

Accountability of the ECB's supervisory activities (SSM)

Citation for published version (APA):

Nicolaidis, P. (2019). Accountability of the ECB's supervisory activities (SSM): Evolving and responsive. *Maastricht Journal of European and Comparative Law*, 26(1), 123-137. <https://doi.org/10.1177/1023263X18822952>

Document status and date:

Published: 01/02/2019

DOI:

[10.1177/1023263X18822952](https://doi.org/10.1177/1023263X18822952)

Document Version:

Publisher's PDF, also known as Version of record

Document license:

Taverne

Please check the document version of this publication:

- A submitted manuscript is the version of the article upon submission and before peer-review. There can be important differences between the submitted version and the official published version of record. People interested in the research are advised to contact the author for the final version of the publication, or visit the DOI to the publisher's website.
- The final author version and the galley proof are versions of the publication after peer review.
- The final published version features the final layout of the paper including the volume, issue and page numbers.

[Link to publication](#)

General rights

Copyright and moral rights for the publications made accessible in the public portal are retained by the authors and/or other copyright owners and it is a condition of accessing publications that users recognise and abide by the legal requirements associated with these rights.

- Users may download and print one copy of any publication from the public portal for the purpose of private study or research.
- You may not further distribute the material or use it for any profit-making activity or commercial gain
- You may freely distribute the URL identifying the publication in the public portal.

If the publication is distributed under the terms of Article 25fa of the Dutch Copyright Act, indicated by the "Taverne" license above, please follow below link for the End User Agreement:

www.umlib.nl/taverne-license

Take down policy

If you believe that this document breaches copyright please contact us at:

repository@maastrichtuniversity.nl

providing details and we will investigate your claim.

Accountability of the ECB's supervisory activities (SSM): Evolving and responsive

Maastricht Journal of European and
Comparative Law
2019, Vol. 26(1) 136–150
© The Author(s) 2019
Article reuse guidelines:
sagepub.com/journals-permissions
DOI: 10.1177/1023263X18822952
maastrichtjournal.sagepub.com



Phedon Nicolaides*

Abstract

This article develops a theory of accountability as a means of increasing regulatory effectiveness in complex policy environments and applies it to the supervisory powers that have been assigned to the European Central Bank through the Single Supervisory Mechanism. It finds that the use of the Single Supervisory Mechanism by the European Central Bank has been evolving. The Single Supervisory Mechanism / European Central Bank has expanded and improved the information it provides to other European Union institutions and the public, and has progressively elaborated the explanation of its decisions and regulatory instruments. These developments are welcome because they are indications of an accountable institution that seeks to demonstrate how its actions meet its obligations. However, there is still lack of a performance benchmark against which the actions of the Single Supervisory Mechanism / European Central Bank can be evaluated and of expert review of Single Supervisory Mechanism / European Central Bank decisions. In complex policy environments it is not possible for outsiders to assess the soundness of regulatory actions without access to confidential information. Therefore, this article proposes that the European Parliament establishes a policy or regulatory audit by external experts who can assess such information on a confidential basis.

Keywords

Accountability, European Central Bank, single supervisory mechanism, supervision, regulation

* Professor at University of Maastricht, The Netherlands; and College of Europe, Bruges, Belgium.

Corresponding author:

Phedon Nicolaides, University of Maastricht, Bouillonstraat, Maastricht 6200 MD, The Netherlands.

E-mail: phedon.nicolaides@maastrichtuniversity.nl

I. Introduction

The European Union (EU) regulation that assigned to the European Central Bank (ECB) supervisory powers over financial institutions frames accountability as a sort of countervailing instrument. According to Recital 55 of the Single Supervisory Mechanism Regulation (SSMR),

the conferral of supervisory tasks implies a significant responsibility for the ECB to safeguard financial stability in the Union, and to use its supervisory powers in the most effective and proportionate way. Any shift of supervisory powers from the Member State to the Union level should be balanced by appropriate transparency and accountability requirements.¹

The accountability requirements that are laid down in the SSMR are intended to ensure that the ECB carries out its tasks effectively, and that it does not misuse its newly acquired powers. Therefore, a natural test of whether those accountability requirements have worked is to examine whether they have actually induced the ECB to use its supervisory powers effectively. Because the aim of supervision is to ‘safeguard financial stability’, ultimately a banking regulator should be judged on whether it succeeds to prevent instability. Such an assessment is necessarily based on economic tests that fall outside the scope of this article. Instead, this article asks whether those accountability requirements are capable of inducing the ECB to improve the effectiveness of the supervisory tasks entrusted to it. It argues that theoretically those requirements are incomplete, but that the empirical evidence is quite positive.

Accountability is a concept that is subject to multiple definitions. It is seen as an instrument of democratic legitimation, often described as ‘input accountability’, or as a means of improving policy implementation, the so-called ‘output accountability’. This article focusses on the output side of the regulatory activities of the ECB in the context of the Single Supervisory Mechanism (SSM).

