The Principle of Proportionality and the European Central Bank*

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The principle of proportionality is a general principle of EU law which applies to the European Central Bank (ECB) in the fields both of monetary policy and banking supervision. In recent years, the issue of the proportionality of the ECB's action has been at the centre of extensive debate in European legal doctrine and jurisprudence. This article aims to contribute to this debate by providing a comprehensive analysis of the meaning and implications of the principle of proportionality in the field of banking supervision and monetary policy.

The article is divided into four parts. Parts I gives a general overview of the origin of the principle and its subsequent developments in light of the case-law of the European Court of Justice. It also reflects on the different meanings of proportionality as a flexible and multi-faceted principle. Part II investigates the principle of proportionality according to an ex ante perspective, i.e. as a principle capable of governing and orienting legislative and administrative action. Under this perspective, the article analyses the way proportionality impacts banking regulation, banking supervision and monetary policy.

Part III deals with the ex post perspective, i.e. the way proportionality is assessed and scrutinized by EU courts. Part IV concludes. Part III and IV will be published in the next issue.

Keywords: Proportionality, EU General Principles, ECB, Banking supervision, Monetary policy, Judicial review

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This article was completed in November 2019, well before the German Constitutional Court's ruling of 5 May 2020. However, we are firmly convinced that the opinions expressed here have not lost their relevance. Rather, they might represent an even more useful contribution to a critical understanding of the German judgment and, more generally, of the role of the principle of proportionality as a general and multi-faceted principle of EU law. We believe that the EZB Urteil is open to criticism for several reasons. Notably, it embraces a wrongful and German-oriented understanding of proportionality, which fails to take into account the way the principle has been shaped in EU law and interpreted over the years by the Court of Justice. Moreover, the German judgment seems to indirectly confirm the advantages of a dual reading, ex ante *and* ex post, *of the principle of proportionality, as demonstrated in this article.*

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1 PART I: NOTION AND SCOPE OF THE PRINCIPLE OF PROPORTIONALITY

1.1 The old roots of the principle

The notion of proportionality, in reference to the use and control of the public power, is as old as the philosophical and political thought of Western civilization. Sometimes it is synonymous with 'moderation', 'self-restraint', 'tolerance'.

Great Greek philosophers referred to proportionality as a guiding principle for the proper use of government by the rulers. Aristotle is renowned, inter alia, for his idea of 'the golden mean' between extremes, based on moderation, proportionality and harmony.[1]

The Roman thinkers also made frequent use of the notion. One of the most famous political thinkers, Cicero, wrote essays on the four cardinal virtues, including 'moderation', intended as a variant of proportionality. Poets and literates also contributed. Horace wrote eternal Odes (as 1.7) on the moderated virility and devotion to public duty.

In the Renaissance, leading political thinkers based their model of government on proportionality. Machiavelli's 'Prince' was thought of as a 'half lion and half fox' leader, using his power according to the different needs in a flexible and proportionate way: using '*virtù*' and tolerance, but also strength – a feature of '*virtù*' – when absolutely necessary and without alternative.[2]

Later on, in the Age of Enlightenment, the centrality of this principle was confirmed, as demonstrated by John Locke in his *Two Treaties on Government*, and enriched with its feature as a test for controlling power.[3] This development has influenced the English and Western systems of government ever since.[4]

So far we have recalled – in a very synthetic way, as is appropriate in this study focused on some new contemporary features of the principle – the constant use since the time of the Greeks of proportionality as a political principle proposed by

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1 A. Ryan, *On Politics* 83 et seq. (London 2012). In Aristotle's thought proportionality is closely related to the idea of justice (*see* V. Ethica Nicomachea): M. D'Alberti, *Proporzione, proporzionalità e giustizia*, in *Liber amicorum Augusto Cerri* 276 (Napoli 2016).

2 N. Viroli, *Machiavelli* (Oxford 1998); M. Ciliberto, *Niccolò Machiavelli, Ragione e Pazzia*, (Bari 2019). The reference to proportionality and moderation was frequent also in literature. As an excellent example, praise for moderation was also made by Shakespeare in *Measure for Measure*: 'O, it is excellent to have a giant's strength, but it is tyrannous to use it like a giant' (Act II, II, 107–109).

3 J. Dunn, *The Political Thought of John Locke* (Cambridge 1969); A. C. Grayling, *The Age of Genius. The Seventeenth Century and the Birth of the Modern Mind*, 279 et seq. (London 2016).

4 R. Ashcraft, *Revolutionary Politics and Locke's Two Treaties on Government* (Princeton 1986).

scholars and thinkers to the rulers for good government (in modern terms, an *ex ante* principle) and since the seventeenth century as a tool for controlling power (the *ex post* approach).

It is a principle which is shaped step-by-step to operate with just measure, respecting the limits of power and limiting individual rights only when absolutely necessary, subject to judicial control.

The famous *dicta* of the German legal scholar Fritz Fleiner ('don't shoot sparrows with cannons', 1912)[5] and by Lord Diplock in the English case *R. v. Goldstein* ('the principle of proportionality prohibits the use of a steam hammer to crack a nut if a nutcracker would do it')[6] must therefore be considered modern expressions of a principle with remote origins.

1.2 Proportionality as a juridical principle

Very soon proportionality became a juridical principle, as well: a principle according to which the public institutions cannot impose sanctions, burdens nor limitations of any kind on the private sphere beyond what is appropriate for pursuing the public interest, is strictly necessary and not disproportionate.

Even in the Middle Ages, Article 20 of the English Magna Charta (1215) provided a textual reference to proportionality in relation to criminal offences.[7] Also, in most of the other parts of the Charta the principle's relevance was implicit.

On that basis, proportionality in England – as a variant of 'reasonableness'[8] – has been progressively considered to be a feature of the general principle called Rule of Law. It is curious that, just at the end of the twentieth century, English scholars and judges (despite the seminal judgments *Brind*, 1991; *Wheeler*, 1985; and *NALGO*, 1992)[9] discussed the 'continental' origins of the principle, forgetting its traditional role in their own legal order.[10]

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5 F. Fleiner, *Institutionen des Deutschen Verwaltungsrechts*, 354 (Tübingen 1912).

6 *R v. Goldstein* [1983] 1 W.L.R. 151 at 155.

7 'For a trivial offence a man will be fined only in proportion to the degree of his offence, and for a serious offence, correspondingly, but not so heavily as to deprive him of his livelihood' quoted by J. Jowell, *Proportionality and Unreasonableness: Neither Merge nor Takeover,* in *The Scope and the Intensity of Substantive Review* 41 (H. Wilberg & M. Elliot eds, Oxford-Portland 2015). *See also* J. Jowell & A. Laster, *Beyond Wednesbury: Substantive Principles of Administrative Law,* Pub. L. 368 (1987).

8 P. Chirulli, *L'evoluzione del controllo giurisdizionale sulla discrezionalità nel Regno Unito: dalla ragionevolezza alla proporzionalità*, Dir. proc. amm. 72 (2019).

9 *R v. Secretary of State for the Home Department, ex parte Brind* [1991] 1 A.C. 696; *Wheeler v. Leicester City Council* [1985] AC 1054 and *NALGO v. Secretary of State for the Environment The Times*, (2 Dec. 1992).

10 The discussion is considered in J. Jowell & A. Lester, *Proportionality. Neither Novel nor Dangerous*, in *New Directions in Judicial Review* 51 (D. Oliver & J. Jowell eds, London 1988); P. Craig, *Unreasonableness and Proportionality in UK Law*, in *The Principle of Proportionality in the Laws of Europe* (E. Ellis ed., Oxford 1999). Still unresolved is the discussion whether proportionality may become a generalized head of review. *See* in particular: M. Taggart, *Proportionality, Deference, Wednesbury,* NZ L. Rev. 423 (2008); P.

In some important national jurisdictions, such as in Germany, the legal doctrine on proportionality as a distinct principle was supported by the jurisprudence,[11] consolidated long ago in the 'three limbs' case law: (1) suitability/appropriateness[12]; (2) necessity[13]; and (3) proportionality in the narrow sense.[14]

Proportionality has been used in Germany as a ground for an intense judicial review of administrative action for a long time: first as it related to the protection of fundamental rights[15] and to contrast the administrative acts having a negative influence on the individual sphere (*Eingriffsverwaltung*), then covering the scope of all administrative actions.[16]

In most of the other European jurisdictions, proportionality, even if not considered a principle in itself, has resulted as a feature of more general principles, such as '*excès de pouvoir*' in France or '*eccesso di potere*' in Italy.

In France, following a long consideration of proportionality as a symptom of *excès de pouvoir* in the form of manifest error of appreciation and patent injustice, the first formal recognition of proportionality in the jurisprudence was the *Ville Nouvelle Est* case, in 1971.[17]

For its part, Italy has an old scientific tradition of proportionality. Gian Domenico Romagnosi, a founding scholar of administrative law (early ninetieth Century), based his model of good administration on the idea that public interests can prevail over private rights only when it is truly necessary, and with the least possible sacrifice for the affected parties.[18]

The case law of the administrative courts[19] has recognized proportionality as a variant of the reasonableness test since the late ninetieth century, not much different from France and England.

Craig, *Proportionality, Rationality and Review*, NZ. L. Rev. 265 (2010); Lord Carnwath, *From Rationality to Proportionality in the Modern Law,* H. K. L. Rev. 44 (2014).

11 Particularly important the case *Apotheken*, decided by the German Constitutional Court in 1958 (BVG), (11 June 1958). *See also* the judgment by the same Court of (16 Mar. 1971).

12 A mean is appropriate to achieve a goal when, with its help, the result can significantly be promoted.

13 There is no other means that would be equally effective, but less intrusive.

14 The measures adopted by the public authorities must not be such as to place an excessive and intolerable burden on the person concerned.

15 T. Stein, *Der Grundsatz del Verhältnismassigkeit*, in *X° Internationalen Kongress für Rechtsvergleichung*, 281 (Tübingen 1978).

16 As noted by D. U. Galetta, *General Principles of EU law as Evidence of the Development of a Common European Legal Thinking: the Example of the Proportionality Thinking,* in *Common European Thinking* (H.-J. Blanke et al. eds, Heidelberg 2016).

17 Anticipated for some aspects in the judgment *Benjamin* of the Conseil d'Etat, 19 May 1934. The principle of proportionality has been riaffermed by the Conseil d'Etat in the important arrêt *Association pour la promotion de l'image et autres*, 26 Nov. 2011. The *arrêt* makes explicit use of the 'triple test' of the measures: '*adaptées, nécessaires, proportionées à la defense de l'ordre public*'.

18 G. D. Romagnosi, *Principi fondamentali di diritto amministrativo onde tesserne le istituzioni*, 40 et seq. (Prato 1835).

19 A. Sandulli, *La proporzionalità dell'azione amministrativa* (Padova 1998); F. Trimarchi Banfi, *Canonedi proporzionalità e test di proporzionalità nel diritto amministrativo*, Dir. proc. amm. 361 (2016). Differently,

We may say that before the establishment of the principle of proportionality in EU law, the principle was recognized as such in one leading legal order (Germany), as well as in other orders as a feature of broader principles.[20] In brief, proportionality was a true common principle of most of the legal orders of the EU Member States.

The French and Italian jurisdictions are good examples of the interplay with the EU in developing the general principles of EU law. Proportionality as such has been recognized in the two countries as a concurrent result of the case law on *excès de pouvoir*[21] and *eccesso di potere*, on the one side, and the ECJ case law on the other.

