account holder and the intermediary to record in book-entry form assets (generally in fungible form) held by the latter in the name of or on behalf of the former, and for this purpose to submit the entitlement to such assets to a specific law that will govern the correlative rights of the account holder. \textit{In fact, in our opinion, a securities account is nothing more than an account agreement} which will in fact create, subject to the conditions organised by the law governing the account agreement (which also may impose specific duties on the intermediary in terms of accounting treatment, etc.), the rights and obligations of the parties relating to the securities deposited with the intermediary.

\textsuperscript{30} This paper is not the place to comment on and answer every question or criticism raised in the above-mentioned letters or Opinion; however, a specific discussion of such other arguments could take place in the near future as part of the recent EU Council decision (June 2005) to launch a limited impact study on the Hague Securities Convention.

\textsuperscript{31} By contrast, the actual underlying French dematerialised securities would of course continue to be held by the French bank with Euroclear France as the CSD (or through another direct affiliate of Euroclear France) under the French law regime.
rights in the pool of similar securities held by the US branch of the French bank). The latter situation is what US banks can already require and obtain from the NY branch of a French bank if they are more interested in indirect holdings under US law than in direct holdings under French law. In any case, this does not lead to any “relocation” of assets.

– “The Hague Convention may have tangential impacts on EU securities settlement systems which will apply different laws to the securities held in their systems”. Again, it is difficult to understand how an EU SSS could ever agree to maintain securities accounts governed by different laws (whether EU ones or not) without totally jeopardising the fungibility of the securities held, transferred and pledged in the system (as is also recognised in the above-mentioned ECB Opinion: see paragraph 12). This would moreover directly impact the reliability of the protection granted jointly to its participants in case of insolvency of the operator, as well as the application of the SFD as such (which requires one EU law to apply to the settlement and custody rules of such a system). There are moreover additional constraints defined in the various regulatory standards that apply to such a system in terms of legal soundness (i.e. the 2001 CPSS-IOSCO recommendations on securities systems; the 2004 ESCB-CESR Standards; and the 1998 EMI/ESCB standards for the use of securities systems for ESCB collateral transactions). The ECB Opinion states however that “there could be no guarantee that” in fact an SSS would only select one law (see paragraphs 11 and 12). In our view, the guarantee is precisely the adverse consequences described above that would derive from the application of multiple laws to securities holdings. In addition, EU regulators may impose on SSSs specific limitations under the above-mentioned regulatory standards to avoid such “abuse” (if at all conceivable) as implicitly suggested in the ECB Opinion (see paragraph 10).

– “The Hague Convention is not transparent since third parties cannot know by which law the account agreement – and as a result the securities recorded on such an account – is governed” (see paragraph 14 of the ECB Opinion). The transparency of securities holdings and pledging mechanisms is currently an issue with regard to cross-border electronic securities; however, this difficulty already exists for securities accounts held with any multi-branch intermediary that operates on a cross-border basis, since third parties are not better equipped to know where the account of their debtor is actually located or maintained or by which law the recorded securities may be governed, especially as long as there are still some uncertainties about applicable law (for example, third parties today do not necessarily know whether their debtors are even in a custody relationship with a particular intermediary, which often obliges them to initiate attachment proceedings against multiple intermediaries simultaneously). From the above perspective, the transparency of collateral arrangements has not increased at the EU level with the elimination of any publicity requirements for the constitution and perfection of collateral in the Collateral Directive. However, public authorities and banks supported this simplification.

All in all, the new criterion introduced by Article 4.1 of the Hague Convention to determine the law applicable to book-entry securities seems reasonable, and avoids any future discussions or “second-guessing” by competent Courts on the
reality of the “location of a securities account”, since the Courts will simply have to apply the law of the account agreement (or any other law chosen to govern proprietary aspects if this differs), provided that the relevant intermediary has an office in the jurisdiction whose law has been selected.

10. *Fall-back rules*, assuming there is no law chosen to govern the account agreement or specifically the property aspects of it, are organised in a “cascade” system by Article 5 of the Hague Convention in favour of the application of the law of the particular office through which the account agreement was entered into (Article 5.1), or – failing this – by reference to the law of the jurisdiction under whose law the relevant intermediary is incorporated or otherwise organised (Article 5.2), or, in turn, by reference to the law of the country where the intermediary has its principal place of business at the time the account agreement is entered into (Article 5.3).

11. Another helpful achievement of the Hague Convention is the stipulation in Article 6 of factors that are considered explicitly as *irrelevant* for the purposes of determining the law applicable to book-entry securities (the so-called black list of excluded connecting factors). These are:
   - The place where the issuer is incorporated or organised, etc.;
   - The location of underlying certificates (no “look-through approach”; see above Section 4 (i));
   - The location of the issuer’s register;
   - The location of any intermediary other than the ‘relevant’ one.

12. In contrast to the EU legislative framework (the SFD, WUD and Collateral Directive), the Hague Convention does not protect parties to the account agreement, nor any interested third parties, against any negative implications of applicable insolvency law on their respective rights as determined by the Convention law. Foreign insolvency law which is applicable to the insolvency of, say, the account holder or of its counterpart, as collateral provider, may still prevent the non-insolvent counterpart from directly enforcing its rights or from being preferred over other classes of creditors (ranking of claims). Such insolvency law could also eventually lead to the avoidance of previous securities transactions made to defraud general creditors or during a certain “suspect” period before insolvency (“voidable preferences”) (see Article 8.2). As a norm of private international law, the Hague Convention is confined to the level of determining the applicable substantive law in an international context without regulating either this substantive law or the impact of applicable insolvency law. However, Article 8.1 of the Convention explicitly confirms the sole applicability of the “Convention law” (the law determined under

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32 On this EU regime, see D. Devos, “Collateral Transactions in Payment and Securities Settlement Systems: The EU Framework”, op. cit.
33 The harmonisation of substantive securities laws will be the subject matter of the UNIDROIT draft Convention, which was circulated in December 2004 to UNIDROIT Member States for negotiations in May 2005 and, at EU level, of the work of the newly established working party of the Commission in charge of the Legal Certainty Project (see the Communication of the European Commission on Clearing and Settlement of April 2004).
the rules of the Convention) to govern the proprietary aspects of book-entry securities for any event that occurred before the opening of that insolvency to the exclusion of any diverging solution, in terms of any conflict of law rule, which would derive from the applicable insolvency law.