The structure of this article is as follows. Section 2 analyses the concept of accountability from a theoretical perspective and derives the essential elements of accountability of an institution such as the ECB, which is responsible for the rather loosely defined policy objective of ‘financial stability’. Section 3 reviews the accountability arrangements laid down in the SSMR, as developed by the Interinstitutional Agreement (Agreement) and the Memorandum of Understanding (MoU) between the ECB and the European Parliament (EP) and between the ECB and the EU Council (Council), respectively. Section 4 investigates how the ECB demonstrates in its Annual Reports the effective use of its supervisory powers. Section 5 presents the findings of the assessment of the accountability of the SSM by the European Commission (Commission) and the European Court of Auditors (ECA). Section 6 assesses whether the ECB has so far acted in an accountable manner and proposes ways for strengthening the accountability of ECB. Section 7 summarizes the main points of the article.

Before proceeding, an important point of clarification is in order. The institution that has been vested with regulatory powers over financial institutions is the ECB. However, for stylistic convenience this article refers to the accountability of the SSM. It should always be read as the accountability of the ECB in carrying out its regulatory tasks.

1. Council Regulation No. 1024/2013/EU of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, [2013] OJ L 287/63.

2. Evolving and responsive: a new approach to understanding accountability in complex policy environments

The purpose of this section is to argue that in complex policy environments accountability arrangements need to have a built-in evolutionary process. Since the literature on accountability and the various definitions of accountability used in the different articles in this volume are reviewed in the introduction to this special issue, this section focusses only on the use of accountability mechanisms to improve policy effectiveness.

Article 1 of the SSMR stipulates that

this Regulation confers on the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions, with a view to contributing to the safety and soundness of credit institutions and the stability of the financial system within the Union and each Member State, with full regard and duty of care for the unity and integrity of the internal market based on equal treatment of credit institutions with a view to preventing regulatory arbitrage.

The ultimate obligation imposed on the ECB is the protection of financial stability. The term ‘financial stability’ is not defined anywhere else in the SSMR.

It is no accident that the SSMR is silent on the meaning of financial stability. It is a term that is difficult to define precisely. That is why there is no universally acceptable definition.² It follows that the SSM/ECB has to operationalize that term through appropriately chosen regulatory instruments and regulatory actions. It follows that, at minimum, the SSM/ECB should be explicit about the correspondence between its instruments and the achievement of financial stability, and should explain its choices to those to whom it is accountable: that is, the EP, the Council, and ultimately EU citizens.

Explanation is a necessary condition (although not by itself sufficient) for the SSM/ECB to prove that it has carried out its tasks in the spirit of the SSMR. It must justify that its instruments and actions are the most appropriate or the most effective in achieving the tasks assigned to it. Explanation and justification presuppose the existence of an explicit or implicit performance benchmark. However, the SSMR does not define any such benchmark, nor has the Council done so in any subsequent legislation. An accountable institution is therefore implicitly (although not necessarily) indentured to set up a benchmark against which its performance can be evaluated.

When a benchmark cannot be meaningfully defined in advance or when several such benchmarks can be credibly defined, we can only ask how someone else would have performed in similar circumstances. An action is justified when another person, equally qualified, would act in a similar fashion. Such kind of comparative assessment may not be easy to conduct in practice. Ultimately, the only option for the institutions to which the SSM/ECB is accountable to control its actions is to rely on expert opinion.

Performance benchmarks and expert opinions are needed in complex policy environments because it is always difficult to achieve predetermined policy objectives on first attempt. A cycle of implementation, evaluation, adjustment and further implementation is normally necessary. Accountability, with its in-built requirements for explanation and justification, becomes a tool for policy experimentation and search for optimal solutions. An accountable institution is one that

2. See the various definitions in G. Schinasi, ‘Defining Financial Stability’, *IMF Working Paper* No. 04/187 (2004), <https://www.imf.org/external/pubs/ft/wp/2004/wp04187.pdf>.

adjusts its regulatory instruments and actions as it learns and gains experience from the successes or failures of its regulatory actions. This is also the reason why an accountable institution must have room for manoeuvre and adjustment. Hence, it must have sufficient operational independence to be able to define at least some of its actions without external influence.

If an accountable agent has to learn, adjust and justify to its principal how it achieves broad but not precisely defined objectives, it follows that accountability should be conceived as a structured and continuous interaction between the principal and the agent. We now arrive at the rather counterintuitive conclusion that it is not only necessary for the agent to adjust but also for the principal. Accountability is an evolving process. Both the principal and the agent learn from the agent's actions. The principal adjusts the benchmark of performance against which it assesses the agent and the agent demonstrates how it meets the shifting benchmark as it gains practical experience. Given that accountability arrangements are established in order to strengthen the effectiveness of the application of the tasks assigned to the agent, it is indeed indispensable that learning and feedback loops are created. Ability to take corrective action is an essential feature of effective policy implementation.³

We can now apply this understanding of accountability to the SSM. The overall objective of the SSM is the protection of 'financial stability'. According to the ECB, financial stability is defined as the absence of excessive systemic risk, which, in turn, is defined as a reduction in financial products that affects welfare; this, in turn, is attributed to imbalances, shocks and contagion.⁴