Both jurisdictions are now formally open to the full operational influence of the EU general principles, including proportionality, as demonstrated in Italy by the recent Code on Administrative Proceedings (2010, Article 1) and by the general law on procedure (1990, Article 1). The courts are largely using the proportionality test also with regard to domestic matters,[22] making this a typical case of spill-over effect.

As in the case of similar principles (certainty of law, legality, equality, etc.), it was obvious for the ECJ to ascertain that proportionality was a typical general principle of European law; as well as one of the small group of general principles which can be called 'super-principles' due to their highest relevance, but without giving space to a formal hierarchy.[23]

Looking to past discussions,[24] the criticism of the ECJ for having developed proportionality as a general principle when it was a principle recognized only in a limited number of countries appears groundless. Apart from the ECJ's attitude in recognizing as general those principles of national dimension when fit to contribute to the process of European integration and to ensure the effectiveness of EU law[25] (the best-known case is the principle of legitimate expectations, a mostly

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so far, the Italian Constitutional Court has been quite cautious in checking the exercise of power on this basis.

20 G. Gerapetritis, *The Application of Proportionality in Administrative Law, Judicial Review in France, Greece, England and in the EC*, (Athens 1997).

21 G. Braibant, *Le principe de proportionnalité,* in *Mélanges offerts à Marcel Waline*, I, 297 (Paris 1974).

22 Trimarchi *supra* n. 19.

23 *See* below at para. 5. M. P. Chiti, *Diritto amministrativo europeo*, 177 (Milano 2011). Now also C. Zilioli considers proportionality as a super-principle: *Proportionality as the Organising Principle of European Banking Regulation*, in *Zentralbanken, Währungsunion und stabiles Finanzsystem* (T. Baums et al. eds, Berlin 2019).

24 Introduced by the basic works of A. Sandulli, *La proporzionalità dell'azione amministrativa, cit.*; D. U. Galetta, *Principio di proporzionalità e sindacato giurisdizionale nel diritto amministrativo*, (Milano 1998). The main contributions on the origin of the general principles are: J. Schwarze, *Zwischen Tradition and Zukunft. Die rolle allgemeiner Rechtsgrundsätze im Recht der Europäischaen Union,* in *Europa Recht. Strukturen. Dimensionen und Wandlungen des Rechts der Europäischen Union. Augewaelte Beiträge,* 118 et seq. (J. Schwarze ed., Baden Baden. 2012); G. Tesauro, *Alcune riflessioni sul ruolo della Corte di giustizia nell'evoluzione dell'Unione europea,* in *Il diritto dell'Unione europea,* 483, 487 (2013).

25 Chiti, *supra* n. 23, at 179; Tesauro, *supra* n. 24, at 483 et seq.

or uniquely German principle[26]), we can confirm that proportionality really was common to most Member States, even if recognized in different ways.

1.3 The scope of proportionality

Why has proportionality, which has constantly been present in Western philosophical, political and institutional civilization as a basic principle, assumed only recently a more precise legal relevance?

Proportionality is used both as a principle for guiding the rulers in the government and administration of their systems, and also as a principle for controlling the proper use of power. In that way it is a tool of good government and protection of private rights, foremost among which are fundamental rights.

Furthermore, its 'popularity' comes from its flexibility, its capacity to be adapted to different situations and kinds of exercise of power. In times when the discretionary power – in all its variations, from 'full discretion' to 'technical' discretion – is inevitably the most commonly used model of administration, proportionality fits in perfectly for a proper use of the public power and for its control.

One can say that proportionality is one of the criteria for an appropriate use of discretionary powers by public administrations because it allows for the evaluation and balancing of the various interests, private and public, at stake. At the same time, proportionality is also a specific test for judicial control over the correct use of the discretionary powers.

In these two concurrent meanings, proportionality is strictly related to the principle of Rule of Law, which provides that all exercises of public authority must be based on law and remain within its confines.[27] As a consequence, the ECB is also an institution acting in adherence to the Rule of Law, subject to this head of review.

Considering that the Rule of Law is one of the basic principles of the EU, in the EU legal system, the use of the proportionality test by the EU courts gives substance to Article 19 of the TEU providing that the Court of Justice (ECJ) of the European Union 'shall ensure that in the interpretation and application of the Treaties the law is observed'.

As said, even the discretionary power is subject to the test of proportionality. The General Court has stressed, in the *Crédit mutual Arkéa*[28] judgment, that the

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[26] H. C. H. Hofmann, G. C. Röwe & A. H. Türk, *Administrative Law and Policy of the European Union* 75, 178 et seq. (Oxford 2011).

[27] O'Leary, *Europe and the Rule of Law, ECB Legal Conference 2018*, Frankfurt a M., 187, 188 (2018).

[28] Case T-712/15 *Credit mutuel Arkéa v. European Central Bank* ECLI:EU:T:2017:900.

interpretation of the relevant legislation by an administrative authority (including the ECB) cannot bind the EU courts, which have exclusive jurisdiction to interpret EU law, even in the case of discretionary powers.[29]

Of course, our topic (proportionality in EU banking supervision and monetary policy) – one of the last matters where proportionally has been recalled – is raising a host of new problems. The first issue arose because, in the past few years, the European Central Bank has gained a key role in the European economic and financial governance, notably by adopting unconventional monetary policy measures, taking part to the so-called Troika within the financial assistance programmes, and being entrusted with important supervisory tasks with regard to the banking sector within the frame of the European Banking Union. Another issue arose because some functions, especially monetary policy, show manifest political features. Lastly, an issue arose because the ECB is an expert authority whose 'constitutional independence' (Article 282 TFEU) is considered as an expression of its technical expertise, confirmed by the EU legislation (Regulation no. 1024/2013) which refers to a 'margin of discretion' for the ECB.

This article discusses these problems and offers a package of indications for the most appropriate use of the principle of proportionality, both as a principle guiding the use of the Union competences and as a judicial test for reviewing the proper exercise of public power. Before examining these issues in closer detail, it would be worthwhile to briefly recall the origins and evolution of the proportionality principle in EU law.

1.4 Proportionality in EU law

Under EU law, proportionality has become both a principle provided by the primary law and a general principle recognized by the ECJ. As such, it prevails over national laws, but it also prevails over secondary EU law. It can be applied by the Member States as a criterion of interpretation when EU law is implemented in their legal orders.[30]

A further feature of proportionality in EU law is that, as a consequence of the principle of conferral (Article 5.1 TEU), it regards the use of Union powers and

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[29] Of particular interest the points nos. 75 and 178–180.

[30] For a convincing assessment on the position of general principles in the system of EU sources of law, *see* J. Ziller, *Hierarchy of Sources and General Principles in EU Law*, in *Verfassung und Verwaltung in Europa, Festscrift für J. Schwarze* 334 (U. Becker et al. eds, Baden Baden 2014). On the part of the Member States, U. Villani (*Istituzioni di diritto dell'Unione Europea*, Bari, 2016, 86 et seq.), shared by Zilioli, *supra* n. 23, considers that proportionality imposes obligations to the Member States, whose infringement may be reviewed by the Court of Justice. *See also* W. van Gerven, *The Effect of Proportionality on the Actions of Member States of the EC: National Viewpoints from Continental Europe,* in *The Principle of Proportionality* (E. Ellis ed., *supra*, n. 10).

the allocation of functions (possibly also in apparent contrast with the principle of subsidiarity), without enlarging the competences in any way (Article 5.1 TEU, second line). The point has been reaffirmed in the case C-450/17 by A.G. Hogan in his conclusion at paragraph 57.[31]

The development of the principle in European Economic Community (EEC), European Community (EC) and EU law is well-known after a series of important studies[32] which we can synthetize by recalling the main points of interest and clarifying what we have assumed as basic parameters.

Even before the EEC Treaty of 1957, the principle of proportionality was considered intrinsic to the European Coal and Steel Community (ECSC) Treaty, signed in 1951. The presence of this principle and other general principles of law was affirmed by the ECJ as a consequence of its duty to assure the respect of the law in the interpretation and application of the Treaty (Article 31, European Economic Community Treaty (EEC) Treaty). The Court referred to such principles considering that even if the Treaty did not provide any rule, it was due 'to solve the problem by reference to the rules acknowledged by the legislation, the learned writing and the case law of the Member States'.[33] Hence, the specific reference to proportionality in the seminal cases: *Federation de Charbonniere de Belgique* and[34] *Mannesmann*.[35]

In line with the first ECJ case law on the ECSC, the jurisprudence also confirmed the principle in the EEC legal framework. The leading case is *Internationale Handelsgesellschaft*,[36] not by chance raised by a German Court and related to the protection of fundamental rights.

The first reference to proportionality in the primary law of the Union was made by the Treaty on the EU (the Maastricht Treaty) of 1992, Article 3 (b), then Article 5 of the TEU. Confirmed in Protocol no. 2 'on the application of the

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[31] A. G. Hogan, Opinion in C-450/17, *Landeskreditbank Baden-Württemberg Förderbank v.* European Central Bank ECLI:EU:C:2018:982: the division of competences between the Union and the Member States is governed by the principle of conferral (Art. 5.1 and 5.2 TEU) and that the principle of proportionality cannot alter it.

[32] Beyond the studies of A. Sandulli & D. U. Galetta, (fn. 24), *see* G. de Burca, *The Principle of Proportionality and Its Application in EC Law*, YEL 105 (1993); T. von Danwitz, *Der Grunsatz der Verhältnismässigkeit in Gemeinschaften Recht*, in *Europäisches Wirtschaft & SteurrerRecht,* 393 (2003); J. Schwarze, *European Administrative Law*, (London 2006), Ch. 5; X. Groussot, *Creation, Development and Impact of the General Principles of Community Law: Towards a Jus Commune Europeum?* (Europa Law Publishing 2006); *The Principle of Proportionality in the Laws of Europe* (E. Ellis ed., *supra* n. 8); W. Kahl, *Die Europäisieregung des subjektiven öffentlisches Rechts,* Juristische Arbeitsblätter 41 (2011); N. Emiliou, *The Principle of Proportionality in European Law,* (London 1996); A. Barak, *Proportionality: Constitutional Rights and their Limitations* (Cambridge 2012); S. Cognetti, *Principio di proporzionalità. Profili di teoria generale e di analisi sistemica*, (Torino 2011).

[33] Case 7/56 and 3–7/57 *Algera* ECLI:EU:C:1957:7.

[34] Case 8/55 *Federation de Charbonniere de Belgique* ECLI:EU:C:1956:7.

[35] Case 19/61 Mannesmann ECLI:EU:C:1962:31.

[36] Case 11/70 *Internationale Handelsgesellschaft* ECLI:EU:C:1970:114.

principles of subsidiarity and proportionality', annexed to the Amsterdam Treaty, with some relevant additions.

After a continuous refinement by the ECJ, as in the well-known *Hoechst* case,[37] the principle of proportionality was enshrined in the Treaty of Lisbon. In the TEU at Article 5.1, second part ('The use of the Union competences is governed by the principles of subsidiarity and proportionality') and Article 5.4:

> under the principle of proportionality, the content and form of Union action shall exceed what is necessary to achieve the objectives of the Treaties. The institutions of the Union shall apply the principle of proportionality as laid down in the Protocol on the application of the principles of subsidiarity and proportionality

and in Protocol No. 2 on 'Subsidiarity and Proportionality', which is particularly important for the organization and regulation functions. See Article 2: 'Before proposing legislative acts, the Commission shall consult widely … '; and Article 5: 'Draft legislative acts shall be justified with regard to the principles of subsidiarity and proportionality. Any draft legislative act should contain a detailed statement making it possible to appraise compliance with the principles of subsidiarity and proportionality'.