13. The Convention also contains some provisions that aim at organising a transitory regime for pre-Convention account agreements or interests, or in case the law governing the account agreement changes. These rules may be summarised as follows:

– For account agreements entered into before the entry into force of the Hague Convention (see Article 16), the Courts may treat either the pre-Convention account agreements that would have the effect through any express terms (agreed law to govern the account agreement) that a specific law governs some of the property aspects (“issues specified in Article 2.1”), or those pre-Convention agreements that refer instead to a jurisdiction in which “the account is maintained”, as validly governing all proprietary aspects of the recorded book-entry securities under the Convention regime (Article 4.1). In both of the above scenarios, this is provided that the relevant intermediary had at the time of the pre-Convention account agreement in question an office that qualified under Article 4.1, second sentence (see above).

– In case of conflicts between pre and post-Convention interests in book-entry securities, it is the Convention law that will determine how the conflict must be settled (see Article 15; for more details, see the Explanatory Report, No 15-1).

– In case the law governing the account agreement changes (or the proprietary aspects of it), according to the traditional solution, the new law will as a rule immediately govern the proprietary aspects of the account agreement, except for some events that remain governed by the old law (see Article 7) and on which parties were legitimately entitled to rely on (e.g. existence of an interest, priority between interests arisen, the perfection of a disposition, made before the new law; the protection of “pre-change” rights in case of attachment of securities; or of an insolvency event occurring after the change in law).

4 CONCLUSIONS

14. Until now, the variety of possible governing laws has led to considerable legal uncertainty at international level regarding the determination of the precise national law governing securities credited to an account with an intermediary in a cross-border context. This legal uncertainty generates in turn legal risks for both the securities industry and investors to the extent that the law governing book-entry securities determines the protection offered to the holder in case of insolvency of the intermediary, as well as the formalities to be complied with to create, perfect and enforce collateral arrangements on such securities.
At the EU level, some Directives have been enacted since 1998 (e.g. the SFD, WUD and Collateral Directive) which contain provisions in the field of private international law. However, these new rules, even though they have substantially increased the level of legal certainty at the EU level, remain limited to the EU and do not address the rest of the world, or all aspects of the securities holdings or even all market players. These shortcomings are precisely what the Hague Convention seeks to address. It is therefore not correct, in our view, to state that “the existing Community regime is sufficiently satisfactory and does not require an urgent or compelling signature of the Convention” (see paragraphs 15 and 20 of the ECB Opinion).

In view of the above, and in spite of the criticism that the Hague Convention may attract (as is generally the case with any new legislation, whether at national or at EU level), this paper strongly maintains that this Convention should be supported by the ESCB and adopted by the EU Member States as quickly as possible. Any major delay in the adoption process at the EU level would simply put into question the existence of the Convention itself by sending a message to the rest of the world that the EU is now doubting its previous engagement. This is also an issue of credibility, and would in turn discourage other countries from pursuing the adoption process any further, leaving EU intermediaries without any uniform global solution for the law applicable to EU securities holdings, and maintaining the existing legal uncertainties on this crucial issue concerning transactions with the rest of the world. In this respect, the author certainly cannot support the view (see the ECB Opinion, paragraph 15) that a conflict of law rule, such as the Hague Convention, cannot be adopted before substantive laws have been harmonised, as promoted on a worldwide basis by the UNIDROIT draft Convention, or at least at Community level through the proposals that will emerge from the work of the newly established Legal Certainty Group. Such harmonisation is indeed still uncertain and, in any event, a matter of considerable work for many years to come. In the meantime, there is an urgent need to achieve harmonisation on this very basic first step in order to achieve legal certainty and predictability for the securities business, which is the determination of the applicable law to book-entry securities. If this key issue is left uncertain, and if the parties to an account relationship can not even rely on the law they agreed upon (whatever its weaknesses or strengths), but are still exposed to the risk that another unexpected law might be applicable, then the harmonisation of substantive laws (which is not a synonym for full equivalence) is simply pointless.

As a collateral taker, the ESCB has a major interest in legal certainty with regard to securities holdings and related collateral transactions, even though the current features of its monetary policy transactions may be less demanding in that most that are conducted by individual central banks are still domestic asset-based. With respect to the ESCB cross-border use of collateral, another central bank is used by the home national central bank
(NCB) as an intermediary directly holding local securities under local law on behalf of the home central bank (the CCBM). The use by NCBs of eligible links between eligible SSSs for monetary policy purposes is limited (so far) to EU assets held with EU SSSs under the protection of the SFD and Collateral Directive.

However, for those central banks that use collateral schemes whereby they reflect (in their own books, under their own collateral technique, and governed by their own law) the corresponding interest in securities held on their behalf in the “issuer SSS” either by the local NCB acting as the CCB, or by their home “investor SSS” via links, the Hague Convention might further enhance legal protection by confirming the application of the law governing the account in the home NCB’s books.

Some SSSs in the EU may also have a less clear regime for the holding (through links) of foreign securities in their own books under their own law than for their domestic securities, in which case they are indeed indirectly holding book-entry securities in a similar way to a custodian. Here again, they may benefit from the legal certainty provided by the Hague Convention, whether or not they hold EU or non-EU foreign securities.

Finally, the ESCB, given that it is composed of central banks which oversee EU systems and are concerned by systemic risk implications in a global worldwide market economy, should also support any major initiative which may reduce legal risks for its own financial intermediaries at the EU as well as the international level when dealing with other non-EU intermediaries.

