



Università
Ca' Foscari
Venezia
Dipartimento
di Economia



With the support of the
Erasmus+ Programme
of the European Union

JEAN MONNET CHAIR

"DIGITALISATION IN EU FINANCIAL STUDIES" - EUDIFIN

The main responsibilities of the ECB: interactions and potential problems between monetary policy and prudential supervision.

Angelica Tiozzo Caenazzo Anzolin

MSc Student in Finance

Ca' Foscari University of Venice

EUDIFIN course: International Financial Regulation



EUDIFIN

RESEARCH WORKING PAPER NO. 11

JULY 2020

NOTICE

The work has been produced by the author in the framework of EUDIFIN's teaching and research activities.

As part of the assessment methods, each EUDIFIN courses require students to engage in a research-oriented assignment. This assignment prompts students to deal with the current political and scholarly debate revolving around the challenges the European Union faces to further integration in the internal financial market. This learning experience rewards those students who demonstrate interest, commitment and dedication, and who are keen to channel this enthusiasm into a "contest" between peers for the best "Research Papers".

The best papers will be published as EUDIFIN Working Paper on the EUDIFIN website of Ca' Foscari University of Venice.

UNIVE.EUDIFIN



Abstract

The new banking supervisory framework, implemented after the financial crisis of 2007, introduced relevant changes for what concerns the organisation of the regulatory and supervisory fields. In particular, the European Central Bank (ECB), which already had the primary authority in terms of defining and implementing the monetary policy of the euro area, was empowered with prudential supervisory responsibility. Embedding two such delicate and distinct functions within the same European institution entails, undoubtedly, positive interactions and benefits for their performances by the ECB, as well as potential negative consequences that need to be taken into account and efficiently tackled. The purpose of the present paper is the analysis of the interplay between the monetary and supervisory policies carried out by the ECB, focusing on the measures that should be implemented in order to guarantee the effectiveness of the two functions. The main results of this work relate to the fact that the benefits of integrating monetary policy and prudential supervision within the same institution outweigh the potential risks; however, possible repercussions of monetary policy decisions on financial stability should always be considered.

Key Words: ECB, monetary policy, prudential supervision, financial stability.

Summary

1.	Introduction	5
2.	ECB	6
2.1.	Relevant features and purposes	6
2.2.	Monetary policy function	7
2.3.	Supervisory function	9
3.	Interactions	11
3.1.	Benefits	12
3.1.1.	Informational advantages	12
3.1.2.	Coordination	13
3.1.3.	Independence	13
3.2.	Potential problems to address	14
3.2.1.	Reputational risks	14
3.2.2.	Conflicts of interests and biased decision-making	14
3.2.3.	Loss of independence and excessive power	15
4.	How to tackle the problems	15
5.	A controversial instrument: APP	17
6.	Conclusion	18
	Bibliography	20

1. Introduction

During the 2007-2008 financial crisis, the problem of fragmentation within the regulatory and supervisory frameworks in the European Union (EU) became clear and particularly relevant, emphasising an urgent need for harmonisation. The first aspect was tackled by creating a tier system for banking regulation, where the three levels are strictly related among them. The supervisory problem, instead, underwent a complete redesign that occurred in two phases: the first involved the creation of the European System of Financial Supervisors (ESFS), whereas the second consisted in the establishment of the European Banking Union (EBU). With the creation of this Union the ECB, besides its major role as monetary policy maker, was granted the authority to carry out the prudential supervision function within the Eurozone. Since then, the Central Bank is responsible for the achievement of two distinct objectives, price stability and financial stability, although the focus should always lie on monetary policy, thus aiming at the maintenance of price stability as its primary task. It follows that the incorporation of two such essential conditions within a single institution, the ECB, is on the one hand strategic and, on the other, quite delicate and problematic. To overcome potential conflicts between monetary and supervisory responsibilities, the principle of separation is of particular importance: the Central Bank ensures that the objectives, decision-making processes and tasks between the two domains are separated.¹

The scope of this paper is mainly the double-sided authority and responsibility of the Central Bank within the euro area, according to the legal basis of its purpose (Article 127 of the Treaty on the Functioning of the European Union [TFEU]).

The relevancy of the topic under consideration relates to the fact that it represents a great step in the history of the European banking system and that it remains very timely still today, given that finance is among the most dynamic and ever-changing sectors.