Moreover, the principle has been referred to in Article 52.1 of the Charter of Fundamental Rights, according to which:

> Any limitation on the exercise of the rights and freedoms recognized by this Charter must be provided for by the law and respect the essence of those rights and freedoms. Subject to the principle of proportionality, limitations may be made only if they are necessary and genuinely meet objectives of general interest recognized by the Union or the need to protect the rights and freedoms of others.

In EU law, proportionality is expressly developed according to the contours laid out within the national legal orders: as a principle working as head of review of discretionary decisions and policies (Article 5 TEU) and as a principle aimed at the protection of rights provided by EU law, beginning with fundamental rights, of course (Article 52.1 Charter).

As noted above, proportionality is a multi-faceted principle appreciated in all the national jurisdictions of the EU for its flexibility in the diverse situations where it can be relevant. It is even more important in the EU because this supranational jurisdiction is quite original ('an order of new kind' created by the EEC Treaty, as stated by the Van Gend en Loos judgment),[38] with several novelties regarding the peculiar relationships with the Member States, the organization model, public functions and guarantees.

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[37] Joined cases 46/87 and 227/88, *Hoechst AG v. Commission* ECLI:EU:C:1989:337.
[38] Case 26/62 *Van Gend en Loos v. Administratie der Belastingen* ECLI:EU:C:1963:1.

1.5 Proportionality for regulating, supervising and reviewing

As stated above, proportionality is a principle used for regulatory purposes, guiding the implementation by the public administrations, and as a ground for judicial review. Accordingly, this research will investigate the principle of proportionality under two main perspectives: the *ex ante* and the *ex post*.

It is well-known that in legal writing the principle of proportionality is usually examined as a ground for reviewing the action of public bodies.[39] In that respect, proportionality is more often understood as a powerful instrument in the hands of the judiciary for counterbalancing and controlling the growth of administrative powers and discretion.[40] We will denominate this application of proportionality the '*ex post* perspective', as the proportionality of an action taken by an EU institution is assessed by a judge within a judicial proceeding, following a legal action raised by an applicant.

Proportionality also plays a crucial role according to an '*ex ante* perspective', as a principle capable of governing and orienting legislative and administrative action. Under this perspective, its application is a day-to-day operation which impacts the discretionary choices of EU bodies and institutions with a view to ensuring a correct balance between conflicting interests.

The application of the proportionality test *within* the proceeding leading to the adoption of a legal act can thus support an appropriate use of discretionary powers by EU bodies and institutions in the best pursuit of the public interest.[41] This holds true both for general regulatory acts and for individual administrative decisions.

It goes without saying that the two dimensions are strictly interconnected, as the one defines and influences the other. Admittedly, proportionality theories in the EU legal order are mainly based on the analysis of the Court of Justice's case-law. At the same time, the way the principle is interpreted and applied by the courts influences the actions of legislative and administrative bodies, according to a circular movement. This should not come as a surprise, since it is well-known that administrative law (and notably EU administrative law) has mainly been developed through the action of EU courts.[42]

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39 P. Craig, *EU Administrative Law* 642 et seq. (Oxford 2018); S. De Nitto, *A proposito della proporzionalità come criterio giuridico*, Riv. trim. dir. pubbl. 1035 et seq. (2017).

40 T. Tridimas, *General Principles of EU Law*, 140 (Oxford, 2d ed., 2006) claiming that 'proportionality is often perceived to be the most far-reaching ground for review, the most potent weapon in the arsenal of the public law judge'.

41 According to Gerven, *supra* n. 30, at 58, 'proportionality is about weighing conflicting interests involved in (...) the pursuit of a regulatory aim and the deployment of appropriate regulatory means'.

42 M. P. Chiti, *I signori del diritto comunitario. La Corte di giustizia e lo sviluppo del diritto amministrativo europeo*, Riv. trim. dir. pubbl. 796 (1991).

Nevertheless, one cannot underestimate the importance of the application of proportionality *within* the exercise of power. Proportionality – as a general-principle governing the adoption of discretionary choices[43] – should be duly considered by policy-makers, rule-makers and decision-takers. This is especially true for the ECB as a new leading player in European economic and financial governance.[44] As this research aims to demonstrate, the respect of EU general principles and procedural guarantees is in fact all the more important for a 'very powerful and independent, yet unelected'[45] institution. In this vein, the principle of proportionality – just like other EU general principles and procedural guarantees – is not only aimed at protecting the rights of the addressees, but it also helps achieve a well-balanced decision, resulting from an all-encompassing assessment of divergent interests.

The *ex ante* perspective will be analysed in Part II.

As an *ex post* tool of review, proportionality is one of the most important general principles of EU law in the case law of the ECJ and of the General Court (GC). More recently, proportionality has been recalled in cases related to monetary policy and banking supervision, part of the banking union law established in the present decade. It has been recalled also outside the EU banking union, as by the Basel Committee on Banking Supervision, 2012.

So far, the cases on monetary policy have originated from the national courts – constitutional courts or courts of last instance – requesting an ECJ preliminary ruling (under Article 267 of the TFEU). The judgments of the ECJ have, for the most part, been delivered by the 'Grand Chamber', since the cases were quite new and of great impact to the institutional framework of the EU.[46]

On the other hand, the banking supervision cases are more numerous and usually raised before the GC through direct actions (under Article 263 of the TFEU). The proportionality argument is used quite frequently by the applicants; in

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[43] Zilioli, *supra* n. 23. The Author analyses proportionality as a principle which must be taken into account at three different regulatory levels: Union legislative level, national implementing level and administrative level by supervisors.

[44] On the new role of the ECB *see* in particular, G. Lo Schiavo, *The Role of Financial Stability in EU Law and Policy* (The Hague 2017); A. Hinarejos, *The Euro Area Crisis in Constitutional Perspective* (Oxford 2015); T. Beukers, *The New ECB and Its Relationship with the Eurozone Member States: Between Central Bank Independence and Central Bank Intervention*, 50 Com. Mkt. L. Rev. 1579–1620 (2013).

[45] M. Draghi, Opinion piece, transcript of Mario Draghi's speech at PR Manager of the Year Award (15 July 2014).

[46] M. P. Chiti, *The European Banking Union in the Case-Law of Justice of the European Union*, in *The Palgrave Handbook of European Banking Union Law* 105 et seq. (M. P. Chiti & V. Santoro eds, New York City 2019); *Judicial Review in the Banking Union and in the EU Financial Architecture*, in *Quaderni di ricerca giuridica della Banca d'Italia*, n. 84, (2018).

only one case has the GC annulled an ECB supervisory decision.[47] Almost all the judgments delivered by the GC have been appealed; so far, the ECJ has confirmed the first tier verdicts, also with regard to the proportionality argument.

Banking supervision is now fully operational and has a great impact on the European banking system. Considering the interests involved (the supervised banks, the shareholders, etc.) and sometimes the systemic relevance in their jurisdiction or for the entire EU, one can predict a large amount of future litigation which increasingly refers to proportionality, even if it has not been very successful so far as a test of review.

The *ex post* perspective will be analysed in greater detail in Part III.

1.6 The expansion of the principle of proportionality to new fields

The expansion of the principle to the monetary and supervisory functions was inevitable and appropriate.

It was inevitable because, under Articles 5.1 and 5.4 of the TEU, the use of the Union competences is governed by the principle of proportionality, without limitations. Also, the institutions and all Union bodies – including the regulatory authorities (EBA, ESMA, EIOPA) – must respect the principle of conferral (Article 5.2 of the TEU), the Rule of Law (Article 2 of the TEU) and the principle of effective judicial protection (Article 2 of the TEU and Article 47 of the Charter of Fundamental Rights). These principles apply to all 'the content and form of the European action' carried out by the institutions, bodies, offices and agencies, and therefore also apply to the ECB and its new supervisory tasks with no derogation.

The expansion to our subject matter is also appropriate because, firstly, the powers conferred upon the ECB under the SSM Regulation, part of the banking union law, and the new tasks of monetary policy[48] are subject to the general principles of EU law, including proportionality, both in regulation and in judicial control. Secondly, flexibility, which is the main feature of proportionality, is particularly suitable for the best implementation of the new functions.

For these reasons, the diffuse reference to the proportionality principle by the EU courts was expected as a 'natural' development.

Nevertheless, as proportionality is a powerful tool for guiding the exercise of power and controlling its implementation, it could be considered as a limitation of

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[47] Joined cases T-733/16, T- 745/16, 757/16, 751/16, 758/16, 768/16 *La Banque Postale v. European Central Bank* ECLI:EU:T:2018:477. For a comment: A. Magliari, *Intensity of Judicial Review of the European Central Banks's Supervisory Decisions*, Central Eur. Pub. Administration Rev. 73–86 (2019,).

[48] M. Draghi, *Twenty Years of the ECB's Monetary Policy,* Speech at the ECB Forum on Central Banking, Sintra, (18 June 2019).

the ECB's 'constitutional' independence and special expertise as a technical institution.[49]

The problem was resolved in 2003, well before the establishment of the comprehensive legislation of the banking union by the *Olaf* case[50] concerning the legality of an ECB decision aimed at excluding the ECB from OLAF (Anti-Fraud Office) controls[51]; thereby stressing its independence as provided for by the Treaty and the ECB Statute.

The case was prepared with the support of the well-thought-out conclusions of Advocate General Jacobs. In his paragraph no. 155, followed by the Court, he stated that despite a high level of independence:

> the principle of independence does not imply a total isolation from, or a complete absence of cooperation with, the institutions and bodies of the Community. The Treaty prohibits only influence which is liable to undermine the ability of the ECB to carry out its tasks effectively with a view to price stability and which must therefore [be] regarded as undue.[52]

The Court agreed with these conclusions and stated: '(1) [R]egardless of the distinctive features of its status within the Community legal order, the ECB was established by the EC Treaty in the same framework of the other institutions'; (2) pursuant to the EC Treaty, the 'ECB falls squarely within the community framework' (paragraph 92). 'The independence of the ECB does not have the consequence of separating it entirely from the EC and exempting it from every rule of Community law' (paragraph 153).

Since that judgment, the ECB and the Commission, which in some respects may also be considered an expert institution, have fully accepted that proportionality can be used as a test of the validity of their measures. The defensive arguments of the ECB before the EU courts confirm that the principle is definitely accepted and must be assessed carefully.

The legal science, for its part, shares in a large majority these developments.[53] The expansion of the principle to the monetary and supervisory functions is considered an obvious next step after its fortune in fields of law which share some similarities, such as State aid and competition law. As will be demonstrated below, in spite of a general positive attitude, the results of the application of the

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[49] The new features of the 'independent administration' (Art. 298 TFEF) are considered by S. Battini, *Indipendenza e amministrazione fra diritto interno ed europeo*, Riv. trim. dir. pubbl. 947 et seq. (2018).

[50] Case C-11/00, Commission *v.* European Centra Bank ECLI:EU:C:2003:395.

[51] M. P. Chiti, *The New European Economic Governance and the Banking Union*, Eur. Rev. Pub. L. 189 (2016).

[52] The Opinion of A-G Jacobs can be found at ECLI:EU:C:2002:556.

[53] *See* the essays collected in Chiti & Santoro, *supra* n. 46.

proportionality test in the fields considered herein are not so many and not as significant as expected.