This is what the Hague Convention offers: a unique opportunity to adopt at international level a uniform global rule for the determination of the law governing book-entry securities accounts. This is in reality the first key step in achieving legal certainty for securities holdings, before any further harmonisation of substantive legislation.
Il contributo passa in rassegna gli strumenti di legislazione comunitaria che non sono destinati ad armonizzare le legislazioni nazionali, ma a fornire un regime giuridico opzionale in grado di essere utilizzato in tutta l’Unione Europea. Esso descrive: (a) alcune fattispecie esistenti, quali la Società europea e la Società cooperativa europea; (b) alcuni progetti in corso, quali la Società mutua europea e i progetti per la normativa contrattuale europea; (c) alcune iniziative del mercato attualmente esaminate a livello Comunitario, quali l’ipoteca europea (Euromortgage), il Pan-European Trust Instrument, per la costituzione di fondi fiduciari, e il Pan-European Direct Debit Scheme; (d) alcuni strumenti opzionali creati dagli operatori del mercato finanziario e sostenuti dal SEBC, come STEP (Short-Term Euro Paper) e EMA (European Master Agreement). Lo studio comprende anche talune valutazioni critiche sulla tecnica in parola: viene ricordato come una metodologia simile esistesse anche all’inizio del Mercato comune nel contesto della libera circolazione delle merci, allorché i produttori, desiderosi di evitare le barriere tecniche nazionali alla vendita pan-europea, potevano scegliere di adottare le numerosissime specifiche comunitarie. Questa prassi onerosa terminò con la sentenza “Cassis de Dijon”, che consentiva le vendite pan-europee. Nel contributo si sostiene che, piuttosto che seguire la strada del 26° regime, dovrebbe essere realizzata una giurisprudenza simile (che al momento non esiste) per permettere la vendita pan-europea di prodotti finanziari a seguito dell’autorizzazione dello Stato membro di origine. Viene anche suggerito che le Società europee dovrebbero poter utilizzare i prodotti finanziari pan-europei, invece di essere costrette a frammentare sul piano nazionale le proprie attività finanziarie. Si rammenta, infine, che nulla ostacolerebbe gruppi di Stati membri, ad esempio i paesi dell’area dell’euro, che volessero agevolare l’integrazione dei rispettivi mercati, attraverso una legislazione concertata che istituisca strumenti opzionali uniformi.
I  INTRODUCTION

Beyond its primary objective of achieving and maintaining price stability, the European System of Central Banks (ESCB) is legally bound by its secondary objectives, as defined in Article 105 of the Treaty establishing the European Community (“the Treaty”), to “support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community”. One of these Community objectives is the establishment of a common market, which, following the abolition and prohibition of internal exchange controls in the early 1990s, encompasses the internal market for financial services and markets. Monetary unification in 1999 removed the last barriers for financial integration, namely exchange risk and trading under different units of account. The construction of a common and integrated financial market has been defined by the European Council and by the Council of Ministers on repeated occasions as a priority for Community action. As the ESCB is an organisation created by the Law, it must act as determined in its constitutive charter: all its actions that are compatible with its primary monetary policy objective are legally bound to aim at fulfilling the secondary objectives as well, of which financial integration is paramount.

Disregarding legal reasoning, the achievement of an integrated financial market is also in the interest of the Eurosystem: it is bound to carry out ‘single’ policies in 12 (and soon more) financial market environments, in which the potential for asymmetries and distortions is relatively high. The more integrated the financial markets become, the more homogeneous the performance and the effects of the Eurosystem’s single policies will be.

At the end of 2004, the members of the Governing Council of the ECB elaborated and adopted a “Eurosystem Mission Statement” that is consistent with the above. After recalling its primary objective, the Statement reads: “Acting also as a leading financial authority, we aim to safeguard financial stability and promote financial integration”.

The Legal Committee of the ESCB has on numerous occasions dealt with matters related to the integration of financial markets in Europe. From a legal perspective, and given that financial services and markets are a highly regulated area, the objective of achieving a single internal market for financial services

1  See Article 2 of the Treaty.
2  Capital movement restrictions within the European Community were abolished in Stage I of Economic and Monetary Union (EMU) by way of secondary legislation, and at primary law level by the Maastricht Treaty. See Articles 51 (2) and 56 (1) of the Treaty.
3  For example, the European Council, Cologne, June 1999 stated that it “considers rapid progress in this [single market for financial services] area to be essential”. Other examples include: the European Council, Lisbon, March 2000: “It is essential to exploit the potential of the euro to push forward the integration of EU financial markets”; the European Council, Stockholm, March 2001: “Rapid implementation of the Financial Services Action Plan is of the utmost importance” (this summit approved the Wise Men’s Report (the “Lamfalussy methodology”)). The European Council, Barcelona, March 2002, similarly stated that it “reaffirms its strong commitment to achieving fully integrated securities and risk capital markets by 2003 and financial services markets by 2005”.
4  Available at www.ecb.int
5  Author’s emphasis.
is a challenging one. It encompasses technical complexity as well as policy and political issues. At the political level, the overall aim of integrating financial markets, which has been repeatedly and clearly stated by the supreme Community bodies, seems to be contradicted at lower levels by the staunch protection extended by the authorities of the Member States to their national financial centres.

The approach followed to create a single internal market for financial services has relied on the traditional Community method: minimal harmonisation by way of Directives. And indeed, this is what existed at the start of Monetary Union: minimal harmonisation, and a whole array of differing rules in the Member States, whereby host countries have sometimes generously used the “general good” concept to protect their own local markets.6

The establishment of eight regulatory or advisory committees7 (also known as the “comitology” procedure) covering all sectors of financial services, following the methodology recommended by the Committee of Wise Men on the Regulation of European Securities Markets8, is a heavy-handed and burdensome mechanism when it comes to catering for the needs of today’s financial services. The legislative process is still slow and the success of such a methodology remains to be seen. The Community institutions are considering their strategy for the next decade, and should ensure an intelligent implementation of the Lamfalussy comitology procedure. While a sectoral comitology structure may satisfy the technical expertise needed to regulate financial services, three aspects need to be considered: (i) the inbuilt conflict of interest owing to the national composition of these committees, leading to the need for compromise solutions; (ii) the enhancement of diversity as a result of the maintenance of the instrument of Directives rather than Regulations9; and (iii) the tendency to keep ‘Level 1’ legislation extremely detailed, rather than limit it to framework principles. The maintenance of generic “general good” exceptions to the free provision of financial services, plus an even greater application of the subsidiarity principle, does not seem to be the most efficient model for achieving market integration.

This article does not dwell on legal harmonisation, which is the task of the comitology procedure described above. Nor does it advocate maximum, rather than minimum, harmonisation. Instead, it points to a different methodology aimed at facilitating financial integration via the creation of pan-European regimes which are non-mandatory for market participants. It proposes that the

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6 “General good” rules, as an exception to the general principle of free provision of services, should be used restrictively by Member States; any use with the disguised aim of protecting local markets would qualify as being incompatible with the Treaty.
7 The Financial Services Committee (FSC), European Banking Committee (EBC), Committee of European Banking Supervisors (CEBS), Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), European Insurance and Occupational Pensions Committee (EIOPC), European Securities Committee (ESC), Committee of European Securities Regulators (CESR), and European Financial Conglomerates Committee (EFCC).
8 Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, Brussels, 15 February 2001. The procedure was initially limited to just the securities markets.
9 Directives entail national implementation, which produces diversity in the detail; Regulations do not require national implementation, and thus preserves equal rules throughout the EU.
Community institutions should provide market participants with the option of using financial instruments that benefit from a “European passport”, i.e. ones that can be used equally throughout all 25 Member States, if necessary by way of a Community legal act or with the support of Community bodies. Such instruments would not need the prior harmonisation of national laws, but would instead represent an additional option on top of the financial instruments already covered by national legislation. Participants in financial markets, i.e. investors, lenders, borrowers, issuers, etc., could choose to use such instruments throughout the 25 Member States, in parallel to their right to keep using the nationally regulated financial instruments. This methodology has sometimes been named a “26th regime”.