The aim of the paper is the analysis of the various interconnections that take place between the monetary and supervisory functions of the ECB, including positive interactions as well as potential problems that need to be addressed.

¹ Cassola, Kok, and Mongelli, "The ECB After the Crisis."; "ECB Website."

As leitmotif of this analysis, the following aspect should be considered: since it is clear enough that the ECB has a central role in the definition of the monetary policy of the Eurozone and that its authority has been empowered with prudential supervisory tasks, how can the implementation of the two functions be strictly separated on a legal basis and, simultaneously, in need of collaboration and synergies? And, more specifically, allowing for these interactions between the two functions, potential challenges arise and should be addressed: should any repercussion of monetary policy on financial stability be taken into consideration?

This work comprises, besides the abstract and the present introduction, other five sections. Firstly, a brief description of the ECB is provided, focusing on its peculiarities and on the two main functions of monetary and prudential supervisory policies. After that, the interplay between the two domains is analysed: the benefits of integrating the two functions in a single institution are mainly in terms of informational advantages, coordination of policies and independence for the supervision; on the other side, the potential drawbacks that could occur are related to reputational risks, conflicts of interests and biases on the decision-making process, loss of independence and gain of excessive power. The following chapter deals with the measures to be taken in order to prevent or tackle these possible problems. Then, the focus moves to a specific and controversial instrument of monetary policy, the Asset Purchase Programme (APP), which is described and analysed also through a case law, thus highlighting the potential repercussions of monetary policy issues on the stability of the financial system. Lastly, the conclusion contains the principal remarks of this analysis.

2. ECB

2.1. Relevant features and purposes

The ECB, established in 1998 by the Treaty of Amsterdam and headquartered in Frankfurt, is the central bank for the 19 countries of the Eurozone. Together with the national central banks of the 27 Member States of the EU, it constitutes the European

System of Central Banks (ESCB)²; furthermore, the ECB and the national central banks of the Member States whose currency is the euro form the Eurosystem, according to the just-mentioned Article. As part of the system, whose primary objective is the maintenance of price stability³, the main aim of the ECB translates into conducting monetary policy and, thus, maintaining price stability within the Eurozone over the medium term.⁴ The legal basis for the afore-mentioned purpose of the ECB is provided by Article 127 TFEU. However, paragraph 6 of this Article extends the powers of the ECB, including an important role for the institution within the supervisory field, although confined to the prudential level: indeed, the Article underlines that the European Council and Parliament may confer specific tasks on the ECB in terms of prudential supervision of credit institutions and other financial institutions, excluding insurance undertakings. It follows that the ECB has developed two distinct objectives: in addition to the original and primary purpose related to monetary policy, the Central Bank is also entitled to perform a supervisory activity, but only in terms of prudential supervision.

2.2. Monetary policy function

As already stated, monetary policy is the primary commitment of the ECB. The aim of its monetary policy is the stability of prices, defined by the institution itself as a yearly increase in the Harmonised Index of Consumer Prices (HICP) for the Eurozone lower than 2%.⁵ To this end, the ECB is also concerned about keeping inflation rates below, but close to, 2%.

To get a better understanding of this function, the sources of EU monetary law should be considered. According to Article 3(4) of the Treaty on European Union (TEU), the EU is required to constitute both an economic and a monetary union, where the euro is the single currency. Besides the economic aspect, the establishment of a monetary union within the Eurozone implies the definition of an independent monetary policy by the ECB and the introduction of a single currency and of a single regulation and

² Art. 1 of the Statute of the ESCB and of the ECB, in accordance with art. 282(1) TFEU.

³ Art. 2 of the Statute of the ESCB and of the ECB, in accordance with art. 127(1) and art. 282(2) TFEU.

⁴ "ECB Website."

⁵ Ibid.

supervision of financial institutions in the euro area. This idea is stressed in Article 119 TFEU, with paragraph 2 requiring that a single currency is set and a single monetary policy is defined and conducted, always supporting the leading goal of price stability. With particular emphasis on monetary policy, Article 127 TFEU (already presented as the legal basis for the ECB's purpose) provides clear insights into the issue. In addition to price stability, the ESCB is also required to sustain the general economic policies in the EU. The Article, then, describes the basic tasks of the ESCB as "to define and implement the monetary policy of the Union, to conduct foreign-exchange operations consistent with the provisions of Article 219, to hold and manage the official foreign reserves of the Member States, to promote the smooth operation of payment systems."