Another ECB document explains that:

... for the ECB, financial stability means the financial system can withstand shocks without major disruption. (...) Stability is all about balance. The financial system features a complex web of dependencies and interactions between different actors. (...) Risks can arise at different levels and in different forms. (...) So risks and vulnerabilities affecting one actor can impact many others, throwing the system out of balance and threatening overall financial stability. (...) We constantly monitor the financial system to detect potential risks and vulnerabilities early on and assess what needs to be done. (...) the ECB's new banking supervision function watches over individual banks so that the banking sector remains safe, and, ultimately, to enhance financial stability in Europe.⁵

These definitions of financial stability are far from being precise or operational. In the absence of a well-defined policy objective and without a common understanding of how the term 'financial stability' can be operationalized in practice, the SSM – the agent in this instance – needs to be given sufficient room to learn and adjust its policy instruments and calibrate its regulatory supervision of banks. But, as explained above, the quid pro quo for conceding room for policy manoeuvre to the SSM is that the SSM has to demonstrate how its regulatory actions and instruments evolve over time and respond to the lessons it draws from its own successes and failures. If it is to be credible, any proof provided by the SSM has to be verified by peers or experts acting on behalf of the principal.

Since the EP – which is the principal to which the Board of the SSM testifies and provides answers – is not an expert itself, review by outside experts on behalf of the EP is indispensable for

3. See P. Nicolaidis, *Microfoundations of Policy Implementation* (Routledge, 2012).

4. See the website of the ECB: <https://www.ecb.europa.eu/pub/fsr/html/index.en.html>.

5. See the website of the European Central Bank, 'Spotlight on Financial Stability', *European Central Bank* (2016), https://www.ecb.europa.eu/explainers/tell-me-more/html/financial_stability.en.html.

the proper assessment of the SSM's actions and for identifying what needs to be improved. This is even more relevant in relation to financial stability and banking supervision, where academic research and practice regularly discover new sources of risk and different means of addressing that risk.

Therefore, this article will now examine how the SSM/ECB's accountability has been defined, how the SSM/ECB has performed, and how the various accountability arrangements have evolved.

3. The SSM/ECB's accountability framework

As stated in the Introduction, the SSMR conferred regulatory tasks on the ECB concerning the prudential supervision of credit institutions,⁶ and it established the SSM. The regulatory tasks were assigned on the basis of Article 127(6) of the Treaty on the Functioning of the European Union (TFEU), whereby 'the Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions'.

Both Recital 55 recalled above, and Recital 85 to the SSMR refer to democratic accountability and thereby imply that accountability is a political instrument. It is the means by which the ECB is held responsible for its actions to the ultimate source of legitimacy, which is the citizens.

Article 20 SSM lays down four democratic accountability mechanisms:

1. annual reporting to the EP and the Council;
2. transmission and presentation of the Annual Report to the EP, the Council, the Commission and to the Euro group;
3. participation in hearings before the Euro group and the EP competent committees; and
4. replies to parliamentary questions and to questions posed by the Euro group.

It is safe to conclude that the SSMR uses broad, nonspecific and parsimonious language in defining accountability arrangements.

The details of these accountability mechanisms vis-a-vis the EP and the Council are furthermore contained in a MoU between the EP and the ECB, and in the Agreement concluded between the ECB and the Council.⁷ They define the content of the reports that the ECB must prepare, the rules for the conduct of its hearings and meetings, and its procedures for appointments. It is worth noting that both the Agreement and the MoU require that the Annual Reports explain the execution of the supervisory tasks.

At the time of writing, the ECB had published four Annual Reports on its supervisory activities, for 2014, 2015, 2016 and 2017. The reports provide a comprehensive account of the regulatory model of the ECB, its regulatory priorities, regulatory activities and institutional structure through which it pursues those priorities. The latest report, which was published in March 2018 and

6. Council Regulation No. 1024/2013/EU of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, [2013] OJ L 287/63.

7. Interinstitutional Agreement between the EP and the ECB on the practical modalities of the exercise of democratic accountability and oversight over the exercise of the tasks conferred on the ECB within the framework of the SSM, [2013] OJ L 320/1; European Central Bank, 'Memorandum of understanding between the Council of the European Union and the European Central Bank on the cooperation on procedures related to the SSM', *European Central Bank* (2013), https://www.ecb.europa.eu/ecb/legal/pdf/mou_between_eucouncil_ecb.pdf.

arguably offers the most up-to-date information, is analysed in more detail in the following section, which examines how the ECB explains its own actions.

Formally, the SSMR hence appears only to oblige the SSM to inform the EP and the Council of what it does, that is, no sanctioning mechanism has been foreseen. On the face of it, it does not appear to be onerous. But, as documented later on, this deceptively innocuous requirement has developed into a more demanding and challenging process in practice.

It should be noted that, in addition to those democratic accountability arrangements, the mechanisms of judicial accountability before the Court of Justice of the EU and of administrative accountability before the ECA remain available.