2 OPTIONAL INSTRUMENTS CREATED BY COMMUNITY LAW

2.1 THE EUROPEAN COMPANY

Thirty-one years after it was first conceived, the European Company Statute (SE) was finally adopted on 8 October 2001, and entered into force in October 2004. In its Preamble, the SE states that it aims at facilitating the incorporation and management of companies with a European dimension without the impediments of having to deal with differences in national company law.

The incorporation of a European company is optional. National companies with pan-European activities may continue to be incorporated under national law, but Regulation 2157/2001 provides for the right, when its conditions are fulfilled, for the company’s shareholders to convert the company into a European company. In the case of a new company, the Regulation permits its founder members the option – but without any obligation – to adopt the SE or to incorporate under national law.

Moreover, the solution provided by Regulation 2157/2001 to the old debate as to whether a European company should have a two-tier or a one-tier board system, which paralysed the adoption of the Regulation for many years, is to offer greater freedom to its shareholders. It is the shareholders, and not the Member States, that can decide in favour of either of the two models. The preservation of employees’ rights is ensured by the accompanying Council Directive, which regulates employee involvement in company affairs.

Because of the rights of establishment and the freedom to provide services, any company incorporated in a Member State may in principle trade throughout all

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10 Meaning a regime that is different to the regimes of the 25 Member States, optional to them and applying throughout the EU.
Member States. Therefore, the benefit of having a European company is relatively limited. Its greatest advantage is the legal capacity to transfer the seat of the company anywhere in the European Union (EU) without changing its statute or affecting its legal personality, capacity and ongoing activities. This benefit will however be extended to nationally chartered companies once the draft 14th Company Law Directive on the Transfer of Seat is adopted and implemented.

The initial design of the European company as an optional instrument for business participants with pan-European activities was indeed valuable. However, the above objective has been only partially achieved, since Regulation 2157/2001 is not a comprehensive set of company law rules, and foresees that whenever matters are not regulated in the Regulation itself, the loophole will be filled by the national company law of the registered seat of the European company. Moreover, the Regulation contains a non-discrimination provision, whereby a European company is to be treated in exactly the same way as a public limited liability company in each of the Member States. This means that, for better or worse, a European company is also affected by national company law, since it cannot be put into a position of advantage or disadvantage with regard to national public companies. Thus, both the law of the seat and the law of each of the Member States in which a European company performs its activities have an influence on its corporate status.

Regulation 2157/2001 is indeed an imperfect legal construction, the result of compromise. It will take time to see how attractive the European company is, and may perhaps lead to future reforms designed to improve the attractiveness and use of this optional instrument. However, in the financial sector, a major multinational banking group has recently announced its consolidation into an SE.

2.2 THE EUROPEAN COOPERATIVE COMPANY

The initiative to set up an European Cooperative Society, which was first suggested by the European Parliament back in 1983, finally succeeded in 2003, when the Council adopted the Statute for a European Cooperative Society (SCE). Its objective is identical to the aims of Regulation 2157/2001, and the Preamble of Regulation 1435/2003 mirrors several paragraphs of Regulation 2157/2001. Its constituent membership needs to be “physical persons resident in different Member States or legal entities established under the laws of different Member States”; it also allows for the creation of a European cooperative society.

14 Article 9.
15 Paragraph 5 of the Preamble and Article 10.
16 Nordea, a financial conglomerate with banks in Sweden, Finland, Denmark, Norway and Poland; insurance companies in Finland, Denmark, Norway and Poland; and asset management activities based in Sweden, announced this at the High-level Conference held in Brussels on European Financial Integration: Progress & Prospects, on 22-23 June 2004. Nordea is the result of a cross-border merger that took place in 2001 between Merita Bank (Finland), Nordbanken (Sweden), Unibank (Denmark) and Christiania Bank og Kreditkasse (Norway).
in order to merge branches or subsidiaries of a cooperative when these are located in a Member State other than the state of their head office. The SCE has as its principal objective “the satisfaction of its members’ needs and/or the development of their economic and/or social activities”.

Similar to the SE, an SCE is governed by the Council Regulation, by its by-laws, by the laws of the Member States on cooperatives, and by the consequences of an “equal treatment” rule\(^\text{19}\) that preserves a level playing-field between the SCE and the national cooperatives.

Cooperative banks represent a fairly sizeable percentage of the EU banking sector. Thus, this optional instrument could potentially cater for the needs of those cooperative banks whose business extends beyond national boundaries.

### 3 Optional Instruments in the Process of Being Created by Community Law

#### 3.1 The European Mutual Society

The European mutual society is a relatively old project\(^\text{20}\) which is conceptually similar to the European Company Statute. It aims at providing an optional instrument for the establishment of a mutual society with a multinational membership that carries out cross-border business. Employees’ rights are safeguarded and harmonised by way of a supplemental draft Directive on the involvement of employees.

A European mutual society requires a minimum membership of two persons, either physical or legal, resident or with a seat in two or more Member States. It may also be established by domestic pre-existing societies when there is a relevant cross-border dimension in the business carried out by its members at the time of its incorporation. The European mutual society has legal personality, and the draft regulation provides for basic corporate rules. The draft regulation does not affect compulsory social security schemes managed in some Member States by provident mutual societies.

The proposal had its first reading in the European Parliament in 1993\(^\text{21}\), and was overall supported. The insurance and pensions industry is currently urging the Council and Parliament to go ahead with the proposal. However, building societies, despite being mutual institutions that are active not only on the retail (mostly mortgage-related) side but also on the money market, derivatives and other wholesale markets, are unlikely to see any advantage in the European mutual society until pan-European (mortgage) products may be marketed.

\(^{19}\) Articles 8 (2) and 9 of the Regulation.

\(^{20}\) The Commission proposal dates from 18 December 1991 (COM (91) 273/5 and 273/6 final (OJ C 99, 21.04.1992, pp. 40 and 57)).