The functioning of the ESCB is based, essentially, on the Statute of the ESCB and of the ECB (hereinafter referred to as "the Statute"). Inter alia, it states that the main operations for the ECB and the national central banks to achieve the ESCB's objective and perform its tasks are open market and credit operations.⁶ A more complete set of monetary policy instruments comprises open market operations, non-standard monetary policy measures and standing facilities. Regular open market instruments include both *main refinancing operations* (MROs) and *longer-term refinancing operations* (LTROs), which are liquidity-providing reverse transactions in euro with maturity and frequency of, respectively, one week and three months; other open market instruments are *fine-tuning operations*, designed to reduce the impact of unexpected liquidity fluctuations on interest rates, and *structural operations*, aimed at regulating the structural position of the Eurosystem with respect to the financial system. Among non-standard measures there are *LTROs with three-year maturity, targeted longer-term refinancing operations* (TLTROs), offering long-term financing at attractive conditions to credit institutions in order to improve credit conditions in the private sector and prompt lending to the real economy, and *asset purchase programmes* (APPs), which are outright asset purchases to stimulate growth across the Eurozone and support the inflation objective. Lastly, standing facilities deal with overnight provision and absorption of liquidity, are decentralised to national central banks and include two instruments: the *marginal lending facility* allows credit institutions to obtain overnight credit from the Eurosystem (against adequate eligible assets), while the *deposit facility* allows credit institutions to make overnight deposits

⁶ Art. 18 Statute.

with the Eurosystem. In particular, for the ultimate goal of controlling inflation rates and prices, the ECB can effectively influence the financing conditions in the economy by dealing with specific interest rates. To this aim, the key rates set by the ECB's Governing Council are the ones on the MROs, on the marginal lending facility and on the deposit facility. Since the rates on the marginal lending facility and on the deposit facility are, respectively, above and below the MROs' rate, they represent a ceiling and a floor for the overnight market interest rate at which banks lend to each other, defining a sort of acceptable range.

It is to consider that the ECB and the national central banks are subject to the monetary financing prohibition⁷: they are prevented from providing any type of credit facility to institutions within the public sectors of the EU and Member States, and also from purchasing debt instruments directly from them. In addition to this, the ECB's Governing Council is empowered by the Statute to limit Emergency Liquidity Assistance (ELA) operations⁸, should they be in contrast with monetary policy.

As a final consideration, in the context of monetary policy the decision-making process results to be mostly centralised, while national central banks are responsible for the performance of most Eurosystem's operational tasks; nevertheless, functional reasons are strongly centralised.⁹

2.3. Supervisory function

As a response to the financial crisis of 2007 and to the core problem of fragmentation and heterogeneity in the domain of banking supervision, the EU adopted a two-step solution to create a new adequate supervisory model. The main deficiency in the institutional frameworks at that time was the focus limited to the micro-prudential level, addressing the risk of individual bank failures, without considering the consequences on the risk of the whole financial system.¹⁰ Therefore, a relevant improvement was the recognition of the need to address also the risk of a system failure. In 2010 the first step

⁷ Art. 123 TFEU.

⁸ The ECB is not allowed to provide ELA, only national central banks can become lenders of last resort (LOLR) and provide ELA to a financial institution, under precise conditions.

⁹ Cassola, Kok, and Mongelli, "The ECB After the Crisis."

¹⁰ Carboni, Pariès, and Kok, "Exploring the Nexus."