4. How the SSM/ECB demonstrates that it uses its regulatory powers effectively

The ECB's Annual Reports on supervisory activities are thus one of the main accountability instruments and the principal written evidence of whether the SSM/ECB carries out its regulatory tasks effectively.

Both the Agreement between the ECB and the EP and the MoU between the ECB and the Council require that the first item to be covered in the Annual Report is the 'execution of the supervisory tasks'. However, neither the Agreement nor the MoU define any standards of reporting or benchmarks of performance. This is left to the ECB, which is not unreasonable as long as it can be confirmed that the reporting and performance are satisfactory.

So far, the ECB has published four Annual Reports on its supervisory activities. The first three Annual Reports are similar in length, with the fourth being considerably longer; and their main subjects are each the same (for example, accountability, appointments, legal instruments), although their contents vary according to the particular tasks that the ECB had to perform in each period. Understandably, the first Annual Report outlines the process of the establishment of the SSM. The second Annual Report explains its institutional structure. The third Annual Report pays more attention to the functioning of the regulatory system. The fourth Annual Report has more extensive coverage of the role of the SSM in the resolution cases of 2017; it will now be examined more at length.

The relevant parts to assess how the ECB/SSM complies with its duty to ensure accountability and to allow other stakeholders to hold it accountable are contained in Chapters 1 and 5 of the 2017 Annual Report. Chapter 1 indeed deals with the main task of the SSM, which is financial stability. It explains the primary risks in the banking sector and outlines the supervisory priorities that address those risks (for example, nonperforming loans, risk management), 'taking into account the latest developments in the economic, regulatory and supervisory environment'.⁸ Then it explains the implementation of the Supervisory Review and Evaluation Process (SREP) model of supervisions. SREP is a harmonized approach across the Eurozone. SREP evolves all the time as new data are fed into the process from the various stress tests and aims to ensure a banks' capital requirement correlates closely with its risk profile. It also examines the viability of the business model of each bank and the adequacy of its governance and risk management. The SSM published

8. European Central Bank, 'ECB Annual Report on Supervisory Activities', *European Central Bank* (2017), <https://www.bankingsupervision.europa.eu/press/publications/annual-report/pdf/ssm.ar2017.en.pdf?63a120afab30be18171c083089709229>, p. 10.

an explanatory document on SREP in December 2016. There is also an account of other methodologies used to assess the various kind of risk and the steps undertaken by the SSM to measure them and improve banks' responses to such risks in the event that they materialize.

On the other hand, Chapter 5 on the organizational set-up of the ECB banking supervision refers specifically to the discharge of accountability requirements. Indeed, it acknowledges that 'this Annual Report has been produced as one of ECB Banking Supervision's main accountability channels in accordance with the SSM Regulation'. In this connection, it lists the following:

- The appearances of the SSM chair before the EP;
- The number of replies to MEPs' questions;
- The submission to the EP of the proceedings of the SSM Board meetings;
- The attendance of Council meetings by the SSM chair; and
- The interaction with the ECA and the main recommendations of the ECA in its special report.

There is no qualitative self-assessment in the 2017 Annual Report of how well complied with the accountability requirements were. By contrast, the 2016 Annual Report does mention that the EP was 'satisfied' with a new format for submission of the SSM Board proceedings. Chapter 5 of the 2017 Report also reviews the decisions taken by the SSM Board and by the Administrative Board of Review. The Administrative Board, which deals with appeals to SSM decisions, examined five review requests.

Although the Annual Report, in Chapter 5, refers explicitly to the discharge of SSM/ECB's accountability requirements, the information it provides is rather basic, as it only lists procedures and does not enlighten the reader on how the performance of the SSM was evaluated by those to whom it reported. More relevant and interesting information is provided in Chapter 1, which explains what the SSM did to prevent financial instability.

In this context, it is important to note that preventing instability is not the same as maintaining stability. This is because the SSM may have addressed, say, three risks to financial stability, but failed to identify and/or deal with a fourth risk. Naturally, a non-expert does not know whether the SSM did everything that it possibly could to maintain financial stability. This is the main weakness of Chapter 1 of the Annual Report. It does not indicate how well the SSM performed in relation to some predetermined benchmark.

This raises the crucial question of whether it is reasonable to expect the SSM/ECB itself to evaluate its own performance. This issue is considered in more detail in the next section; this assesses the existing accountability arrangements, how they have been assessed by the Commission and the ECA, and whether they are adequate or whether they need to be strengthened.

5. Accountability arrangements and their assessment by the Commission and the ECA

Accountability arrangements have been assessed by the Commission (a) and by the ECA (b) in recent reports.⁹

9. This section does not consider the report by Transparency International EU, *op. cit.*, because it assesses the ECB as a whole, rather than the SSM. However, Section 6 does refer to the main recommendation of the report concerning the SSM.