1.7 General features of the case law

EU case law indicates that the substance of the German tradition has been 'translated' into Union law. More precisely, the three limbs of proportionality[54] in the EU system are aimed at verifying whether a measure is: (1) appropriate or suitable to achieve the objectives ('suitability'); (2) necessary ('the less restrictive measure'); and (3) not excessive and proportionate to the objective pursued ('manifest disproportionality').[55] Actually, often the Court does not make a distinction between the second and the third test[56]

The case law regarding these recent novelties indicates that the intensity of judicial review through the proportionality test is, in general, different when the case involves widely discretionary powers and policy decisions as opposed to when the case is disciplined by a comprehensive law or when fundamental rights are at stake.[57] In the first situation, the judicial review is of low/medium intensity; in the latter cases it may be quite strong.

Despite the different intensities of review, in both cases the courts should not substitute their own judgment for the decisions reviewed, according to the 'marginal' or 'limited' standard of judicial review, and to the general *ratio* that the role of the EU courts is in principle limited to deciding whether 'the contested decision is based on materially incorrect facts, or is vitiated by an error of law, a manifest error of appraisal or misuse of powers' (see, for instance, *British American Tobacco*[58]). On the contrary, the courts' approach based on the principle of proportionality tends to substitute their judgments on questions of law (error of law), simply laying down the legal meaning of the disputed term provided by the Treaties or the EU legislators,[59] even though the courts are keen to provide some autonomy to the decision maker when 'discretion' is involved.[60]

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54 Followed carefully in the ECJ Judgment in Joined cases C-78/16 and 79/16 *Pesce* (or *Xylella)* ECLI:EU:C:2016:428.

55 A good example is joined cases C-92/09 and C-93/09 *Volker und Markus Schecke GbR* ECLI:EU:C:2009:284, on protection of natural persons with regard to processing of personal data.

56 As noted by F. Jacobs, *Recent Developments in the Principle of Proportionality in EC Law*, in *The Principle of Proportionality in the Law of Europe*, *supra* n. 10.

57 C. Zilioli, *Justiciability of Central Bank's Decisions and the Imperative to Respect Fundamental rights*, ECB Legal Conference (2017).

58 Case C-491/01 *R v. Secretary of State for Health, ex parte British American Tobacco (Investments) Ltd and Imperial Tobacco Ltd* ECLI:EU:C:2002:741.

59 The risk could be harder through an extensive use of the proportionality test, as explained by Jacobs, *supra* n. 56.

60 P. Craig, *Judicial Review of Questions of Law: A Comparative Perspective*, Oxford Legal Studies Research Papers, no. 56/2009.

Recent applications of the proportionality test to monetary and supervisory functions appear to confirm the previous case law.[61] On one side, proportionality is, or should be, inevitably restrained by the intrinsic political character of most monetary policy decisions; on the other, supervision – which is extensively regulated – provides an opportunity for intense judicial review.[62] Upon first glance it could be considered that a comprehensive law – such as the banking supervision law – prevents an intrusive review. To the contrary, detailed rules do not limit the powers of the implementing authorities to the extent that they grant them a wider scope of choice among a number of interests and solutions.

Monetary policy and supervision demonstrate that the proportionality test is not a model crafted once and for all, but rather a test which is multi-faced, flexible, and assumes new character depending on the situation.

1.8 The main lessons from the case law

The leading cases on monetary policy and banking supervision will be examined extensively in Part III. However, it is possible at this point to draw the main lessons from the case law.

8.1. As for monetary policy, these lessons include: (1) a significant use by the courts of the proportionality test; (2) an active attitude of the ECJ, compared to the traditional deferential approach to matters of a *quasi*-political nature[63]; (3) sometimes the ECJ has played a 'creative' role, shaping some measures (such as the Outright Monetary Transactions OMT in the *Gauweiler* case[64]) with terms and conditions; (4) evidence of a partial overlapping of the proportionality test and the 'manifest error' ground; (5) a new relevance of traditional grounds for review in the perspective of the proportionality test, such as the duty to give reasons.

8.2. As for banking supervision, Regulation 1024/2013/EU provides, at recital No. 64, the requirement to respect 'the margin of discretion left to the ECB' to decide on the opportunity to take those decisions". In exercising its supervisory powers under the Single Supervisory Mechanism (SSM), the ECB enjoys a special status of 'expert institution', with a margin of discretion which is,

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[61] M. P. Chiti, *The European Banking Union in the Case Law of the Court of Justice of the EU*, in *The Palgrave Handbook of European Banking Union Law* (M. P.Chiti & V. Santoro eds, *supra* n. 46).

[62] A recent judgment has confirmed this conclusion, even on a new matter: the ECB non-contractual liability on its policy for restructuring the Greek public debt in 2012. *See* Case T-107/17 *Steinhoff* ECLI:EU:T:2019:353. According to the GC, pointed out that the broad discretion enjoined by the ECB in adopting opinions means that only a manifest and serious disregard of the limits of that discretion can render it non-contractually liable; in the specific case of the Greek public debt, the restructuring was not a disproportionate and intolerable infringement of the right to property of the investors.

[63] *See* the most influential case so far:, Case C-493/17 *Weiss* ECLI:EU:C:2018:1000.

[64] Case C-62/14 *Peter Gauweiler and Others v. Deutscher Bundestag* ECLI:EU:C:2015:400.

in principle, intangible through the proportionality test. The first case law, already significant in numeric terms and for the quality of the reasoning, demonstrates, however, a different approach by the courts.

As will be observed in Part III, the judicial self-restraint expected under the duty to respect the ECB's margin of discretion has greatly softened, providing room for a detailed review of the supervisory powers. In this way it results as a working compromise between the intensity of the review provided by the proportionality test and the respect of the margin of discretion conferred on the EU institutions at the time the decision was adopted.[65]

The fact that the courts have so far decided positively in the ECB's favour, with only one exception, does not demonstrate any 'deference' towards the ECB, but rather the good – technical and legal – quality of the ECB's decisions.

Supervision has some peculiarities which are relevant for our topic. Firstly, European supervision as regulated by recent legislation is a multilevel (and multi-layered[66]) function, often characterized by composite procedures (well demonstrated by the case *Berlusconi Fininvest*[67]). Even though strongly centralized in the ECB, supervision implies the exercise of discretionary powers at different levels and the relevant consequences (see the *Landeskreditbank* case[68]).

Secondly, in a such specific there is no clear distinction between proportionality and other flexible tests of review as manifest error and unreasonableness.[69] Proportionality is almost always related to other tests, as demonstrated inter alia by the *Arkéa* case, where the review focuses, apart from proportionality, on whether the contested decision is based on materially incorrect facts, or is vitiated by an error of law, manifest error of appraisal or misuse of powers.

Thirdly, the supervisory decisions may be reviewed through administrative remedies prior to judicial control, which can take into consideration all grounds of illegality, thereby filtering access to the courts. This circumstance could affect the relevance of the proportionality test in judicial review, thereby diminishing its role. However, the present legal framework of the Administrative Board of Review

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65 *See* cases *Landeskreditbank*, *supra* n. 31 and Arkéa *supra* n. 28.

66 This feature is not directly related to the focus of the Research, but it shows the genuinely new character of the model. Confirmed by the ECJ case law (Joint cases C-202/18 and C-238/18 *Ilmārs Rimšēvičs and European Central Bank v. Republic of Latvia* ECLI:EU:C:2019:139 and by the legal science (M. Macchia, *Integrazion eamministrativa e unione bancaria*, (Torino 2019)).

67 *See* Case C-219/17 *Silvio Berlusconi and Finanziaria d'investimento Fininvest SpA (Fininvest) v. Banca d'Italia and Istituto per la Vigilanza Sulle Assicurazioni (IVASS)* ECLI:EU:C:2018:1023. For a comment: M. P. Chiti, *I procedimenti amministrativi composti e l'effettività della tutela giurisdizionale,* Giorn.dir.amm. 187 (2019).

68 For a different view, *German Constitutional Court (BUG)*, Judgment 30 July 2019, 2BVG 1685/14, 2 BVG 2631/14.

69 J. Wonters & S. Duoet, *Reasonebleness as a Standard of Judicial Review. Comparative European and Globlal Perspectives*, Riv. trim. dir. pubbl. 35 (2014); F. Trimarchi Banfi, *Ragionevolezza e razionalità delle decisioni amministrative*, Dir. proc. amm. 343 et seq. (2019).

(ABoR) is rather ambiguous, combining the role of ABoR in an unresolved way as a *quasi*-judicial body, aimed at guaranteeing the rights of the interested parties, and the different role of a body which takes part in the ECB decision-making procedure, providing it 'advice'. At the same time, ABoR – which is activated only by private applications – cannot provide *ex ante* advice to the ECB outside the scope of a review procedure.[70]

1.9 The ECB and the principle of proportionality: the main issues

To sum up the first part of this research, we can say that more recently the principle of proportionality – already well-established as a general principle of EU law – has largely also been applied to the monetary and supervisory functions conferred to the ECB. This raises a number of questions which this research aims to address.

On the *ex ante* role of proportionality, the main issues include the following: (1) What is the role of proportionality in banking regulation? Is the current regulatory framework 'disproportionate' when compared to the general objectives of market integration and financial stability?; (2) How can a more proportionate arrangement be achieved for small and non-complex banks?; (3) What is the relationship between proportionality and discretion in banking supervision? What instruments does the ECB have at its disposal for promoting a proportionate approach in day-to-day banking supervision?; (4) Does proportionality also affect the organizational structure of the SSM and the ECB?; (5) Why is proportionality so important for monetary policy? And how does it apply to non-conventional measures? These questions will be answered in Parts II and IV of this article.

On the ex post issues, in relation to judicial review, the main issues include the following: (1) What is the role of proportionality as a test of judicial review? Is it a ground for review clearly differentiated by other tests such as manifest error or unreasonableness?; (2) Proportionality as a unitary, monolithic principle or as a differentiated principle, with several variations according to different situations?; (3) Proportionality as a test for a profound judicial review or just for a light-touch approach?; (4) Proportionality in monetary and supervisory functions: confirmation of the traditional approach, as for competition, or development with some originality?; (5) Possible differences in using the principle on the monetary and supervisory functions. Differences or inconsistencies between the two cases?; (6) Proportionality and the role of fundamental rights; (7) Is proportionality attempting at the full independence of the ECB? These general questions will be answered in Parts III and IV of this article.

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[70] On ABoR, *see also* Part. IV, para. 10.

Moreover, other 'technical' problems arise, including: (1) the possibility that the courts can apply the proportionality test *ex officio*; (2) the admissibility of applications against atypical acts or non-binding measures; (3) the tension between the expansive capacity of the proportionality test and the traditional limits of the limited standard of review, with the possible consequence that proportionality may become a new case of full jurisdiction.

We can anticipate that with regard to question (1), the powers which can be exercised by the EU courts *ex officio*[71] are a matter of strict interpretation, as in the national jurisdictions. Current procedural law does not contain a specific provision on this issue. Therefore, in principle the EU courts should not use the test of proportionality *ex officio*. At the moment the problem is only virtual, as in most of the recent cases the applicants have made reference to this head of review. If the test is not required by the applicants, the courts can deal with proportionality in a collateral way, since the principle is strictly connected to other principles.

Regarding question (2), the jurisprudence demonstrates that in several cases, some of great importance such as *Gauweiler,*[72] the courts have considered the applications against non-binding acts (acts not having the 'seal' of final acts of an administrative procedure, with immediate legal effects) to be admissible. This circumstance confirms a general trend towards an extension of the reviewable acts, based on the principle of effective judicial protection in all cases where personal rights can be affected even in an atypical manner.

Regarding question (3), one may note that the proportionality test is greatly influencing the development of a new case of full jurisdiction. However, the trend must be constrained up to the possible reform of the present procedural discipline by the legislators, which is the only institutional way to reform the law.