\(^{21}\) OJ C 42, 15.02.1993, pp. 114 and 120.
Nevertheless, the existence of this optional instrument may serve as a way round the current barrier of different mutual company laws in the Member States, which hampers the entrance of foreign companies to national markets.

3.2 EUROPEAN CONTRACT LAW

The harmonisation of contract law in Europe has been the subject of extensive analysis and valuable investigation by several groups of academics. In 1989 and in 1994 the European Parliament adopted two resolutions calling for the Commission to start work on a European code of private law. Following this, in 2001 the Commission submitted for public consultation a Communication on European Contract Law, in which several options were offered to deal with diversity in national contract law. In 2003 the Commission issued an “Action Plan” on “More Coherent European Contract Law”, which was discussed in a joint Conference of the Commission and the European Parliament, together with representatives of so-called stakeholders of EU contract law. Finally, in 2004 the Commission outlined in a Communication the details of its plan to offer an optional contract law instrument to market participants.

The proposed Action Plan abandons the idea of full harmonisation of contract law and, among other actions, recommends the preparation and adoption of an “optional instrument, which would provide parties to a contract with a modern body of rules particularly adapted to cross-border contracts in the internal market”. It aims to “facilitate considerably the cross-border exchange of goods and services”, enabling parties to refer to this instrument instead of “insisting on the necessity to apply one party’s national law”. Such an optional instrument would be embedded either “in a regulation or a recommendation, which would exist with, rather than instead of, national contract laws”. It would widen the parties’ contractual freedom, so that “they would only choose the new instrument if it suited their economic or legal needs better than the national law which would have been determined by private international law rules as the law applicable to the contract.”

With regard to the difficult issue of coexistence of the optional instrument with mandatory rules, for instance those on consumer protection, the Commission’s proposal seems to point to including the necessary mandatory provisions within the optional instrument, thereby avoiding the current diversity of national laws in this regard. However, the Communication cautiously states that this is a matter for further reflection.

26 EU institutions, Member States, the ESCB, financial services, consumer organisations, industry, and the legal professions.
28 Paragraphs 90, 91 and 92 of the Commission’s Communication.
The elaboration of the optional instrument will first require a prior step, namely the definition of a ‘common frame of reference’, with the initial aim of helping the EU institutions to achieve consistency when legislating on contractual issues, as well as of becoming “a point of reference by national legislatures inside the EU”, in order to “diminish divergences between contract laws in the EU”.29

The Commission has recognised the complexity and importance of this project by pointing to a horizon of 2009 as the target date for the adoption of this optional instrument.30

4 SOME MARKET PROPOSALS FOR COMMUNITY ACTION TO CREATE OPTIONAL INSTRUMENTS

4.1 THE “EUROMORTGAGE” AND THE PAN-EUROPEAN TRUST INSTRUMENT

In March 2003 the Commission set up the Forum Group on Mortgage Credit (FGMC), an industry advisory group with a mandate to identify and assess barriers to the integration of this part of the financial industry and to make recommendations to abolish such barriers. On 13 December 2004, the FGMC published its first report31, which constitutes a very valuable analytical piece in the framing of further policy towards financial integration. It contains 48 recommendations that the Commission has committed itself to assessing and translating into specific policy measures by the middle of 2005.

For example, recommendation 38 announces that “The Commission should explore the concept of the Euromortgage, for example by way of study, to assess its potential to promote EU mortgage credit markets integration.” And recommendation 39 states: “The Commission should encourage Member States to increase the transferability of mortgages by introducing pan-European Security Trust instruments.”

The “Euromortgage” is also an old concept.32 However, unlike past designs, the FGMC report does not aim at harmonising national mortgage laws, but rather at creating an optional instrument that will run in parallel with national mortgages. Its introduction would require changes in national legislation, in order to create the option for borrowers either to mortgage their real estate under national mortgage law, or alternatively to use a pan-European mortgage that may serve as

29 Ibid., paragraph 60.
30 The time horizon for the adoption of the “common frame of reference” was announced as 2007.
31 Available at http://europa.eu.int/comm/internal_market/finservices-retail/home-loans/index_en.htm
collateral for credit obtained either at home or from foreign lenders, or to cover the issuance of asset-backed securities that may be marketed on a cross-border basis. To achieve this objective, the FGMC report suggests the use of either Directives or Regulations, with the aim of allowing a similar optional financial instrument in all Member States, the so-called Euromortgage, the character of which is outlined in paragraph 117 and Annex VI of the FGMC report.

The pan-European Trust Instrument is defined as a legal construction that allows “a single bank to hold mortgage collateral on trust for all the banks participating in the credit agreement”. The idea behind this is that the Common Law concept of “trust” should be made optionally available in all 25 Member States for the specific purposes of the mortgage credit market, so that a single mortgage (or a plurality of mortgages in favour of one bank) may be financed by a syndicate of lenders on a cross-border basis, and mortgage-backed loans can be traded on a cross-border basis. Although the FGMC report does not specify how this could be achieved, the establishment of such optional instruments would clearly require Community legislation.

4.2 INSURANCE AND OCCUPATIONAL PENSION PRODUCTS

The Commission set up four expert groups\(^{33}\) in October 2003 to assess the state of financial integration following the almost completed adoption of the legislative measures foreseen in the Financial Services Action Plan (FSAP).\(^{34}\) In June 2004, the Commission organised a high-level conference\(^{35}\) on “European Financial Integration: Progress and Prospects” to discuss inter alia the assessment report of each of the four expert groups. The four reports\(^{36}\) are extremely interesting and provide an array of ideas on how to advance financial integration; this paper refers below to only one of these, the report of the Expert Group on Insurance and Pensions.

Following an explanation of the very “disparate nature of the barriers” to the cross-border sale of insurance and pension products, and the extremely marginal amount that such sales represent, the Report of the Expert Group on Insurance and Pensions inter alia recommended:

1. studying the development of a 26th regime;
2. encouraging business to develop pan-European products; and
3. adopting the statutes for a European mutual society.

The reference to a 26th regime is explained in the Report as an “optional EU regime governing essential parameters” of insurance and pension products, in order to “facilitate the marketing of pan-European products on an EU scale.”

