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THE EU GENERAL COURT QUASHES AN ECB DECISION: TOWARDS A NEW CHAPTER ON PRUDENTIAL SUPERVISION AND JUDICIAL REVIEW?

On 13 July 2018 the General Court of the European Union (EuGC) quashed certain European Central Bank (ECB) decisions that denied derogation, as established by Art. 429 par. 14 Reg. No 575/2013 (Capital Requirements Regulation – CRR), to six French credit institutions that were subject to prudential supervision by the bank. Regulation concerns prudential requirements for credit institutions and investment firms, and introduces a new tool, the leverage *ratio*, with the aim of better addressing regulatory shortcomings that surface during financial crisises. Leverage *ratio* is a regulatory measure defined as the amount of total banks or investment-firms equity capital[1] divided by its total exposure. Leverage *ratio* constitutes a transparent, easy to calculate, and credible measure not based on risk, designed to guarantee financial strength of institutions in terms of indebtedness.

The derogation allows the ECB, as a competent authority in the Single Supervisory Mechanism (SSM), to authorize the credit institutions to exclude from calculation of the coefficient of financial leverage some expositions that meet certain requirements.

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1 Known as "Tier 1 capital", namely the money that a bank has stored to keep it functioning through all the risky transactions it performs.

In order to be granted, derogation must refer to expositions that must: a) concern a public sector entity; b) be dealt with in accordance with prudential requirements relating to exposure on public sector entities, and c) be the result of deposits which the institution is legally bond to transfer to the public sector entity referred to in point a) to finance investments in the public interest.

The ECB previously recognized that the conditions to grant the derogation had been met; however, in support of its response, the authority highlights how it still holds a discretionary power to grant or not the exclusion from the calculation of the financial leverage, as requested by the applicants. According to ECB, doubts about the imperfect nature of the mechanism of transferring the exposure constituted by sums of saving accounts from the French public body to the credit institution justify the relevant prudential concerns that led to the rejection of the application.

Such mechanism would have caused the applicants a high risk linked to an excessive leverage coefficient, with a subsequent liquidity shortage-situation. As stated by Art. 4, pt. 94, Reg. No 575/2013, risk of excessive leverage "means the risk resulting from an institution's vulnerability due to leverage or contingent leverage that may require unintended corrective measures to its business plan, including distressed selling of assets which might result in losses or in valuation adjustments to its remaining assets". The ECB considered the event at stake to be representative of one of those particular cases in which the said regulation allows the institution to use the discretionary power to arbitrate between two different goals: respecting the logic of financial leverage coefficient as a measure for the total of the credit institution and, on the other hand, the need to exclude from the estimation of the coefficient all expositions characterized by a particularly low risk profile.

The lawfulness of ECB's discretional power to grant derogation has been also challenged by the applicants.[2] The provision that establishes derogation has been introduced by a sub-delegated act adopted by EU Commission according to Art. 290 par. 1 TFEU. Applicants' arguments were mainly based on the alleged unlawfulness of such further delegation, however, the provision was not challenged on the basis of Art. 277 TFEU, but merely on interpretational grounds, so the General Court dismissed the request.[3] In any case, even if the issue was not addressed by the General Court, a thorough analysis of the preparatory works leading to the adoption of the delegated act, reveals several

2 See points 24-27 of the ruling.

3 See points 54-60.

problematic aspects; the derogation provided seems to go beyond powers granted to the EU Commission and constitute more than an adaptation of the leverage *ratio* established by the Regulation to an extent that contradicts the CRR's very *ratio legis* to introduce it.

The existence of such a discretionary power is confirmed by the reasoning from the EuGC; however, the Court alleges a breach of law and a manifest wrong assessment made by the ECB.

The bank would in fact have been mistaken in valuing the applicants' exposition towards the public French institution, as being included on the assets side of the balance sheet.

In order to justify the denial, the bank also refers in its statement to a case where the credit institutions would have to refund the paid amounts to the investors, and additionally the State guarantee may not be in this case effective due to a default by the French State. According to the Court, such assessment was given without been verified in terms of likelihood.

The Court also points out how there can be discretion as long as objectives pursued by the normative texts are not disregarded, and therefore the relative provisions are not deprived of their useful effect. The general principles behind the bank's decisions, deemed to be without a factual check of their plausibility, have the effect of rendering the derogation provided in the regulation practically inapplicable.

Furthermore, the ECB considered that excessive financial leverage in the event of a liquidity-shortage situation, occurring during the adjustment period in the respective relationships between credit institutions and the French public body, may lead to a sudden risk of forced sale of large financial resources for the applicants, with significant effects on the whole market. Such a statement is manifestly incorrect because of its abstract nature. According to the EuGC, the ECB statement was in fact made without having previously fulfilled the obligation to examine the particularity of the regulated savings of the case in hand, and to conduct with careful attention and impartiality an exhaustive examination of all the relevant facts of the case, an obligation which is even more urgent in the administrative proceedings characterized by a broad

discretion in the decision.[4]

The Court's ruling is likely to be an important step in the process of crafting judicial review on ECB measures, representing the first time that an ECB decision in the prudential supervision sector is annulled, even though it is a first-instance ruling. The decision may also exercise an influence on pending proceedings before the General Court concerning prudential supervision.