consisted in the establishment of the ESFS, according to which the European Supervisory Authorities (ESAs) are responsible for micro-prudential supervision, and the European Systemic Risk Board (ESRB) is instituted as a specific body to deal with the macro-prudential supervision of the whole financial system and, in particular, with systemic risks to financial stability in the EU.¹¹ The second EU response, aimed at organising a centralised system, translated into the creation of the EBU between 2014 and 2016: it is based on three different pillars dealing with specific tasks, the first of which is the Single Supervisory Mechanism (SSM), targeted at the joint supervision of significant banks. Composed of the ECB and the national competent authorities (NCAs), it is a composite and coordinated system where the Central Bank plays a leading role. As mentioned in the initial paragraph on the ECB, its legal basis (Article 127 TFEU) highlights the prevailing monetary tasks, although admitting the possibility of being assigned specific supervisory responsibilities. The legal basis 127(6) is the foundation of the SSM Regulation¹², which empowers the ECB with precise powers and tasks related to the prudential supervision of credit institutions, whereas the NCAs are held responsible for conduct supervision. In particular, the ECB is required to contribute to the safety and soundness of credit institutions and to the stability of the financial system, and to guarantee the equal treatment of credit institutions.¹³ Therefore, the ECB is assigned a key macro-prudential role and, according to Article 5 SSM Regulation, it has the power to implement the macro-prudential measures defined in the EU legal acts transposing Basel III regulatory standards (Capital Requirements Directive [CRDIV]¹⁴ and Capital Requirements Regulation [CRR]¹⁵).¹⁶ The distribution of powers and tasks as well as the cooperation within the SSM between the ECB and the NCAs are clearly defined in the SSM Regulation¹⁷, where it is underlined that the Central Bank is exclusively competent for all the institutions in the participating Member States when dealing with specific activities, for instance granting and withdrawing licenses, authorising qualifying holdings, performing stress tests and Fit and Proper tests in the process of authorisation. It also states that most duties lie on the NCAs, while for the day-to-day supervision a separation in terms of significance

¹¹ Art. 3 Reg. (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010.

¹² Council Regulation (EU) No 1024/2013 of 15 October 2013.

¹³ Art. 1 SSM Regulation.

¹⁴ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013.

¹⁵ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013.

¹⁶ Carboni, Pariès, and Kok, "Exploring the Nexus."; Cassola, Kok, and Mongelli, "The ECB After the Crisis."

¹⁷ Art. 4 and art. 6 SSM Regulation.

applies: the ECB is responsible for significant institutions, while less significant institutions are under the scope of action of the NCAs. The Regulation provides precise specifications regarding the criteria for assessing the significance of a bank.

To conclude this overview on supervision, micro-prudential oversight is conducted in a centralised manner by the ESAs, while macro-prudential supervision is performed both at national and central levels by the NCAs, the ECB and other supranational authorities¹⁸ (namely, the ESRB). Therefore, it could be argued that fragmentation is still in place, with responsibilities being distributed between the ECB and the NCAs, but, actually, harmonisation is pursued, since the ECB has a coordinating role and is required to instruct national authorities, according to the Single Supervisory Handbook.

3. Interactions

Despite the fact that the different functions assigned to the ECB, in particular monetary policy and macro-prudential supervision, are legally distinct and must be kept separated, there exist a number of interactions between them, involving positive trade-offs as well as potential conflicts.¹⁹ The rationale for a coordination between the two domains is given by the fact that macro-prudential instruments, aimed at stabilising the financial system, have a certain influence on monetary policy and on its aim of price stability.²⁰ It follows that price stability and financial stability are complementary goals and should, thus, be mutually reinforcing, considering that the latter can bring significant improvements in monetary policy performance in terms of output and inflation²¹; however, financial stability is only necessary, but not sufficient, to maintain price stability, and vice versa. Indeed, price stability could be achieved also before the ECB was given the responsibility for banking supervision.

It is proved that the positive interplay between the two functions is particularly relevant during economic and financial downturns²², when the information and data collected

¹⁸ Cassola, Kok, and Mongelli, "The ECB After the Crisis."

¹⁹ Ibid.

²⁰ Carboni, Pariès, and Kok, "Exploring the Nexus."

²¹ Angelini, Nicoletti-Altamari, and Visco. "Questioni di Economia e Finanza."

²² Benoît, "Monetary Policy and Banking Supervision."

and provided by the supervisory activity may be of essential help in the implementation of monetary policy.

Among the interactions, a crucial aspect to consider is related to the decision-making process. All the policy decisions of the ECB are attributed to its Governing Council, which is assisted by the Executive Board for monetary policy issues and by the SSM's Supervisory Board for banking supervision and macro-prudential matters.²³ However, in accordance with the already-mentioned principle of separation, the members of the Supervisory Board are rigorously excluded from decisions about monetary policy.

3.1. Benefits

The positive effects of the interconnectedness between monetary policy and banking supervision analysed in this paper refer mainly to the benefits coming from integrating the supervisory role, through the SSM, into the ECB.