The development of pan-European products is also explained in the Report: “Given the wide diversity of new national rules in the pensions area, some feel

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33 On Banking, Asset Management, Securities Trading & Investment, and Insurance.
34 COM (99) 232 of 11.05.1999.
36 The four reports are available at: http://europa.eu.int/comm/internal_market/en/finances/actionplan/stocktaking.htm
that the evolution of a pan-European pension product based on a 26th regime was the only viable way forward in the short term.”

Finally, the last indent refers to the European mutual society statute, as mentioned earlier in this paper. The Report limits itself to stating that “the statutes for a European mutual society should be finally adopted.”

4.3 THE PAN-EUROPEAN DIRECT DEBIT SCHEME

The European Payments Council (EPC) is an industry body that was established by the three main European banking associations at the start of the twenty-first century to represent the payment systems industry and to interface with the central bank community and with EU legislators. In September 2002 the EPC decided to launch a project with the aim of devising a harmonised scheme for direct debit, namely an instrument that allows instructions by clients to debit their bank accounts to be implemented on a cross-border basis. On June 2004, the EPC adopted a Resolution with the parameters of the Pan-European Direct Debit (PEDD) scheme, and which reads: “it appears unrealistic to harmonise the numerous and very different existing national schemes in order to enable customers and banks to effect in the same way euro direct debit transactions throughout the Single Payments Area; [...] a new instrument can coexist in parallel with unchanged national schemes during a transitional period and is the fastest way to launch the implementation of the PEDD; [...] the new instrument is to process both cross-border and national direct debit transactions”. The resolution also contains the parameters of the PEDD, including the criterion that “the migration of payment flows [from national schemes to the PEDD] will be market-driven.”

The PEDD project is an example of a 26th regime, a market-driven, harmonised scenario. The EPC resolution indeed acknowledges that “the full implementation of the PEDD scheme” will require “the removal of all national and EU legal and regulatory barriers.”

5 OPTIONAL INSTRUMENTS CREATED BY MARKET PARTICIPANTS AND SUPPORTED BY THE ESCB

5.1 THE SHORT-TERM EURO MONEY MARKET PAPER (STEP) INITIATIVE

The initiative to create an optional instrument for short-term euro money market paper (STEP) came from the financial market itself, in view of the heterogeneous standards and practices currently prevailing in the fragmented and asymmetric...
short-term money market paper, and with the aim of fostering its development in
those Member States where such a market is either marginal or non-existent. The
legal vehicle to establish this optional instrument is through a market convention
that market participants have to adhere to in order to benefit from the STEP label.
This convention standardises the eligibility conditions for short-term securities
to obtain the STEP label, the eligibility of issuers to issue under that label, the
minimum amounts of the papers, and the disclosure of information and the format
of the documentation. It also sets the rules for the electronic settlement of
instruments issued in book-entry form under the programme, establishes the
provision of data to the ESCB for the production and publication of statistics, and
regulates a STEP Market Committee with the capacity to grant the STEP label
to those issuance programmes that comply with the market convention. The STEP
label does not refer to the financial soundness or creditworthiness of the issuer,
or to the liquidity of the assets, or the accuracy, completeness or truthfulness of
information provided in the STEP information memorandum.

The ESCB’s support of this market initiative became apparent in the Governing
Council decision of 22 July 2004, according to which the ESCB would assume
a clearly defined limited role consisting of the collection and publication of yield
indices and of statistical data on market activity, as well as the provision of some
technical assistance to the STEP Market Committee. This support was requested
by numerous banks, issuers and trade associations in view of the neutrality, pan-
European capacity and independence of the ESCB.

All of the features foreseen in the market convention aim at avoiding a situation
whereby the STEP instruments are covered by the requirements of the Prospectus
Directive. This part of mandatory law is thus not applicable. However, the limits
of market action are shown by the fact that other existing national rules,
including regulatory and/or supervisory regimes, with regard to short-term
securities will continue to apply. The optional instrument is therefore subject
to marginal national legal differences.

5.2 THE EUROPEAN MASTER AGREEMENT

At the start of Economic and Monetary Union in January 1999, one of the
barriers to the successful integration of the secured euro money market and of
the (re-denominated into euro) bond markets was the absence of one single
common market documentation. No less than 15 market standard agreements39
were in use in those markets, implying considerable diversity in the legal
background of trades conducted with the same single currency, with risks linked
to discrepancies between different agreements applying to connected transactions.

Terms and Conditions for Belgium, Rahmenvertrag für echte Pensionsgeschäfte 1997, Rahmenvertrag für
Wertpapierpensionsgeschäfte 2002, Convention-cadre relative aux operations de pension livrée,
Convention-cadre relative aux operations de marché à terme, Acuerdo-marco para operaciones financieras,
AEB, ISDA Master Agreement 1987, ISDA Master Agreement 1992, ISDA Master Agreement 2002. In addition,
for central banking market operations, each national central bank had its own terms and conditions (within
the “minimum common features” established by the Governing Council of the ESCB in 1998).
For this reason, the three main European banking industry associations\(^{40}\) prepared
an optional instrument for use by wholesale market players in both domestic and
cross-border trades, named the European Master Agreement for Financial
Transactions (EMA), which was launched on 17 July 2001.\(^{41}\) The 2001 version
was enhanced on 29 January 2004 with the addition of a “Product Annex for
Derivative Transactions”.

The EMA entails a single legal regime for a wide variety of wholesale
transactions.\(^{42}\) It is therefore an alternative to not only the different national
standards, but also the several ‘international’ master agreements that are product-
specific.\(^{43}\) It is a multi-product agreement which allows for cross-product netting.

This single legal regime is also multi-jurisdictional. Before launching the EMA,
the sponsor organisations obtained legal opinions to ensure the validity and
enforceability of the EMA in most EU Member States and in Switzerland. Thus,
and in contrast with the “international” master agreements which are actually
subject to either English or New York law and jurisdiction, the EMA may be
subject to the law and the jurisdiction\(^{44}\) of many European States, including all
euro area Member States. For this reason, the EMA is available in many
European languages. The implementation of Directive 2002/47/EC of the
European Parliament and of the Council of 6 June 2002 on financial collateral
arrangements\(^{45}\) should ensure the validity and enforceability of the EMA in all
25 Member States.

The use of the EMA by market participants operating in several EU jurisdictions
provides another advantage: a single EMA executed by the head office would
cover the transactions undertaken by its branches. Until now, branches located
in different Member States have had to use the local standard documentation,
with the result that a single legal person would need several market standards
to document as many agreements as the jurisdictions where it operates by way
of branches. The EMA, on the other hand, is a multi-branch agreement and
economises in this respect, providing a consistency that beforehand did not exist.
However, the EMA does not go so far as to cover in a single agreement the trades
of subsidiaries, as it does not permit cross-affiliate netting.