2 PART II: THE ECB AND THE PRINCIPLE OF PROPORTIONALITY: THE EX ANTE PERSPECTIVE

This part investigates the principle of proportionality according to an *ex ante* perspective within three distinct dimensions: proportionality embedded in the supervisory regulatory framework as a principle addressed to the legislator (paragraph 1); proportionality in the application of prudential regulation by supervisory authorities in the exercise of their supervisory discretion (paragraph 2); proportionality in the field of monetary policy, where the ECB is both the policy-maker and, to a certain extent, the authority in charge of applying monetary policy measures (paragraph 3).

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71 K. Lenaerts, I. Maselis & K. Gutman, *EU Procedural Law*, 410 et seq. (Oxford 2015).

72 *See supra* n. 65.

2.1 THE PRINCIPLE OF PROPORTIONALITY AND BANKING REGULATION

As it has been pointed out, 'proportionality is not only a *judicial* doctrine for the Court to apply in reviewing the legality of Community action. It is also a *legislative* doctrine for the political institutions to observe in the exercise of their decision-making functions'.[73] In the frame of EU law, proportionality entails an assessment as to whether the EU should take action and how. Within the limits of the conferred powers,[74] the principle of proportionality, together with subsidiarity, is to regulate the exercise of legislative powers by EU institutions. In areas which do not fall within the EU exclusive competence, subsidiarity provides the initial justification for the EU's intervention, while proportionality requires that 'the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties'.[75] Unlike subsidiarity, the principle of proportionality also applies to areas of EU exclusive competence, such as monetary policy pursuant to Article 3 (c) TFEU and banking supervision within the limits set by the SSM Regulation, as clarified by the ECJ in *Landeskreditbank*. Unlike subsidiarity, the principle of proportionality impacts not only the interaction between the EU and the Member States, but also the relationship between the Union and individuals.

Union legislator is thus 'compelled to strike a balance between a number of interests and needs while pursuing high level policy objectives'.[76] In EU law, this complex operation involves a proportionality check on the legal form,[77] the material scope and content of the legislation. Accordingly, proportionality entails that legislative provisions are calibrated to the regulatory objectives of general interest recognized by the EU, that they introduce the least intrusive means, and that they do not pose an excessive and unnecessary burden on the addressees. The same considerations apply to non-legislative regulatory acts and non-binding acts adopted by EU bodies and institutions having de facto regulatory effects. There does not seem to be any valid reason to exclude the application of this (general) principle also to Commission regulations, ECB regulations, EBA regulatory and implementing technical standards,[78] as well as to soft law acts adopted by the ECB,

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73 Emiliou, *supra* n. 32.

74 *See* the opinion Hogan, *supra* n. 31, para. 57, claiming that 'The principle of proportionality cannot be invoked to devolve a Union competence on the Member States and vice versa'.

75 Article 5(4) TEU.

76 Zilioli, *supra* n. 23.

77 *See* Art. 296 TFEU. It has been observed (Zilioli, *supra* n. 23.) that in the frame of EU law proportionality also impacts the degree of harmonization of Member States' legislations. In that respect, the choice of a directly applicable Regulation rather than a directive, as well as the number and scope of options and discretions conferred upon national authorities, can be understood as an expression of a proportionate approach to EU legislative action.

78 *See* for instance, recital no. 92 of the CRD IV providing that 'the Commission and EBA should ensure that [regulatory technical] standards can be applied by all institutions concerned in a manner that is proportionate to the nature, scale and complexity of those institutions and their activities'.

the EBA or the ESRB. The obligation to conduct prior public consultations or impact assessments further confirms the prominent role of an *ex ante* proportionality check.

Against this background, this article claims that a thorough application of proportionality requirements in banking regulation is of utmost importance. In the banking sector, legal rules and technical standards not only might have a strong impact on individuals' fundamental rights (such as the right to property or the freedom to conduct a business), but they also concern the economy at large. The post-crisis wave of reforms has profoundly modified the regulatory landscape for the European banking sector: it is therefore not surprising that in the last few years, following an unprecedented 'Europeanization' of banking regulation and supervision, proportionality in banking law has become a major concern for the banking industry, especially for the small and medium-sized credit institutions.[79]

As a matter of fact, despite the wide variety of organizational and business models, the EU legislator has decided to basically apply the same regulatory requirements to all credit institutions established in the EU. The rationale underpinning the 'one size fits all' approach (epitomized in the expression '*Single Rulebook*') can be traced back to the objective of ensuring a competitive level playing field in the EU financial market, at the same time safeguarding financial stability.[80]

Admittedly, EU secondary law on banking regulation – in particular Regulation EU No. 575/2013 (CRR) and Directive 2013/36/EU (CRD IV) – contains a number of references to proportionality and to the opportunity of a proportionate application of prudential requirements, having regard to the size, systemic importance, nature, scale and complexity of the activities of the institution concerned.[81] Moreover, the new banking package composed of Regulation EU 2019/876 (CRR II) and Directive 2019/878/EU (CRD V) has introduced other relevant measures to alleviate the regulatory burden on small and

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[79] *See* the Report by the EBA Banking Stakeholder Group on 'Proportionality in Bank Regulation'; A. P. Castro Carvalho et al., *Proportionality in Banking Regulation: A Cross-country Comparison*, Financial Stability Institute Policy Implementation Insight No. 1/2017.

[80] B. Joosen, M. Lehmann, *Proportionality in the Single Rule Book*, in *The Palgrave Handbook of European Banking Union Law* 65 et seq. (M. P. Chiti & V. Santoro eds, *supra* n. 46).

[81] Recital 43 of the CRR states that 'capital requirements should be proportionate to the risks addressed'; recital 46 of the CRR also highlights that 'the provisions of this Regulation respect the principle of proportionality, having regard in particular to the diversity in size and scale of operations and to the range of activities of institutions'. Further examples can be found in Arts 7 and 8 CRR setting out intra-group waivers for prudential and liquidity requirements, in Art. 97.4 CRD IV requiring that 'competent authorities shall establish the frequency and intensity of the review and evaluation having regard to the size, systemic importance, nature, scale and complexity of the activities of the institution concerned and taking into account the principle of proportionality', in Art. 94 CRR on the exemption on the calculation of market risks for banks with small trading books, in Art. 70 of Regulation No 806/2014 on the calculation of *ex ante* contributions to the Single Resolution Fund.

non-complex banks, regarding supervisory reporting, disclosure and remuneration policies.[82]

Many commentators, however, have pointed out that the current regulatory set-up has been shaped on systemically significant institutions, while *vis-à-vis* smaller institutions it would exceed what is necessary to meet the goal of safe-guarding financial stability and protecting depositors. This would result in an overly burdensome regulatory framework for small and non-complex banks, which would be thus compelled to either leave the market or merge with other institutions.[83] According to this perspective, a differentiated approach to banking regulation would not be at odds with market integration and financial stability concerns but would rather contribute to the latter.

We will not enter into this debate,[84] which would take us out of the scope of this research, and we limit ourselves to observing that, as a general principle of EU law, proportionality does require the EU legislator to pursue a balanced and differentiated approach in order to ensure that credit institutions are not submitted to overly stringent regulatory burdens and, thus, to a disproportionate limitation of their fundamental rights. We agree, therefore, with those who claim that:

> the principle of proportionality (...) is not just a limit to be exceptionally used by the CJEU in assessing the legality of regulatory and supervisory actions in banking, but a principle that must inform the EU regulatory and supervisory system and may require also positive actions to remove impediments to proportionate outcomes.[85]

Legal rules imposing restrictions and burdens on individuals should, therefore, be suitable, necessary and not disproportionate to achieve the policy objectives, taking into account the bank's size, its internal organization and business model, the scope and complexity of its activities, its risk profile and the interconnection with other institutions. It is therefore necessary to avoid a 'cascade effect' where disproportionality stemming from Level 1 legislation spreads to the lower

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82 *See* recitals nn. 6 and 7 CRR II, and the new definition of 'small bank' (Art. 4, n. 142 CRR II). For a detailed analysis, which takes into account also the new banking package, *see* Joosen & Lehmann, *supra* n. 80, at 75. *See also* the second Bank Recovery and Resolution Directive (BRRD II or Directive (EU) 2019/879) and the second Single Resolution Mechanism Regulation (SRMR II or Regulation (EU) 2019/877).

83 According to Joosen & Lehmann, *supra* n. 80, at 68 'overregulation and excessively bureaucratic supervision feed the run for size and the elimination of smaller banks'.

84 *See* I. Angeloni, *Another look at Proportionality in Banking Supervision*, Remarks at the 13thAsiaPacific High Level Meeting on Banking Supervision, Singapore, 28 Feb. 2018 arguing that 'Further major advances in the application of proportionality, as now proposed by some in order to soften the prudential burden for certain categories of institutions, should be regarded with great caution (...). Arguments and evidence do not support, on balance, a more favourable treatment to small banks by the micro-prudential regulator or supervisor'.

85 B. Joosen et al., *Stability, Flexibility and Proportionality: Towards a Two-tiered European Banking Law?*, EBI Working Paper Series, No. 20/2018.

regulatory levels and, eventually, to banking supervision.[86] After all, in the EU the very idea of 'prudential regulation' is inherently associated to a risk-based approach that takes into account the banks' risk profile and systemic importance, thus calling for a gradual and proportionate approach to both regulation and supervision.[87]

From a regulatory perspective, two main models of differentiation have been put forward in legal scholarship. The first, which is based on the current set-up, provides a uniform set of rules for all credit institutions, but introduces many exceptions and waivers for smaller and non-complex banks. The second approach suggests the introduction of a 'two-tiered banking law', along the lines of the US or Japanese systems, where the first tier would consist of the current regulatory framework, while the second tier would entail a simplified regime for smaller, non-complex and domestic banks ('Small banking box').[88]

The latter approach could have the advantage of aligning substantive requirements with the distinction of significant and less significant credit institutions established by the SSM Regulation. It has, however, several drawbacks. First, it is not easy to draw a clear-cut line between 'small' and 'large' banks. The distinction cannot be based only on the bank's size, as other qualitative factors should also be taken into consideration. It is therefore extremelydifficult for the legislator to identify *a priori* these criteria or to combine them in a univocal way. Second, in order to avoid an overly complex and fragmented regulatory framework, the distinction should be based on the same criteria applied to determine the 'significance' of a supervised institution under the SSM Regulation. It is well-known, however, that the significance assessment is performed at the highest level of consolidation and, therefore, even small banks which are part of a significant group are subject to the direct supervision of the ECB. Third, also a two-tiered system may be disproportionate to the extent that a differentiated approach could be required even *vis-à-vis* banks belonging to the same tier. In this respect, a two-tiered system can trigger an equally unsatisfactory 'two-size-fit-all' regime. Fourth, this approach is likely to increase the risk of regulatory arbitrage.

Arguably, a more appropriate and viable solution could be to further improve the first approach (or 'modular approach'), at the same time conferring on supervisors a wider margin of discretion as to the application of the relevant legal rules, e.g. allowing them to exempt a credit institution from specific requirements on the basis of a case-by-case analysis and according to a discretionary supervisory

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[86] At the same time, the demand for more proportionality cannot be used to 'call an end to the crisis and swing the pendulum a bit back towards a less regulated and more business-friendly approach' (*see* I. Angeloni, *supra* n. 84.).

[87] *See* the SSM Supervisory Manual, Mar. 2018.