3.1.1. Informational advantages

First of all, a great contribution relates to informational advantages, referring to an easier and regular flow of information. Indeed, through the supervisory activity, additional data on the financial system and the state of the economy are gathered together, besides the valuable information collected in the first place thanks to the monetary analysis; the increased volume of information allows the ECB to enjoy a deeper knowledge about the functioning of the banking sector and to better assess the available monetary policy options, including non-standard monetary policy measures.²⁴ In fact, improvements in the conduct of monetary policy are made possible thanks to a more effective management of risk, as a consequence of exploiting enhanced information on the exposures and health of the financial system.²⁵ In addition to this, informational advantages lead also to a reduction in misjudgements

²³ Cassola, Kok, and Mongelli, "The ECB After the Crisis."

²⁴ Benoît, "Monetary Policy and Banking Supervision."

²⁵ Ampudia et al., "The Architecture of Supervision."

in the creditworthiness of counterparties in monetary policy operations: the Central Bank has a significant incentive to assure a rigorous banking supervision, which, in exchange, provides the ECB with greater control over its balance sheet.²⁶ Even more during crisis periods, the supervisory powers of the ECB can help act more effectively via the banking system, bringing advantages in terms of crisis resolution.²⁷

3.1.2. Coordination

Secondly, the integration of the supervisory function in the ECB implies the almost total absence of coordination failures²⁸: indeed, it creates the opportunity to closely coordinate the two policies and to account for the potential collateral effects they have on each other, ultimately leading to reduce inefficiencies²⁹. This includes also a greater consideration of the interactions between the different powers, which are legally distinct but, at the same time, embodied into a single institution, so that the interdependencies between them are more clearly understood.³⁰

3.1.3. Independence

Another benefit concerns the achievement of political and regulatory independence. In other words, since it is incorporated in the Central Bank, the supervisory function is to some extent exempted from political pressure and regulatory capture; it also benefits from the reputation of the ECB.³¹ Lastly, this ensures that the prudential task is performed by an institution that boasts a deep expertise in the field of macroeconomic and financial oversight.³²

²⁶ Benoît, "Monetary Policy and Banking Supervision."

²⁷ Goodhart, and Schoenmaker, "Functions of Monetary Policy.", 539-560, cited in Beck and Gros, "Monetary Policy and Banking Supervision.", 7.

²⁸ Cassola, Kok, and Mongelli, "The ECB After the Crisis."

²⁹ Ampudia et al., "The Architecture of Supervision."

³⁰ Benoît, "Monetary Policy and Banking Supervision."

³¹ Ampudia et al., "The Architecture of Supervision."

³² Smets, "Financial Stability and Monetary Policy."

3.2. Potential problems to address

Besides the positive aspects just analysed, the combination of the monetary policy and supervisory power within the ECB may entail some drawbacks, which could be particularly harmful for the achievement of the primary objective of the Central Bank's monetary policy, or for the maintenance of the stability of the whole financial system, unless properly addressed.

3.2.1. Reputational risks

One of the main issues to consider are reputational risks³³, i.e. the risks that individual bank failures, frauds or other negative events adversely affect the Central Bank's reputation. Indeed, if its reputation in the context of prudential supervision is damaged, then also its credibility as a regulator can be prejudiced.³⁴ In addition to this, responsibilities coming from monetary policy can lessen the effectiveness of the ECB as a banking supervisor.³⁵

3.2.2. Conflicts of interests and biased decision-making

In charge of both monetary policy and prudential oversight, it is often argued that there is the risk of conflicts between the different policy objectives of the ECB. In particular, it could happen that the Central Bank relaxes its monetary policy in order to avoid negative scenarios (for example, in favour of an institution that is in deep need³⁶), leading to an excessively loose monetary policy. In other words, the ECB may be more lenient as a supervisor than the NCAs. This would trigger an inflationary bias and, thus,

³³ Cassola, Kok, and Mongelli, "The ECB After the Crisis."

³⁴ Goodhart, "The Organisational Structure of Banking Supervision.", cited in Beck and Gros, "Monetary Policy and Banking Supervision.", 7.

³⁵ Masciandaro, "Monetary Policy and Banking Supervision."