A. Commission assessment

The accountability mechanisms applicable to the SSM have been assessed by the Commission in a report that reviews more broadly the application of the SSMR it conducted in 2017 as requested by Article 32 of the SSMR.¹⁰ A more detailed review is carried out in an accompanying Staff Working Document.¹¹

The Commission report distinguishes between administrative, political and judicial accountability. It finds that in general ‘the accountability arrangements applicable to the ECB are overall effective’ (p. 4). It notes in particular that

the ECB is called to account in front of the Court of Justice of the European Union (CJEU) relatively often by addressees of ECB supervisory decisions, which shows that the judicial accountability arrangements are used in practice. Given the liability regime applicable to the ECB and the CJEU’s mandate to review the legality of ECB decisions, the ECB offers broader opportunities for judicial review than many NCAs (p. 4).

Although it is true that the ECB has been a party to many cases, only three cases relating to the SSM have been adjudicated by EU courts between November 2013 and May 2018.¹² Furthermore, the report notes that

[a]s to administrative accountability, the ECB is subject to extensive complementary reviews by various administrative bodies in the EU, namely the Commission, the European Court of Auditors (ECA), the European Banking Authority (EBA) and the European Ombudsman. The ECB has demonstrated that it takes recommendations issued pursuant to such reviews seriously, often translating them into adaptations of its own rules or behaviour (p. 5).

This is admittedly true, but these reviews have not really assessed the effectiveness of ECB’s supervisory actions, although the ECA has been more critical (see below).

The available recourse mechanism against decisions of the ECB – the Administrative Board of Review (ABoR) – is actively used by those concerned and the ECB maintains that its opinions have had an influence in the ECB’s supervisory practice broader than the individual cases to which they relate... This report finds no evidence of shortcomings. It would be useful to take advantage of the growing jurisprudence developed by the ABoR by ensuring more transparency over the work undertaken by the ABoR, for instance through publication on the ECB’s website of summaries of ABoR decisions and with due observance of confidentiality rules (p. 5).

The role of the Administrative Board of Review (ABoR) is important. It acts as an in-house but independent first-instance ‘tribunal’ reviewing SSM decisions. It should be noted that in all three judgments of the General Court cited above, the Court endorsed the ABoR. The fact remains,

10. Commission report on the SSM established pursuant to Regulation (EU) No 1024/201, COM(2017) 591 final.

11. Commission Staff Working Document accompanying Report from the Commission on the SSM, SWD(2017) 336 final. The SWD examines in detail all of the regulatory instruments developed by the SSM/ECB such as, for example, the categorization of financial institutions under its supervision, the running of Joint Supervisory Teams, or the application of horizontally harmonized functions.

12. Case T-133/16 *Caisse régionale de crédit agricole mutuel Alpes Provence v. ECB*, EU:T:2018:219; Case T-52/16 *Crédit Mutuel Arkéa v. ECB*, EU:T:2017:902 and Case T-122/15 *Landeskreditbank Baden-Württemberg v. ECB*, EU:T:2017:337.

however, that none of the decisions of the ABoR is publicly available, which prevents us from understanding what the reasoning has been and thus trumps full accountability.

The Commission goes on to note in its report that '[t]he use of mechanisms for holding the ECB accountable has been intense and regular, and did not demonstrate major shortcomings in the way the ECB pursues its supervisory tasks' (p. 19). The report does not indicate which mechanisms were used, and when, and how.

The report shows that the SSM/ECB is subject to outside scrutiny and that the SSM/ECB is responding to this scrutiny. It also highlights the importance of internal control procedures such as the ABoR and the fact that the ABoR appears to function well, as indicated by recent judgments of the General Court. At the same time, the report reveals the existence of teething problems, but does not really provide any illuminating details. Overall, the assessment of the Commission is not critical.¹³ Perhaps there is no reason to be critical. But since the Commission and the ECB have to work closely together in many different situations, is the Commission objective? Assessment by independent experts would not have encountered this difficulty and potential conflict of interest.

B. ECA assessment

Two recent ECA reports have addressed issues relevant in the examination of the ECB/SSM's accountability conducted here. The first one, ECA's Special Report no. 29 of 11 November 2016 on 'Single Supervisory Mechanism – Good start but further improvements needed' examines accountability mechanisms specifically (p. 43–52). It is more critical than the Commission's report and notes the difficulty in obtaining audit evidence with respect to 'the ad-hoc exchange of views between the European Parliament and the Chair of the Supervisory Board' (p. 20).

In the specific section on accountability, the Special Report states that 'accountability requires the supervisory authority to provide relevant, timely and accurate information to a range of stakeholders in order to create and foster a broad understanding of its activities and performance and receives necessary feedback' (p. 43). ECA is the only one among those who have assessed ECB's accountability, such as the Commission and the International Monetary Fund (IMF), which mentions that an accountable agent should want to receive feedback.

The report defines the following criteria, which are embedded in what it calls 'a strong accountability framework':

- clear articulation of roles and responsibilities;
- a strong mandate for independent external audit for financial, compliance and performance aspects;
- assurance from management about the achievement of policy objectives;
- full democratic oversight; and
- feedback loops to allow for corrective action/improvements.

In relation to these criteria, the ECA report finds that:

13. As already mentioned, the Commission Staff Working Document that accompanies the Commission report is significantly more detailed. But it is more descriptive than critical.