The intensity of the scrutiny of the judicial review on the bank's acts has undoubtedly a significant impact on the degree of independence and autonomy granted to the institutional functions of the ECB; a stronger or more respectful judicial review is able to restructure both the positions of the ECB and of the EuCG in the EU legal system. It is widely accepted that judicial review of ECB policy decisions not only involves a check on the compliance with the formal obligations imposed on the administrative proceeding as a minimum standard, but also forces the ECB to an adequate statement of reasons able to highlight the compliance of the proportionality principle, a correct analysis of the facts and the absence of an evident misuse of powers and of a manifestly wrong assessment.

When reviewing the legality of economic and highly technical EU institutions assessments, which are also characterized by broad discretion, Union Courts normally apply the "limited standard of review". The EU judicature in fact, not only establishes whether the evidence put forward is factually accurate, reliable and consistent, but also determines whether that evidence contains all the relevant data that must be taken into consideration in appraising a complex situation.[5] Review by the General Court is limited to establish whether the evidence relied on is factually accurate and to establish the absence of a manifest error of assessment; it nonetheless remains the case that the correctness, completeness, and reliability of the facts on which a decision is based may be the subject of judicial review.[6]

It is also necessary to point out that judicial review in the supervisory pru-

4 See ECJ, *Technische Universität München v. Hauptzollamt München-Mitte*, C-269/90, 21 November 1991, § 14-27; ECJ, *Commission v. Estonie*, C-505/09 P, 17 November 2011, § 95.

5 As clarified in EJC, *Telefonica and Telefonica de Espana c. Commission*, C-295/12, 10 luglio 2014, § 54.

6 See ET, *Ryanair c. Commission*, T-342/07, § 30.

dential field appears to be more intense than in the monetary field, due to the more detailed set of regulatory rules governing the function and objectives of the ECB in the prudential field.[7]

Most recent trends show how a more severe judicial review on the ECB measures was deemed necessary taking into account the increased power of the ECB following the approval of measures against the financial crisis, such as the regulation of the case in hand. A stricter scrutiny, which has to be different from the deferential approach of the ECB traditionally used in highly technical controversies, becomes in this case necessary, considering that the ECB provision directly affects the applicants. According to C. Goodhart and R. Lastra,[8] the need for competence and expertise in the exercise of CJEU's judicial review could be served as incentive to establish a specialised chamber internal to the CJEU to deal with those highly technical disputes and consequently increase Court's capability to provide more incisive rulings on ECB's activity.

Judicial review, extended to an activity of reform of the merit and of content of the decision, is still hardly compatible, in general terms, with the degree of independence granted to the function assigned to the ECB in the EU legal system.[9] Possible risks of a substitute judgement replacing choices made by the ECB, and carried out through a direct and different judicial assessment of the facts in hand, have, in fact, been pointed out. As Advocate General Cruz Villalòn stated in its Opinion[10] in the above-mentioned Gauweiler case related to the legality of the OMT program, Courts, when reviewing the ECB's activity, must avoid the risk of supplanting the Bank by venturing into those highly technical judgements, in which its necessary to have expertise and experience. Therefore the intensity of judicial review must be characterised by a "considerable degree of caution".

7 See M. Ventoruzzo, *European Rules and Judicial Review in National Courts: Challenges and Questions*, in *Quaderni di Ricerca Giuridica*, Bank of Italy, Rome, 2018, pp. 74-75

8 C. Goodhart, R. Lastra, *Populism and Central Bank Independence*, in *Open Economies Review*, 29, 2018, pp. 49-68.

9 In this regard, see the comments on EJC, *Peter Gauweiler and Others c. Deutscher Bundestag*, C-62/14, 16 June 2015, made by C. Zilioli, *The ECB's Powers and Institutional Role in the Financial Crisis,* in *Maastricht Journal of European and Comprative Law*, 2016, pp. 183-184, and M. Goldmann, *Adjudicating Economics? Central Bank Indipendece and the Appropriate Standard of Judicial Review*, in *German Law Journal*, 15, 2, 2014, pp. 271-280. According to the latter, judicial rewiew should exercise through "rationality checks", which may stand between "full judicial rewiew" and "full discretion" approach.

10 Par. 111.

In conclusion, the ruling suggests that in this case the General Court has only conducted an accurate analysis of the relevant legal framework and also of the administrative proceeding through which the ECB came to the decisions, highlighting its shortcomings and weaknesses. EuGC avoided to conduct a direct and independent assessment on the merits of case. Attention has been given to the respect of ratio *legis* and also to the procedural requirements. By taking this into account, eventual charges based on the alleged EuGC's substitution of ECB's decision may be easily dismissed in the appeal proceeding before CJEU.