³⁶ Gerlach, "Banking and Fiscal Union."

damage the Central Bank's credibility; in addition to this, credit institutions would be prone to increase the risk they bear because of moral hazard, and this would eventually undermine financial stability.³⁷

3.2.3. Loss of independence and excessive power

Lastly, embedding the SSM into the ECB could also lead to a loss in terms of independence: with its major role and increased responsibility, the Central Bank may be more exposed to political pressure. For instance, the prevention of costly bank restructurings or individual bank failures, in order to maintain financial stability, can trigger dangerous political intervention in the Central Bank's issues.³⁸ In these cases, the privileged situation of independence from governments is jeopardised in order to tackle politically-sensitive situations regarding financial regulation, supervision and resolution.³⁹

On the other hand, it is also underlined that empowering the Central Bank in such a manner can result in the inability to efficiently manage and control all the bodies of the institution itself and in a limited responsibility over legislatures and governments.⁴⁰

4. How to tackle the problems

In order to guarantee an effective cooperation between the monetary and supervisory functions within the single institution of the ECB, the potential drawbacks previously analysed should be adequately dealt with.

First of all, reputational risks can be prevented by ensuring an effective use of the SSM's competencies and policy instruments; in addition to this, the responsibilities of the two functions must be appropriately separated, considering also that the split in the

³⁷ Benoît, "Monetary Policy and Banking Supervision."

³⁸ Ibid.

³⁹ Dabrowski, "Interaction Between Monetary Policy and Bank Regulation."

⁴⁰ Beck, and Gros, "Monetary Policy and Banking Supervision."

internal functions should be reflected by an external division concerning communication.⁴¹

In terms of possible conflicts of interests, the problem can be safely managed by organising a governance structure that strictly separates the two areas: this implies a separation for what concerns the objectives, policy instruments, tasks, decision-making processes and bodies, and the Governing Council's meetings, also limiting its intervention in the field of supervision.⁴² Indeed, the primary objective of monetary policy should always be confined to price stability and the members of the decision-making bodies should differ.⁴³ Despite this, separation should not be confused with isolation, because interactions and cooperation between the monetary and supervisory roles should always be ensured.⁴⁴

Lastly, the independent status of the Central Bank can be guaranteed through a strict separation between the supervisory authority, represented by the ECB itself, and a different authority empowered with the specific responsibility for resolution⁴⁵: the latter is the Single Resolution Board (SRB), which works in cooperation with the National Resolution Authorities and is in charge of the centralised system dealing with banking crisis within the SSM, the so-called Single Resolution Mechanism (SRM).

It results that, in general, the separation principle should always be integrated and complied with, in all its forms and applications.

Furthermore, the Central Bank should always be prone to implement macro-prudential policies by applying capital and liquidity regulations, identify losses and individual failures in the banking sector.⁴⁶

⁴¹ Benoît, "Monetary Policy and Banking Supervision."

⁴² Ibid.

⁴³ Gerlach, "Banking and Fiscal Union."

⁴⁴ Benoît, "Monetary Policy and Banking Supervision."

⁴⁵ Ibid.

⁴⁶ Ibid.

5. A controversial instrument: APP

One of the most significant examples of the problems concerning the powers of the ECB is a widely-used (at least in times of crisis) instrument of non-standard monetary policy, known as APP. It has sometimes been criticised and condemned as an illegal attempt of the ECB to provide financial help to the economies in need, violating the monetary financing prohibition to which the Central Bank is subject, according to Article 123 TFEU. The programme represents one of the measures adopted by the ECB to tackle the problem of inflation rates that are too low during periods of financial distress, thus leading to the risk of periods of low inflation lasting for too long: it allows the Central Bank to maintain rates that are still low but close to the aimed 2% level over the medium term.⁴⁷ During the past crisis, the ECB developed a range of APP operations belonging to the so-called Expanded Asset Purchase Programme (EAPP), launched in 2015 and commonly known as Quantitative Easing (QE). In particular, in 2015 the Public Sector Purchase Programme (PSPP) was adopted by the Eurosystem, which conducted indirect net purchases of securities in the public sector.⁴⁸ More recently, in March 2020 a temporary APP, denominated Pandemic Emergency Purchase Programme (PEPP), was initiated in order to face the severe threat to the monetary policy transmission mechanism caused by the COVID-19 pandemic.⁴⁹