- The roles and responsibilities of the SSM as a whole are clearly defined and publicly disclosed in the enabling legislation.
- The Court's audit mandate is defined in the Treaty on the Functioning of the EU.
- A formal performance framework has not yet been developed to provide assurance about the achievement of the SSM objectives.
- Democratic oversight of supervision by the EP is exercised with substantial confidentiality restrictions.
- Feedback arrangements exist but have not yet included general surveys of financial institutions.

Therefore, it appears that the ECA's assessment is not strictly positive, and that in its views, several aspects still need improving. In particular, it notes that while some clear rules have been established and roles and responsibilities have been publicly defined, their positive effects are mitigated by the absence of publication of performance indicators and metrics that would show supervisory effectiveness (p. 81). The ECA indeed finds that the SSM Supervisory Dashboard Pilot is not a sufficient tool in that regard, as it is only available to the Supervisory Board and to senior management; other actors may not rely on it to judge on the ECB/SSM's actions (p. 46).

The ECA report also provides a table with examples of performance indicators. Notably, no indicator refers explicitly to how well regulatory supervision is carried out or whether financial stability is strengthened, which are the direct and indirect duties of the SSM. The report additionally criticises the ECB for not revealing all relevant regulatory information to supervised banks (p. 49–50).

Although the ECA is the only reviewer of the SSM/ECB that has referred to feedback loops, it is not the only one that has stressed the need for explicit performance standards. This issue has also been addressed in the IMF report 'European Union: Publication of Financial Sector Assessment Programme Documentation, Technical Note on Issues in Transparency and Accountability', Country Report No. 13/65, March 2013.

The IMF report notes that 'a particular challenge is that the ECB's conduct of supervision will be subject to limited accountability to an independent or outside authority, beyond the ECB's general obligation to report to the European Parliament and the Eurogroup' (p. 8). It then makes three recommendations.

First, to increase transparency and policy consistency,

... the Supervisory Board could set out as ... the principles and kinds of indicators or information it would generally use in coming to policy recommendations in different areas and publish them. ... In addition to providing a useful guide to consistent policy formulation over time, they also serve as useful benchmarks for policy evaluation (p. 8).

Second,

... the ECB should publish regular reports on its supervisory work. At a minimum, this should include regular (perhaps semi-annual) reports on the evolution of risks and vulnerabilities in the financial system under its supervision, and of its actions to monitor and address those risks and vulnerabilities. The SSM could also consider publishing minutes of the meetings of the SSM Supervisory Board, subject to confidentiality restrictions (p. 9).

Third,

... additional measure which could be considered is to establish a panel of external experts to provide periodic reviews of the ECB's performance and practices with regard to the SSM function (p. 9).

Another Special Report by the ECA examining certain aspects of the ECB's performance was published on 16 January 2018. Special Report No. 2/2018 assesses '[t]he operational efficiency of the ECB's crisis management for banks'.¹⁴ The Report focusses exclusively on the responses of the ECB to threats to financial stability, its handling of the resolution of banks, and its cooperation with the Single Resolution Board. It finds that the organizational set-up is adequate but that the arrangements for coordination and cooperation with other authorities is still incomplete. In view of the broader adjustment and improvement of cooperation procedures, this observation is probably not relevant anymore.

With respect to planning the recovery of troubled institutions, the ECA finds that the ECB monitors the recovery planning process and provides general guidance to banks. The ECB has operationalised the legal requirements for assessing recovery plans in a tool that is efficient and largely comprehensive, but, according to the ECA, the results of recovery planning are not systematically used for crisis identification or management. Apparently, supervised institutions are positive about the recovery planning process.

In relation to crisis identification, the ECA observes that the ECB has allocated tasks and established an overall workflow for crisis identification and response, but its guidance on implementing the relevant provisions is underdeveloped. The ECB has processes for crisis identification, but there is no common set of indicators with clear thresholds to determine deterioration and the key identifier has several drawbacks.

With respect to the ECB's crisis response, the ECA finds that liquidity monitoring tools have been established, but to be operationally efficient the process would need to quantify incurred or likely losses. The ECA concludes that more guidance is required on legal powers and practical measures. In other words, the ECA believes that at least some of the supervisory instruments utilised by the ECB need improvement. Whether indeed the SSM/ECB is accountable should be revealed by future changes in its instruments and procedures.

To summarise so far, the main findings of the assessments carried out by the Commission and the ECA and the main points of the recommendations of the IMF are that the SSM/ECB has pursued its mandate methodically and that, although not everything has been flawless, the SSM/ECB continually adjusts and improves its regulatory decisions, supervisory instruments and the information it makes publicly available as it gains practical experience. In view of the elements of accountability in complex policy environments defined in Section 2, the SSM/ECB is shown to be accountable because it is responsive and takes corrective action. However, performance criteria are still lacking and no systematic external expert assessment has been attempted.