The ESCB began to support this market initiative in 2001 when the Governing
Council decided that the ECB would use this optional instrument for all its repo
operations with its EU and Swiss foreign reserves and own funds counterparties.

\(^{40}\) European Banking Federation, European Savings Bank Group and European Association of Co-operative Banks.
\(^{41}\) Available on the website of the sponsoring organisation, at www.fbe.be
\(^{42}\) Repurchase (“repo”) transactions, securities loans, currency swaps, foreign exchange spot transactions, forward
transactions, put and call options on financial assets and on commodities, interest rate swaps, cap, floor and
“collar” transactions, and combinations and variants of these.
\(^{43}\) TBMA/ISMA Global Master Repurchase Agreement, ISDA Multi-currency Cross-border Master Agreement,
the Overseas Securities Lending Agreement, Global Master Securities Lending Agreement, TBMA Cross-
product Master Agreement and ISDA Cross-bridge Agreement.
\(^{44}\) Contrary to other pre-existing master agreements, the EMA contemplates the possibility for arbitration, and
while allowing full freedom to the parties to organise such arbitration, it foresees two arbitration institutions,
the European Centre for Financial Dispute Resolution and the International Chamber of Commerce. Speeded-
up procedures, technical expertise and confidentiality are strong arguments in favour of the arbitration option.
The Governing Council decided in March 2005 to also use the EMA for the ECB’s derivative operations in 14 EU jurisdictions and in Switzerland. The changeover from existing master agreements to the EMA was swiftly carried out. The ECB continues to use pre-existing standard documentation with counterparties located outside the EU and Switzerland.

With regard to other ESCB members, as of June 2005, the central banks of Austria, Belgium, France, Ireland and Malta have also decided to use the EMA, while the other EU central banks are considering the use of this optional instrument. According to sponsoring organisation sources, the two financial markets in which the EMA is most extensively used are those of Germany and France.

6 CRITICAL REMARKS

6.1 GENERAL COMMENT

This article has focused on an approach to financial integration that avoids or bypasses the need for legal harmonisation. By introducing optional pan-European vehicles and products, financial trades may indeed overcome some national barriers through the use of legal vehicles that have a pan-European ‘passport’; by these means, market players may foresee economies of scale commensurate with the new dimension of EU financial markets. The approach is indeed neither ‘hard’ law harmonisation (in the sense that national legal diversity persists) nor ‘soft’ law (in the sense that once market participants decide to use it, it becomes legally effective and binding). In this it resembles the American example of the Uniform Commercial Code, a set of uniform rules that both contractual parties in their contracts, and State legislators in their law-making, may choose to adopt or follow, but are otherwise not legally binding.

This paper examines a model for market integration in the financial sector that has until now received insufficient attention by European policymakers. Optional instruments are however not new in the Community’s history. In the establishment of a common market for goods, several legal acts in the 1960s and 1970s provided producers with the option either to follow national technical requirements, or to adopt standards harmonised by Community legal acts. The Court of Justice’s “Cassis de Dijon” judgement made redundant the extensive practice of optional harmonisation: the mutual recognition of national standards sufficed thenceforth for the free circulation of goods. As stated in the Commission’s Communication following that landmark judgement: “Any product lawfully produced and marketed in one Member State must, in principle, be admitted to the market of any other Member State”.

47 Case 120/78, Rewe-Zentral AG v. Bundesmonopolverwaltung für Branntwein [1979], ECR, p. 649.
The achievement of a single market for financial services would similarly require its own Cassis de Dijon jurisprudence to ensure that financial services lawfully provided and marketed in one Member State are admitted to the market of any other Member State. This would make the use of optional instruments redundant, as it did for the free circulation of goods, and would require a profound revision of the “general good” exception in the financial *acquis*, limiting its scope and with a European control mechanism. It would also represent an enhancement, beyond purely prudential supervision aspects, of the competences of the home Member State vis-à-vis the host Member State, so that financial services and products marketed in the company’s home state may also be marketed throughout the EU.

Although some jurisprudence of the Court of Justice has pointed in the direction of the Cassis de Dijon jurisprudence in the domain of financial services\(^{49}\), financial products cannot so far be marketed throughout the Community, unlike commodities. The recent Caixabank case\(^{50}\) does not go as far as the Cassis de Dijon jurisprudence, although it questions whether the “general good” exception used by France to justify its prohibition to foreign banks to market in France a financial product marketed – in this case – by Caixabank in Spain is sufficient to limit the freedom of establishment foreseen in the Treaty. It reaches the conclusion that in this particular instance, this is not the case. In this sense, the Caixabank judgement also represents a positive step forward and gives some hope that the Cassis de Dijon jurisprudence will spill over into the financial services.

Unless a similarly radical approach is followed to the one outlined above, it will take many years before the EU can reach the promised land of an integrated financial market by following either the path of legislative harmonisation through the Lamfalussy methodology, or that of optional pan-European instruments. Experience shows that Member States tend to see optional instruments rather like Trojan horses, seeking to introduce harmonisation by default.\(^{51}\) The resistance to the European Company and similar pan-European vehicles, and the requirement that no discrimination provisions be included in such vehicles, show that Member States are not ready to admit competition between their national laws and pan-European standards. Member States seem to prefer the difficult path of approximation of laws, namely through the comitology procedure, whereby they can influence the outcome, to competition with a pan-European optional instrument. Market participants, on the other hand, would wish to operate under maximum freedom, including the optional use of instruments that have a pan-European reach. This article aims at least to submit for renewed debate the potential use of pan-European optional instruments as a tool for fostering financial integration.


\(^{50}\) Case C-442/02, CaixaBank France v. Finance Ministry, judgement of 5 October 2004.

\(^{51}\) The expression is taken from W. Blair and R. Brent, “A Single European Law of Contract?”, *European Business Law Review* 15 (2004), p. 20 (“Those who are opposed to a European code will carefully review these proposals [the optional instrument], lest a Trojan horse is admitted by default”).
6.2 OPERATIONAL INSTRUMENTS FOR PAN-EUROPEAN SOCIETIES

As already described in this article, Community law has provided or is about to provide the option for pan-European vehicles (i.e. the European company, a European cooperative society and a European mutual society). However, it remains to be seen whether they will be successful in reality. So long as these European vehicles need to operate under national rules, there seems little incentive for entities to use them. A pan-European credit institution wishing to benefit from one of these optional vehicles will find that it cannot offer the same financial products throughout the Community, and nor will it be able to raise funds homogeneously in its area of operation. Moreover, its deposit guarantee scheme will differ from Member State to Member State.\(^52\) Pan-European vehicles currently need to adapt their operations to the national rules of each jurisdiction in which they operate.