[88] Joosen et al., *supra* n. 85.

assessment,[89] or vesting supervisors with the power to develop guidelines and methodologies where supervisory approaches are better defined also in light of proportionality considerations. This would allow supervisors to apply a 'tailored proportionality' that, building on the relevant legislation, takes into due consideration all the factual elements and specificities in terms of size, complexity, risk profile, business model and cross-border activities of each supervised entity.[90] If, on the one hand, such approach could increase legal uncertainty and unpredictability of banking supervision, on the other hand one should admit that this is inherent to the very functioning of the principle of proportionality as an elastic principle leading to a more flexible application of substantive rules.

2.2 THE PRINCIPLE OF PROPORTIONALITY AND BANKING SUPERVISION

2.2[a] *The ECB and the 'Supervisory Proportionality'*

The above considerations lead us to consider the 'supervisory proportionality', i.e. the way administrative authorities apply proportionality in banking supervision. Admittedly, banking supervision is a highly regulated sector where the scope of discretion of competent authorities is often constrained by a detailed legal framework and spelled-out technical criteria. This however does not always prevent competent authorities from enjoying a certain margin of supervisory discretion in the application of the law.[91] As we have seen before, this is crucial in order to ensure a proportionate application of banking regulation. It is indeed the supervisors that have the relevant experience and in-depth knowledge of the banks they supervise. Supervisors are therefore best placed to ensure a case-by-case proportional application of substantive law through the exercise of their discretionary powers.

Moreover, the decision-making process can be understood as the legal space where different interests are represented and weighed up. Proportionality

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89 *See* Case T-712/15, *Crédit muteal Arkéa, supra* n. 28, paras 67 et seq. regarding the application of Art. 10(1) CRR and Case T-733/16, *La Banque Postale v. ECB, supra* n. 47 paras 45 et seq. regarding the application of the waiver set out in Art. 429.14 CRR. In these cases, the Court acknowledged that the derogation is made subject not only to the existence of specific prerequisites of a technical nature, but also to the discretionary judgment of the supervisory authority.

90 Angeloni, *supra* n. 84. claiming that 'proportionality means adapting nature and intensity of supervision to the specifics of the bank – its size, its risk profile, its business model – and to the particular purpose being achieved. In practice this means adopting, or coming close to, a case-by-case approach'.

91 *See* for instance, Art. 10 CRR, as amended by CRR II, providing that 'competent authorities *may* [emphasis added], in accordance with national law, partially or fully waive the application of the requirements set out in Parts Two to Eight of this Regulation'. On the discretionary nature of this power, *see Crédit mutual Arkéa v. ECB, supra* n. 28, para. 67. A similar reasoning appears *in La Banque Postale v. ECB supra* n. 47, where the waiver provided by Art. 429.14 CRR has been qualified as a 'derogation entailing the exercise of a discretion' (para. 45).

considerations might therefore arise within the administrative proceeding through the participation of the interested parties and must be exhaustively reflected in the reasoning of the decision.[92] The latter represents the cornerstone of the proportionality assessment as it reflects, on the one hand, the *ex ante* technical and prudential evaluations of the supervisor and, on the other hand, it allows the *ex post* scrutiny of the decision by the judge. Likewise, the administrative remedy provided by the ABoR represents a suitable – yet still improvable – framework for further considerations on the proportionality of a supervisory measures. In that respect, the administrative review lies at the crossroads of an *ex ante* and an *ex post* assessment, as it allows private parties to challenge a supervisory measure according to an *ex post* rationale, at the same time granting the ECB a second chance to reassess the contested decision pursuant to an implementation, hence *ex ante*, logic.[93]

The regulatory framework underpinning the ECB supervisory tasks widely acknowledges the relevance of proportionality. Recital 55 of the SSM Regulation, for instance, provides that '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'. Article 1.3 of the SSM Regulation provides that 'the ECB shall have full regard to the different types, business models and sizes of credit institutions'. Moreover, according to the ECB Guide to Banking Supervision:

> the supervisory practices of the SSM are commensurate with the systemic importance and risk profile of the credit institutions under supervision (…). Accordingly, the intensity of the SSM's supervision varies across credit institutions, with a stronger focus on the largest and more complex systemic groups and on the more relevant subsidiaries within a significant banking group.[94]

Furthermore, the SSM Supervisory Manual[95] extensively recalls the principle of proportionality, by stating that 'the supervisory practices of the SSM will follow the principle of proportionality, tailoring the intensity of supervision to the

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92 On due process guarantees in the SSM, Macchia, *supra* n. 66, at 99.

93 On the distinction between the 'adjudication' and the 'implementation' rationale of administrative remedies, *see* L. De Lucia, *A Microphysics of European Administrative Law: Administrative Remedies in the EU after Lisbon*, Eur. Pub. L. 277–307 (2014); P. Chirulli-L. De Lucia, *Specialized Adjudication in EU Administrative Law: The Boards of Appeal of EU Agencies*, Eur. L. Rev. 832–857 (2015). On the ABoR, M. Clarich, *The System of Administrative and Jurisdictional Guarantees Concerning the Decisions of the European Central Bank*, in *The Palgrave Handbook of European Banking Union Law* 91–103 (M. P. Chiti & V. Santoro, *supra* n. 46); C. Brescia Morra, R. Smits & A. Magliari, *The Administrative Board of Review of the European Central Bank: Experience After 2 Years*, 18(3) Eur. Bus. Org. L. Rev. 567–589 (2017).

94 Principles 7 (Proportionality) of the *ECB Guide to Banking Supervision*.

95 SSM Supervisory Manual on European banking supervision: functioning of the SSM and supervisory approach, ECB (Mar. 2018).

systemic importance and risk profile of the supervised banks'.[96] Proportionality also features in the Basel Committee framework, being part of its Core Principles: Principle 8 (supervisory approach) requires the supervisors to 'develop and maintain a forward-looking assessment of the risk profile of individual banks and banking groups, proportionate to their systemic importance'.

In the performance of its supervisory tasks the ECB is therefore bound to carry out a proportionality check of supervisory measures on a case-by-case basis. In that respect, it is possible to identify a number of variables that supervisors should systematically consider both at an operational level (e.g. at the Joint Supervisory Teams level) and at the decision-making level.

The first element to be taken into account is the nature of the power conferred upon the supervisor by the relevant legal provision. Arguably, the wider is the margin of discretion enjoyed by the ECB, the broader will be the scope of application of the principle of proportionality within the decision-making process. This is particularly true where the ECB enjoys a 'proper' (or 'administrative') discretion[97] or, even more, where it is empowered to make policy choices or to adopt regulatory acts. In such cases, the ECB has the 'capacity to take policy decisions linked to the weighing of conflicting private and public interest'[98] and, in such balancing operation, it is bound to apply a proportionality assessment of the matter at stake. Complex economic assessments, involving controvertible and highly technical evaluations, should also be guided by proportionality, notably in the form of a thorough cost-benefit analysis. On the contrary, there seems to be little room for applying the principle in case of circumscribed powers or purely technical non-discretionary assessments.

Another variable is the impact of the supervisory decision on the individuals' legal sphere. The ECB should duly consider whether the intended supervisory action will negatively affect the addressee's fundamental rights and to what extent. As a matter of fact, supervisory decisions can severely impact the right to property, the freedom to conduct a business, the right to respect for private life, home and communications, as protected by the Charter of Fundamental Rights of the EU and by the European Court of Human Rights (ECtHR).

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[96] For instance, each JST defines an annual Supervisory Examination Programme (SEP) covering the ongoing activities performed off-site by the JSTs and on-site activities performed at the supervised entity's premises by on-site expert teams.

[97] As is known, contrary to German and Italian law, EU law does not clearly distinguish between 'proper' (or 'administrative') discretion and 'technical discretion'. Even in EU legal scholarship, there seems to be no consensus on such distinction: *see* inter alia, J. Schwarze, *European Administrative Law*, (London 2006); M. Prek-S. Lefèvre, '*Administrative Discretion', 'Power of Appraisal' and 'Margin of Appraisal' in Judicial Review Proceedings Before the General Court*, 56 Com. Mkt. L. Rev. 339–380 (2019); R. Caranta, *On Discretion*, in *The Coherence of EU Law. The Search for Unity in Divergent Concepts*, 195 (S. Prechal-B & van Roermund eds, Oxford 2008).

[98] Caranta, *supra* n. 97.

The ECB is endowed with a wide range of supervisory powers as provided for in the SSM regulation. While it is possible to identify *a priori* some measures which are inherently highly intrusive (such as the *ex officio* withdrawal of the banking license), one may claim that the impact of each supervisory decision must be measured on a case-by-case basis and in the light of the relevant circumstances, i.e. against its content, timing and frequency.

Among ECB supervisory decisions, one can distinguish between investigatory powers (as set out in Articles 10–13, SSM Regulation) and supervisory powers *stricto sensu* (as set out in Articles 9, 14–18, SSM Regulation). The former are oriented at gathering all the relevant data and information that are necessary for the exercise of banking supervision; the latter consist of prudential supervisory measures that the ECB can adopt for the purpose of carrying out its supervisory tasks. While investigatory powers generally do not have the same negative impact on the addressees as supervisory measures, one cannot ignore that a proportionality test should also be carried out in case of requests of information and reporting requirements. As the ECJ stated, 'it is necessary that an obligation imposed on an undertaking to supply an item of information should not constitute a burden which is disproportionate to the requirements of the inquiry'.[99] Moreover, proportionality assessment is key in case of on-site inspections.[100] These are coercive measures that can heavily impact the fundamental rights of the addressee, notably Article 7 of the Charter and Article 8 of the ECHR.[101] As recognized by the Court of Justice, EU law affords 'protection against arbitrary or disproportionate intervention by public authorities in the sphere of the private activities of any person, whether natural or legal'.[102] In this vein, public authorities must refrain from carrying out coercive inspections in all those cases where the suspected infringement is so minimal, the extent of the likely involvement of the undertaking so limited, or the evidence sought so peripheral, that the intervention in the sphere of the private activities appears manifestly disproportionate and intolerable in the light of the objectives pursued by the investigation.[103]

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99 *See* in particular, Case T-39/90 *SEP v. Commission* ECLI:EU:T:1991:71, para. 51; Case T-145/06, *Omya v. Commission* ECLI:EU:T:2009:27, para. 34.

100 *See* Art. 13, SSM regulation.

101 *See* ECtHR, judgment of 16 Dec. 1992, *Niemietz v. Germany*; judgment of 16 Apr. 2002, *Colas Est and Others. v. France*. On inspections in EU law, *see* J.-B. Auby, *Le pouvoirs d'inspections de l'Union européenne*, Revue Trimestrielle de Droit Européen 132 (2006); most recently, M. Scholten, *Mind the Trend! Enforcement of EU Law has Been Moving to 'Brussels'*, 24 J. Eur. Pub. Pol'y 1348 (2017); M. De Bellis, *Le ispezioni nei procedimenti europei e la tutela del privato: problemi e prospettive*, in *I procedimenti amministrativi di adjudication nell'Unione europea: principi generali e discipline settoriali* 153–189 (G. della Cananea & M. Conticelli eds, Torino 2017).

102 Case C-94/00, *Roquette Frères SA* ECLI:EU:C:2002:603.

103 *Ibid.*, para. 80.

Supervisory measures resulting from the exercise of supervisory powers *stricto sensu* can have different scope and content. From the addressee's perspective, they can have negative or positive content. Needless to say, the proportionality test plays a fundamental role in case of negative decisions, as the supervisor should duly consider the necessity of the measure, i.e. the lack of alternative and less restrictive means. However, at a closer look, a proportionality test should also be carried out in case of positive decisions, as these may negatively affect third parties, whose interests should be equally taken into consideration by the supervisor within the decision-making process.[104] Accordingly, the proportionality assessment should cover not only the impact of the measure on the addressee but also on other persons who might suffer harm as a result of that measure.