6. An assessment

Section 2 explored the meaning of accountability and proposed that if accountability is conceived as an instrument for ensuring policy effectiveness in complex policy environments, then accountability arrangements should have a built-in evolutionary process. The expected performance of the

14. It can be accessed at: European Court of Auditors, 'Special Report: The operational efficiency of the ECB's crisis management for banks', *European Court of Auditors* (2018), https://www.eca.europa.eu/Lists/ECADocuments/SR18_02/SR_SSM2_EN.pdf.

agent needs to evolve as both the principal and the agent learn from the activities and past performance of the agent. This section aims to demonstrate that to a large extent the SSM/ECB has acted as an accountable institution would be expected to do, despite the fact that the obligations defined in the SSMR are rather general and the Agreement with the EP and the MoU with the Council do not define more precise regulatory tasks. In fact, not only does the SSM provide much more information than what it is formally required to do, the EP has also expanded significantly its use of expert review to assess the performance of the SSM. This means that the EP is not ‘soft’ on the SSM. However, this section also argues that despite the overall positive findings, an essential element is still missing.

As shown in Section 4, the chapter dedicated to accountability of the ECB’s Annual Report on its supervisory activities (Chapter 5) merely lists the presentations by Supervisory Board members and meetings between the Supervisory Board Chair and the EP and Council. As previously stated, Recital 55 of the SSMR foresees that

... the ECB should (...) be accountable for the exercise of those tasks towards the European Parliament and the Council as democratically legitimised institutions representing the citizens of the Union and the Member States. That should include regular reporting, and responding to questions by the European Parliament in accordance with its Rules of Procedure, and by the euro Group in accordance with its procedures [*emphasis added*].

Reporting either through the Annual Report or through bilateral meetings need not be the only means by which the SSM/ECB is held accountable. The second sentence of the part of recital 55 cited above uses the word ‘include’. This confirms that the SSMR does not list exhaustively all possible accountability channels.

Article 20 of the SSMR, which lays down specific accountability arrangements and defines the SSM’s obligations on reporting and responding to questions, also mentions in paragraph 9 that

... the ECB and the European Parliament shall conclude appropriate arrangements on the practical modalities of the exercise of democratic accountability and oversight over the exercise of the tasks conferred on the ECB by this Regulation. Those arrangements shall cover, inter alia, access to information, cooperation in investigations and information on the selection procedure of the Chair of the Supervisory Board [*emphasis added*].

Presumably the EP can decide what those appropriate arrangements may be, and that the reporting and responding to questions are not the only such arrangements.

Therefore, the rest of this section answers the following two questions:

1. Have the reporting and responding-to-questions mechanisms functioned well?
2. Should there be other arrangements?

The answer to the first question must be ‘rather well’. The Annual Reports are long and detailed and the latest one states that apparently the EP was ‘satisfied’. There is no information on whether the exchanges with the Council were equally satisfactory, but there is no reason to believe otherwise.

We also saw in previous sections that the Commission and the ECA found that the SSM/ECB provided much information and guidance to banks and adjusted its own regulatory procedures and

standards in response to the lessons it drew from feedback and the enforcement of its regulatory instruments.

Transparency International EU, in its recent report on the ECB, proposed that ‘the ECB should create a public version of the tool it uses to provide an overview of the supervision of Eurozone banks, the SSM Supervisory Dashboard Pilot. This will allow the public to assess whether ECB banking supervision is achieving its objectives.’¹⁵ However, given the complexity of the policy tasks of the SSM and the confidentiality of information in specific decisions, the public will not be able to gain a better understanding than it can from currently available documents, and experts will not be given the necessary information to go deeper into specific decisions.

The answer to the second question, that is, whether there should be additional arrangements, is more difficult. Although the SSMR confers regulatory tasks to the ECB, it does not define them in any operational detail. Consequently, it is for the ECB to define its specific regulatory instruments. Moreover, the purpose of centralising banking regulation in the hands of the ECB is to protect financial stability in the Eurozone as a whole. Given the intrinsic complexity of the tasks assigned to the ECB, it is not surprising that the wording of the SSMR is rather general. What is surprising is that the EP–ECB Agreement and the Council–ECB MoU do not require the SSM/ECB to explain how and why it converts its broad tasks into operational instruments and how they relate to its ultimate goal of preservation of financial stability. The Annual Reports state what the SSM does. They do not explain why it has chosen the particular regulatory procedures and instruments.

Indeed, it is not obvious how the broad supervisory objectives of preserving financial stability and ensuring the soundness of financial institutions translate into the chosen instruments and procedures and justify the SSM’s actual decisions. It is not easy for stakeholders to check whether those broad objectives have been achieved in practice and therefore whether the ECB has done what is supposed to do. Therefore, it is incumbent on the SSM/ECB not just to explain what it does but to justify how its actions protect the financial system and preserve stability.

Although Chapter 1 of the Annual Reports provides extensive explanation of the risks identified by the ECB and the measures it took to address them, it still does not explain why those were the most appropriate actions in protecting financial stability. The ECB’s website on supervision website is also a goldmine of information.¹⁶ Apart from listing the legal documents, it outlines the SSM’s supervisory objectives and processes (the SREP), the supervisory teams, the supervisory cycle and, perhaps most importantly, the letters with the specific instructions sent to banks.