This article submits that the option of using such entities would be promoted if the Community enabled the use of pan-European instruments – for instance, the possibility to use a Community-regulated single deposit guarantee scheme, or to issue securities\(^53\), offer deposits, consumer loans, life insurance policies or occupational pension products under a single framework. This would require the Community to design and adopt additional optional instruments, which may exist in parallel to national rules.

6.3 THE INTEGRATION OF THE EURO AREA

Optional instruments do not necessarily need to be adopted by the Community. A group of Member States seeking to facilitate the further integration of their financial markets could coordinate the adoption of multi-jurisdictional optional instruments by way of national rule-making, enabling these instruments to be mutually recognised and operative within their markets. The start of the third stage of Economic and Monetary Union on 1 January 1999 and the disappearance of currency barriers for the integration of the financial markets of the participating Member States has arguably entailed the emergence of a business case with regard to optional rule-books that would facilitate the integration of financial services within the single monetary area. The cross-border consolidation of markets or of market infrastructures may be facilitated if adequate legal vehicles are made available to concerned parties.\(^54\) Participating Member States should have a policy to provide participants with the legal instruments needed to achieve the economies of scale that Monetary Union makes possible. This paper contends that the technique of optional instruments – in addition to the more complex process of legal harmonisation in a community of 25 Member States – may usefully contribute to this end.

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52 For instance, in the example of Nordea bank mentioned in footnote 16, one of the attractions of becoming a European company does not and will not materialise unless amendments are introduced to the current Community Directive governing the Deposit Guarantee Scheme for credit institutions that would allow for a single regime irrespective of whether the European company is operating in several jurisdictions.

53 It may be recalled that pan-European official banks such as the European Investment Bank (EIB), the European Bank for Reconstruction and Development (EBRD) or the ECB need to operate under national legal systems when they issue securities, and do not have a framework that enables them to operate under a single set of rules.

54 The business case for a single optional legal structure is supported by the existence of entities that functionally operate on a cross-border basis but are subject to several national rules, such as the Euronext stock exchange and the Euroclear and Clearstream securities settlement systems, etc..
EPILOGUE

Lorenzo Bini Smaghi

This book has been written by a group of friends of Paolo Zamboni Garavelli in memory of his human qualities and to honour his wide-ranging career as a central bank lawyer. I knew Paolo Zamboni Garavelli for many years, and witnessed his personal and professional excellence. Therefore I am pleased to be able to add my modest contribution to this book.

The authors are all, or have all been, central bank lawyers, engaged collectively in the preparation of the institutional and operational framework of the ESCB, as well as in the many supplementary and subsequent tasks entrusted to the Working Group of Legal Experts of the EMI (WGLE) and to the Legal Committee of the ESCB (LEGCO).

This book also commemorates 10 years of work of the WGLE and LEGCO and their contribution to the legal framework for the introduction of the euro, as well as to the general legal framework of the ESCB and the Eurosystem.

Central bank lawyers operate in an environment of economists. Their ‘client units’ and decision-making bodies are the policy makers, normally professional economists. Lawyers are therefore required to have a sound understanding of economic processes and paradigms, in order to take into account the economic effects of legal decisions.

The relationship and interaction between law and economics is as old as the study of economics as a distinct science. Adam Smith, Jeremy Bentham, Karl Marx, to name but a few, addressed this relationship. Also on the lawyers’ side there has been and still exists a systematic approach to the economic foundation or effects of legal institutions, such as in the theory of Rudolph von Ihering on the impact of private interests in the law, or the work of Max Weber on the effects of law on sociology and collective behaviour, or in contemporary works of legal philosophy by Professor Guido Calabresi of Yale University, or the US Supreme Court Judge Antonin Scalia, both of Italian origin. Since the sixties this relationship has been the subject of a whole area of academic research, with Nobel Prize recognition in the cases of Friedrich Hayek, James Buchanan, Ronald Coase, Gary Becker and Douglas North. It has many aspects. The school of ‘economic analysis of the law’ initiated at the University of Chicago by Professor Richard Posner, which, starting from the observation that the behaviour of persons is determined by the legal system, suggests that the common law approach reflects an ‘efficiency logic’ whilst civil law systems serve other objectives (such as fairness, reduction of uncertainties, etc.); the school of ‘public choice’, which analyses how private interests operate in the public law domain and have an impact on law-making, as well as the role of the public sector in correcting the effect of market forces; the ‘game theory’, studying the effect of rules on interaction between people, based on the fact that one person’s choices depend on what other persons choose and vice versa; the ‘institutionalist’
school, focusing on the impact of institutions in the economy; etc. These many facets of the relationship between law and economics show that ‘reductionism’ of the issue into a ‘form versus substance’ relationship, the former being the law and the latter the economy, is inaccurate. Both interact and are interdependent, and lawyers as well as economists, despite their different backgrounds, need to understand this interdependence.

The work of central bank lawyers is of enormous relevance in this context. Central banks are core institutions of the financial system and therefore of the economy. Satisfying the ‘institutionalist’ theory, the setting-up of the ESCB itself has had an important impact on the European economic scene and on the behaviour of economic operators. The rules governing its operational framework reflect ‘public choices’ that have an effect on markets. The advisory contribution of central banks to rule-making in the Community and in the Member States has indeed shaped future economic decisions. I encourage central bank lawyers to deepen their sensitivity towards the economics of legal acts and decisions, as befits the role and responsibilities of central banking in modern societies.

Paolo Zamboni Garavelli was for a period of his professional life the Head of a newly-created Office for the Law of the Economy in the Banca d’Italia. A department composed of lawyers and economists, mandated precisely to analyse the economics of draft national legislation in order to enhance the advisory contribution of the Banca d’Italia to the law-making processes affecting the Italian economy. Some important pieces of advice and proposals for legislation came out of this department. It is both his due, and also fitting, that a group of central bank lawyers, also immersed in this complex area of the relationship between law and economics, have decided to honour his memory in the manner that he would most appreciate: by a series of legal articles on the ESCB.