Supervisory measures are generally addressed to credit institutions. Sometimes, however, although formally addressed to the latter, ECB decisions materially affect physical persons' legal sphere, as it happens, for instance, for the assessment of the fitness and propriety (FAP) of the members of the management bodies of the supervised entities.[105] In such cases, the proportionality test is further complicated by the fact that both the supervised entity and the appointee could be affected by FAP decisions; at the same time, when adopting a negative decision, the ECB should attentively balance the adverse consequences for the individual concerned with the interests of the supervised entity to be safely and soundly managed by a suitable and qualified person. In this case – as in other authorization procedures (e.g. the licensing procedure set out in Article 14 and the acquisition of qualifying holdings set out in Article 15) - the ECB should carefully assess whether, instead of adopting an outright negative decision, the prudential objective underpinning the authorization power could be equally attained by means of a positive decision imposing specific conditions or obligations to be fulfilled by the addressee.[106]

In sanctioning procedures, the principle of proportionality should be at the heart of the supervisory judgment as to the *if*, the *how*, the *when* and the *amount* of the imposition of a penalty.[107] Furthermore, according to Article 18 SSM regulation, administrative penalties must be effective and dissuasive. This means that proportionality must also be assessed against the objective expressly established by

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[104] In this respect, the lack of participatory rights of third parties which are not subject of the proceedings, but that could be adversely affected by the supervisory decision,raises some concerns as to the very possibility for the ECB to adequately take into account such divergent private interests within the administrative procedure.

[105] *See* Art. 4(e), SSM Regulation, Arts 93–94, SSM Framework Regulation, and Arts 91 et seq., CRD IV.

[106] *See* Zilioli, *supra* n. 23. *See also* G. Lo Schiavo, *Conditions and obligations in ECB Supervisory Decisions as Ancillary Provisions Under SSM Law*, 14 Eur. Co. & Fin. L. Rev. 94–120 (2017).

[107] *See* Art. 18 SSM Regulation. *See ex multis*, Case C-617/10, *Åkerberg Fransson* ECLI:EU:C:2013:105, para. 36.

the legislator, which is to dissuade from repeating the same violation, and not to punish its addressee.

A particularly thorough proportionality test – which analytically takes into account all the alternative and less restrictive means – must be carried out in case of application of supervisory measures according to Article 16 of the SSM Regulation, of early intervention measures or before conducting a 'failing or likely to fail' assessment. Besides, in such cases, it is the legislator who has *ex ante* defined a sort of physiological progressivity between supervisory actions, placing them on an ideal scale of increasing impact on the credit institution. The ECB should also consider, according to a prognostic analysis, the potential effects of a supervisory measure on the reputation and trustworthiness of a credit institution, i.e. the risks arising from negative perception on the part of customers, shareholders, investors and market analysts. Similar considerations apply to the publication of decisions imposing administrative penalties on credit institutions.[108]

A very delicate assessment of proportionality underpins the *ex officio* withdrawal of a banking license.[109] Such decision should be indeed understood as an *extrema ratio* measure, subject to a strict proportionality assessment, given its de facto irreversible impact on the credit institution and on its shareholders. It comes therefore as no surprise that two appeals are currently pending before the Court of Justice alleging a breach of the principle of proportionality of ECB decisions withdrawing the banking license.[110]

Furthermore, a proportionate approach to supervision requires to assess the impact of a supervisory measure against the risk that such measure is intended to prevent.[111] According to a risk-based approach, the ECB should carefully weigh up the impact of the intended measure with the risk raised by the credit institution, the likelihood of its verification, and the negative consequences on the single entity, on its stakeholders and/or on the banking system as a whole, also considering potential spill-over effects. Such operation always implies a probabilistic – hence discretionary – assessment of a future and uncertain event. In this respect, one may

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[108] *See* Art. 18.6, SSM Regulation and Art. 132.1, SSM Framework Regulation.

[109] As the former Vice-Chair of the Supervisory Board, Sabine Lautenschläger, made it clear in a Lecture at the Florence School of Banking and Finance (Florence, 15 Mar. 2018): 'Imagine a bank breaches capital requirements. Then we have to ask how severe that breach is and whether it might just be temporary. If it's just a marginal breach which could be healed within a reasonable period of time, it might not be proportionate to declare the bank "failing or likely to fail". We also need to take into account that a bank depends on the markets. So how do they react? A bank in trouble might quickly lose the trust of the markets. This could lead to a bank run, which requires supervisors to act differently'.

[110] *See* Case T-698/16, *Trasta Komercbanka v. ECB*, Case T-321/17 and *Niemelä and Others v. ECB*, still pending (accessed 4 July 2020).

[111] *See* in particular, M.Passalacqua, *A Possible Reconstruction of Risk Regulation in Financial Markets*, in *Ius publicum*, 2013, claiming that 'risk acquires legal relevance as a "regulatory" parameter for the ensuing adoption of precautionary and preventive measures intended to avoid future damages'.

distinguish between preventive (and precautionary) measures and corrective measures. In fact, only for the former a probabilistic assessment of the risk is needed, while for the latter the risk that the legal provision intended to avoid has already occurred and positively ascertained by the authority. Accordingly, also the proportionality test will be slightly different in the two cases. As for corrective measure, the proportionality assessment seems simpler, as it does not require a predictive evaluation of uncertain elements; on the contrary, the proportionality test of a preventive measure should always take into account not only the impact on the addressee, but also the seriousness, the probability, the timing, the nature and scale of the risk to be addressed. By way of example, the same supervisory measure could be deemed disproportionate if intended to avoid a risk that appears unlikely and far in time and, by contrary, proportionate if the risk is highly probable or imminent.

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At the same time, such balancing operation requires assessing the risks in light of the legitimate objective pursued by the relevant legal provision conferring the supervisory power. As it is well-known, the primary objective of prudential supervision is anticipating and preventing any risks or shocks that may arise to the stability of the financial system and to the safety and soundness of credit institutions. Such general objective should be assessed on a case-by-case basis, also taking into account the specific objective underpinning each legislative provision conferring preventive or precautionary supervisory powers to the ECB.[112]

2.2[b] *A Proportionate Approach to Banking Supervision: The Role of Soft Law Acts*

A proportionate approach to banking supervision can also be fostered by the adoption of non-binding administrative rules, such as internal guidelines, methodologies or policy stances. As it is known, soft law measures cannot be considered as 'rules of law' which the administration is bound to observe, but rather 'rules of practice',[113] of a flexible nature, from which the administration may not depart in an individual case without giving adequate reasons.

The ECB, within the exercise of its supervisory discretion, adopted a wide set of non-binding acts attempting to operationalize proportionality within the decision-making process. This is a positive development, as it provides operational

[112] *See* for instance, Art. 429 CRR aiming at constraining excessive exposures irrespective of the riskiness of the institution's investments, and the derogation contained in para. 14 of the same article, as interpreted by the General Court in *La Banque Postale*, *supra* n. 47.

[113] Joined Cases C-189/02, C-202/02, C-205/02 to C-208/02 and C-213/02, *Dansk Rørindustri* ECLI:EU:C:2005:408, para. 209. While not imposing any obligations on third parties, these instruments bind the ECB and create legitimate expectations as to how the ECB will perform its supervisory tasks.

guidance to the ECB's Business Units in charge of conducting a day-to-day prudential supervision.[114]

For instance, proportionality plays a key role in relation to the performance of the supervisory review and evaluation process (SREP). Article 97.4 CRD IV requires competent authorities to establish 'the frequency and intensity of the review and evaluation (…) having regard to the size, systemic importance, nature, scale and complexity of the activities of the institution concerned and taking into account the principle of proportionality'. In this vein, EBA Guidelines on the revised common procedures and methodologies for the SREP and supervisory stress testing lists a number of factors and elements that supervisory authorities should consider within the evaluation process in order to apply prudential requirements in a proportionate manner. The ECB on its part also published internal documents setting out general criteria and methodologies of the SREP. As for less significant institutions (LSIs), the ECB adopted a Methodology booklet addressed to national authorities laying down different approaches to LSIs, based on the riskiness of the bank and its potential impact on the domestic economy. The ECB Methodology classifies LSIs as high-priority or non-high-priority institutions with a view to determine the intensity, the frequency and the granularity of the SREP assessment, as well as the supervisory expectations and the information reporting requirements.[115] This soft law document fosters a proportionate approach to banking supervision by setting out a 'minimum supervisory engagement model' for small and non-risky banks.

Moreover, proportionality explicitly applies to the assessment of the fitness and propriety (FAP) of the members of the management bodies of the supervised entities, according to Article 4.1(e) of the SSM Regulation and Articles 91 et seq. of the CRD IV. The ECB Guide to fit and proper assessments specifies how suitability criteria should be commensurate with the size of the credit institution, the nature, scale and complexity of its activities, as well as the particular role to be filled. The Guide describes in detail the modality of FAP assessment, at the same time it introduces open-textured 'materiality' thresholds to be assessed on a case-by-case basis, 'in a balanced way, weighing up the factors that speak in favour of and against the appointee'.[116] The FAP assessment too can result in a 'differentiated

[114] An exhaustive list of ECB non-legally binding legal acts, instruments and documents is provided by R. Bax & A. Witte, *The Taxonomy of ECB Instruments Available for Banking Supervision*, (6) ECB Econ. Bull. (2019).

[115] *See* the Report from the Commission on the Single Supervisory Mechanism (Brussels, 11 Oct. 2017 COM(2017) 591 final) claiming that 'flexibility and proportionality means that NCAs are able to adapt their supervisory activities to the size, complexity and riskiness of the respective institutions. In this context, especially the ECB's efforts to develop a SREP methodology for LSIs i.e. based on the SREP methodology for SIs, but embeds features that allow for proportionality and supervisory flexibility, are much welcomed'.

[116] ECB FAP Guide, Principle 5 (Principles of due process and fairness).

approach to the assessment procedure or the application of suitability criteria (...) and will come down to an individual analysis and supervisory judgment'.[117]

Proportionality considerations also permeate the ECB Guidance to banks on non-performing loans (NPL),[118] setting out differentiated strategies according to the levels of NPLs. Proportionality also features as an organizing principle as:

> all banks need to have in place an appropriate and proportionate organisation relative to their business model (...). High NPL banks are therefore expected to devote an appropriate and proportionate amount of management attention and resources to the workout of those NPLs and to the internal controls of related processes.[119]

Finally, the principle of proportionality has been key in harmonizing the exercise of options and discretions (O&Ds) left to supervisors in applying EU legal rules. In order to ensure a level playing field and a consistent application of supervisory standards across the Euro area, the ECB decided to also harmonize the exercise of O&Ds for smaller banks through a recommendation addressed to national competent authorities.[120] At the same time, this exercise allowed the ECB to put forward a regulatory strategy capable of accommodating, where appropriate and necessary, the differences between significant and less significant banks. The soft law instruments adopted by the ECB pay adequate attention to proportionality. Overall, they represent a suitable tool for improving a proportionate approach to supervision. In fact, on the one hand, they lay down flexible and operational indications, based on general principles and open-textured formulas which do not excessively constrain the ECB's margin of discretion and allow a tailored evaluation of every single case. On the other hand, they seem capable of guiding the ECB Business Units in the exercise of a proportionality check within each assessment procedure. Furthermore, the publication of such guidelines and methodologies increases the transparency of the ECB's action and fosters the predictability of its supervision.