A fair conclusion is that the SSM/ECB itself publishes more than what it formally has to and explains more than it is legally obliged to do. This of course, coincides with the SSM’s own interests as a regulator. By guiding banks on how to comply with the new regulations, its own tasks become more manageable. An accountable agent that is entrusted with regulatory tasks must be transparent about how it intends to enforce the rules for which it is responsible.¹⁷

15. Transparency International, ‘Two Sides of the Same Coin? Independence and Accountability of the European Central Bank’, *Transparency International* (2017), <http://transparency.eu/resource/two-sides-of-the-same-coin-independence-and-accountability-of-the-european-central-bank/>, p. 7.

16. It can be accessed at: European Central Bank, ‘Single Supervisory Mechanism’, *European Central Bank* (2019), <https://www.bankingsupervision.europa.eu/about/thessm/html/index.en.html>.

17. See the SSM’s explanation of its dialogue with banks: European Central Bank, ‘Dialogue: a cornerstone of supervision’, *European Central Bank* (2019), <https://www.bankingsupervision.europa.eu/press/publications/newsletter/2017/html/ssm.nl171115.en.html>.

The role of the EP as a principal has also evolved and expanded. This conforms to the expectations of the theoretical discussion in Section 2. The EP uses external experts not only to review the performance of the SSM but also to make recommendations on the future development of the regulatory framework. For example, in the public hearing held on 26 March 2018, two external experts assessed the 2017 SREP results. In the public hearing held on 9 November 2017, four external experts presented their views on how the SSM should tackle nonperforming loans. Expert papers on various topics have been prepared for the EP since 2015. The EP also publishes the questions submitted by members of the European Parliament to the SSM and the answers they received.¹⁸

On the basis of the above findings, the following conclusions may be drawn:

- Neither the overall policy objective of financial stability, nor the specific regulatory instruments of the SSM have been defined in detail in the SSMR.
- The SSM/ECB has, nonetheless, defined precise regulatory instruments and procedures.
- The SSM/ECB provides extensive information about its regulatory activities and comprehensive guidance to banks and engages in dialogue with the banks it supervises.
- Although the MoU and the Interinstitutional Agreement are rather general, in practice the Annual Reports and the website of the SSM/ECB explain in depth the activities of the SSM. However, the Annual Reports do not define a benchmark of performance, nor do they carry out a self-evaluation of how well the SSM performed over the period covered by each Report, nor do they explain why the SSM chose the particular regulatory procedures and instruments. The 2017 Annual Report does mention the assessments of the Commission and the ECA.
- The EP has widened the process of reviewing the performance of the SSM by commissioning external experts to submit written comments and recommendations.
- The EP's external experts have not attempted a detailed review or audit of actual regulatory decisions of the SSM. They have not attempted to replicate the tests or a sample of tests carried out by the SSM, for the simple reason that they do not have access to the relevant information.

The above findings lead to the following two recommendations:

1. The SSM/ECB should explain why and how its regulatory procedure and instruments are the most effective for ensuring financial stability, as the SSMR requires.
2. The EP should consider how independent experts acting on its behalf and respecting confidential information can be enabled to carry out audits of sample of regulatory decisions.

18. The various documents are published on the website of the EP on banking supervision: European Parliament, 'European Parliament Committees – Banking Union', European Parliament (2019), <http://www.europarl.europa.eu/committees/en/econ/banking-union.html?tab=Banking%20Supervision>.

7. Conclusions

The establishment of the SSM represents a significant shift of economic competences from Member States to the ECB. Member States have defined accountability arrangements in order to make the actions of the ECB democratically legitimate. An independent institution that is accountable assures citizens that it acts on their behalf to further the common interest.

Accountability is not only an instrument of democratic legitimacy. It is also a mechanism for ensuring that the ECB carries out its tasks effectively. In other words, making an institution accountable is equivalent to incentivising it to self-assess and seek to improve its performance. Continuous improvement and adjustment is evidence of accountability.

On the whole, this article has found ample evidence that despite the fact that the various accountability arrangements are not very precise, in practice the SSM/ECB itself has set more specific policy targets, has provided extensive explanation of how it enforces its regulatory powers, and has adjusted its instruments according to the experience it has gained. This continuous adjustment and sharpening of regulatory instruments is proof that the SSM/ECB feels accountable and acts responsibly.

A sort of expert review has been carried out by the EP. What remains to be done further is, first, to have a better explanation of how the regulatory actions of the SSM/ECB protect financial stability; and, second, to establish procedures for auditing samples of actual regulatory decisions of the SSM/ECB.

Acknowledgment

I am grateful for comments on earlier drafts to Michele Chang, Diane Fromage, Tony O'Connor, a CERiM referee and to participants of the conference on the Accountability of the ECB organised by the University of Maastricht in Brussels on 29-30 May 2018. A more extensive version of this article has been published as a CERiM paper, University of Maastricht.