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[117] ECB FAP Guide, Principle 4 (Proportionality) making reference to many criteria such as 'the level or areas of knowledge, skills and experience, or in terms of the time commitment required of members of the management body in its management function and members of the management body in its supervisory function'. Moreover, for each criterion the ECB Guide provides a further guidance as to the assessment of proportionality. *See* for instance, the criterion of 'good reputation', in relation to which the Guide affirms that 'Members of the management body shall at all times be of sufficiently good repute to ensure the sound and prudent management of the supervised entity. Since a person can either have a good or a bad reputation, the principle of proportionality cannot apply to the reputation requirement or to the assessment of the reputation requirement, which should be conducted for all institutions in an equal manner'.

[118] ECB Guidance to banks on non-performing loans, Mar. 2017.

[119] ECB Guidance to banks on non-performing loans, at 23.

[120] ECB Recommendation of 4 Apr. 2017on common specifications for the exercise of some options and discretions available in Union law by national competent authorities in relation to less significant institutions (ECB/2017/10).

2.2[c] *The Principle of Proportionality as an Organising Principle*

In broader terms, the principle of proportionality can also be understood as an organising principle,[121] impacting the whole structure of the SSM and the internal organization of the ECB.

On the one hand, proportionality affects the distribution of responsibilities between the ECB and national authorities. The architecture of the SSM is designed to enshrine proportionality to the extent that it is based on the distinction between significant and less significant institutions. Accordingly, proportionality concerns have been addressed at legislative level and cannot be used to subvert such distinction according to a case-by-case evaluation.[122] However, the ECB should abide to the principle of proportionality also when adopting individual decisions regarding the qualification of a bank as significant or less significant including the application of the 'particular circumstances' clause under Article 70 SSM Framework Regulation or when deciding to take over the supervision of an LSI pursuant to Article 6.5lett. b) SSM Regulation.

On the other hand, proportionality also plays a key role as an efficiency principle influencing the ECB's internal organization. In this vein, the size and the overall composition of JSTs should reflect the nature, complexity, scale, business model and risk profile of the supervised entity. The decision-making procedures are also influenced by proportionality considerations, as it has been made clear by ECB Decision 2017/933 setting out a general framework for delegating decision-making powers.[123] In this respect, proportionality requires to strike the balance between supervisory efforts and resources, on the one hand, and supervisory outcomes, on the other. This is also clarified by Principle 7 of the ECB Guide to Banking Supervision stating that 'the implementation of this principle facilitates an efficient allocation of finite supervisory resources'.

Overall, in its organizational dimension, the principle of proportionality functions as a tool to ensure good administration and the correct allocation of administrative powers and resources within the SSM. Under this perspective, the

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121 Zilioli, *supra* n. 23.

122 *See Landeskreditbank*, *supra* n. 31.

123 *See* Recital 6 of ECB Decision 2017/933: 'A Union institution may therefore establish measures of an organizational nature, delegating powers to its own internal decision-making bodies, insofar as such measures are justified and respect the principle of proportionality'. *See also* the Report from the Commission on the Single Supervisory Mechanism observing that 'disproportionate use of the ECB's resources in case of routine decisions or decisions with a lower overall Impact (…) often required a disproportionate amount of efforts and resources from both the ECB and the NCAs in preparing the formal decision-making process'.

proportionality principle pursues an efficiency rationale, which appears primarily oriented at ensuring the effective and consistent functioning of the SSM.[124]

2.3 The principle of proportionality in monetary policy

It is well-known that the EU Treaties do not contain a precise definition of monetary policy. Yet, primary law contains a number of provisions regarding the mandate, the objectives, the tasks and the implementing instruments of the ECB and of the European System of Central Banks (the 'ESCB').[125] Article 127 TFEU provides that 'The primary objective of the European System of Central Banks shall be to maintain price stability' and that '[w]ithout prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union'. Chapter IV of Protocol No. 4 (the Statute of the ESCB and of the ECB) lays down the monetary policy operations available to the ECB and to national central banks. Primary law also defines the limits and boundaries of the monetary function, e.g. by prohibiting monetary financing of Member State or preventing the ECB from directly carrying out economic or fiscal policies. Furthermore, the TFEU specifies that monetary policy for the Member States whose currency is the Euro falls within the EU exclusive competences[126] and that in this field the ECB is the only EU institution empowered to adopt legal acts such as regulations, decisions, recommendations, and opinions.[127]

Within the limits of the powers conferred upon it, the ECB enjoys a particularly wide margin of discretion in drafting, announcing, and implementing the most adequate instruments for achieving the objectives set out in the Treaties. Contrary to banking supervision, the ECB's discretion in monetary policy is not heavily constrained by a detailed legal framework composed of binding rules and soft law acts. In monetary policy, the principle of proportionality thus becomes one of the most important constraints for the ECB.

The issue of proportionality of ECB monetary policy measures recently hit the scene in relation to the adoption of unconventional measures. In normal times, central banks can maintain price stability over the medium term by steering the

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[124] *See* Angeloni, *supra* n. 84, claiming that the distinction between SIs and LSIs 'is an operational necessity: a proportionate way to ensure an efficient supervision over such a large and diversified bank population must rely on a division of labour between the ECB and the national authorities'.

[125] For a comprehensive overview of the ECB institutional framework, *see* in particular C. Zilioli & M. Selmayr, *The Law of the European Central Bank* (Oxford 2001); R. Smits, *The European Central Bank. Institutional aspects*, (The Hague 2007); R. Lastra & J.-V. Louis, *European Economic and Monetary Union: History, Trends and Prospects*, Y.B. Eur. L. (2013).

[126] Article 3.1 (c) TFEU.

[127] Article 132 TFEU.

level of key interest rates. In times of deep recession or economic crisis, however, when the transmission channel of monetary policy is severely impaired, conventional monetary tools may prove inadequate to achieve monetary objectives. This requires central banks to expand the money supply by resorting to direct lending to the private sector, or to outright purchases of government bonds, corporate debt or other debt instruments.[128] Such policy choice is widely discretionary as it entails both a delicate balancing of diverse interests and complex economic assessments.

In this respect, it is worth recalling that there is not a legal distinction between conventional and unconventional monetary tools[129] and that both measures are legally available to the ECB in so far as it acts within the limits set out in the Treaties.[130] Accordingly, unconventional measures cannot be considered as an extension of the ECB's mandate, nor do they represent an expression of the 'implied powers' theory. Likewise, proportionality cannot be invoked to expand the ECB's mandate beyond the powers conferred upon it by the Treaties. Proportionality considerations, therefore, come into play only after the ECB has verified that the intended measure is not an *ultra vires* act and that it responds to the primary objective of price stability.

In monetary policy, an *ex ante* proportionality assessment implies that the ECB's actions must, first, be suitable to address the identified risks to price stability. In that respect, the ECB should assess whether and when conventional measures prove insufficient and non-standard tools become more appropriate for achieving

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[128] On the distinction between conventional and unconventional monetary policy measures, L. Bini Smaghi, *Conventional and Unconventional Monetary Policy*, Keynote lecture at the International Centre for Monetary and Banking Studies (ICMB), (Geneva 28 Apr. 2009), arguing that 'unconventional measures can be defined as those policies that directly target the cost and availability of external finance to banks, households and non-financial companies. These sources of finance can be in the form of central bank liquidity, loans, fixed-income securities or equity'.

[129] The distinction is drawn from the economic literature and it relies on the fact that unconventional measures have not been previously used. *See ex multis*, M. Stone & E. B. Yehoue-K. Ishi, *Unconventional Central Bank Measures for Emerging Economies*, IMF Working Papers n. 09/226; P. Cour-Thimann & B. Winkler, *The ECB's Non-standard Monetary Policy Measures: The Role of Institutional Factors and Financial Structures*, ECB Working Paper, No. 1528 Apr. 2013. From a legal perspective, unconventional (or non-standards) tools can be defined as measures with medium/long-term objectives period not directly affecting the interest rate. *See* for instance, A. Durré, F. Drudi & F. P. Mongelli, *The Interplay of Economic Reforms and Monetary Policy: The Case of the Euro Area*, 50 J. Com. Mkt. Stud. 881–898 (2012). *See* however, in legal doctrine M. R. Lastra, *The Evolution of the European Central Bank,* 35(5) Fordham Int'l L. J. 1260 at 1268 (2017), arguing that 'the ECB has used standard and nonstandard measures of monetary policy in response to the crisis to ensure the proper working of monetary transmission and the provision of liquidity to the euro area banking system. Standard measures are open market and credit operations (Art. 18 ESCB Statute), and minimum reserves (Art. 19 ESCB Statute)'.

[130] The OMT programme, for instance, formally belongs to the operations provided for in Art. 18.1 of the ESBC Statute. However, as clarified by A. G. Villalon in his Opinion to the Case C-62/14, *Gauweiler*, *supra* n. 64, at para. 120, 'the OMT programme uses the powers set out in Article 18.1 of the Statute in a way which is at some remove from the ECB's standard practice in carrying out its operations'.

price stability. Secondly, the ECB's intervention must be necessary to achieve the proposed objective and cannot go manifestly beyond what is necessary to achieve that objective. Unconventional tools include a broad range of measures aimed at easing financing conditions. The ECB has to assess whether alternative measures (including conventional and/or the combination of other non-conventional tools), would not permit to achieve the primary objective as effectively and rapidly.[131] Furthermore, the ECB cannot consider only the effects on its primary purpose, but also any other potential side-effects (e.g. on bank profitability). Monetary policy measures, especially unconventional ones, always have distributional effects and strongly impact the economy at large.[132] they have, in short, a political dimension. This is why, from an *ex ante* perspective, the third limb of the proportionality test (the *stricto sensu* proportionality assessment) is of crucial importance. According to a prognostic (hence, inevitably uncertain) and to a (as far as possible) all-encompassing analysis, the ECB should assess that the expected benefits of a monetary policy measure outweigh its overall costs and that potential side effects are not manifestly disproportionate to the primary objective of price stability. One cannot ignore however that such weighing operation is highly complex and controvertible as non-standard measures have not been previously applied and this reduces the predictability of their effects.

The ECB is therefore required to constantly monitor the proportionality of the adopted measures in order to preserve the right balance between costs and benefits. In this respect, proportionality can also be attained by attaching safeguards, time-limits, eligibility criteria and other restrictions to monetary measures, with a view to limit the scope of monetary intervention and to prevent an excessive interference with the economic and fiscal policies.

Finally, one may argue that the ECB communication strategies also contributed to a more gradual and proportionate impact of unconventional measures. By previously announcing and publicly explaining the content and the aim of monetary interventions, the ECB could test the reaction of the markets before implementing the measure.[133] This, in turn, also fostered the transparency and accountability of ECB monetary policies during the crisis.

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[131] Y. Mersch, *Necessity, Proportionality and Probity – Central Bank Independence in Unconventional Times*, Speech at the ECB and its watchers XX conference, Frankfurt am Main, (27 Mar. 2019) argues that the principle of proportionality provides for 'a hierarchy of tools, where unconventional measures should be used only once conventional measures have been exhausted'.

[132] *Ibid.*

[133] On the ECB communication strategies *see ex multis*, D. Masciandaro & D. Romelli, *From Silence to Voice: Monetary Policy, Central Bank Governance and Communication*, Baffi Carefin Centre Research Paper series, No. 2016/27; A. Canepa, *L'intervento della BCE nella crisi fra misure di politica monetaria non convenzionali e strategie di comunicazione*, in *La banca centrale europea: il custode della costituzione economica* 191 (C. Buzzacchi (a cura di), Milan 2017).