Besides the Gauweiler case⁵⁰, the PSPP constitutes another example where the ECB's monetary policy is addressed constitutional complaints by the Federal Constitutional Court, referring, inter alia, to the violation of Article 123 TFEU. In this case, the sentence of the Court of Justice of the European Union (CJEU) of 11 December 2018 (Case C-493/17 Weiss and others) stated, firstly, that the ECB did not overpass its Treaty role, since the PSPP is to be considered part of monetary policy and it complied with the principle of conferral, according to Article 5(1) TEU in conjunction with Article 119, Article 127 et seq. TFEU; secondly, the monetary financing prohibition was not violated either, as the effects of the programme occurring in the secondary market were not equivalent as if it would have happened in the primary market, and the main aim of Article 123 TFEU of encouraging Member States to pursue prudent budgetary policies

⁴⁷ "ECB Website."

⁴⁸ Ibid.

⁴⁹ Ibid.

⁵⁰ C-62/14 Gauweiler, dealing with the legality of the ECB's Outright Monetary Transactions (OMT) programme.

was not defeated.⁵¹ The German Court agreed on the compliance with the monetary financing prohibition; however, a second sentence pronounced on 5 May 2020 by the German Court argued that the Federal Government and the German Parliament, in breach of the German law, failed to address the requests to object on the ECB's implementation of the PSPP, considered not conformable with the principle of proportionality⁵². For this reason, the Bundesbank is required not to participate in the programme, unless the ECB provides adequate evidence that its monetary policy decisions are not in contradiction with the afore-mentioned principle. According to some experts, the consequences of the most recent German sentence could be very harmful, with potential repercussions to the whole financial sector. Indeed, by questioning the legality and legitimacy of the Central Bank's policy, other Member States could be prompt to challenge the authority of the ECB and the primacy of European law⁵³; others argue that the sentence, given its impropriety, was made in such a delicate period, triggering the risk of instability in the Eurozone⁵⁴; according to Pezzuto⁵⁵, the former executive of the Bank of Italy, the main effect of the German decision is to weaken the ECB's authority and, therefore, to undermine the financial stability of the euro area. To conclude, the analysis shows as monetary policy decisions, which are essential to efficiently face periods of financial crisis, can lead to internal disagreements within the Eurozone and, consequently, adversely affect the purpose of prudential supervision to maintain financial stability.

6. Conclusion

From the present analysis, both theoretical and practical (through the presented case law), it emerges that several interactions exist between the monetary and supervisory functions of the ECB. Indeed, although the two policies are legally distinct, the need for cooperation between them is particularly relevant, and led to the incorporation of the supervisory activity within the institution that was already responsible for monetary policy definition and implementation in the Union, which is the Central Bank. The work

⁵¹ Bundesverfassungsgericht, "ECB Decisions."; Pezzuto, "Implicazioni sentenza Corte costituzionale."

⁵² Art. 5 TFEU.

⁵³ Caravita, "L'arroganza del Tribunale di Karlsruhe.", cited in Pezzuto, "Implicazioni sentenza Corte costituzionale."

⁵⁴ Fabbrini, "Eurozona e diritto dell'Unione.", cited in Pezzuto, "Implicazioni sentenza Corte costituzionale."

⁵⁵ Pezzuto, "Implicazioni sentenza Corte costituzionale."

underlines that the benefits resulting from this integration are several and of different nature, ranging from considerable advantages in terms of information, to the possibility of closely coordinating the two policies and preventing or reducing inefficiencies, to the condition of independence from which the supervisory activity can benefit. However, negative consequences of the fact that two such different functions are performed by the same authority can be experienced and should be addressed sufficient attention in order to diminish their effects. Therefore, while positive interactions are significant, the potential drawbacks should be properly managed with an adequate organisational design⁵⁶ as to guarantee the efficient and effective performance of both functions. The primary solution is related to the principle of separation, according to which the two responsibilities are kept separated in terms of objectives, decision-making process and tasks, and this can be possible through a proper governance structure. However, it is essential that separation does not mean isolation, since the two functions need to keep in contact and be coordinated.

Furthermore, the analysis of the APP and of the case law concerning the Federal Constitutional Court shows how problems in the implementation of the monetary policy of the Union by the ECB can lead to potential threats to the stability of the whole financial system, in particular during periods of financial distress.

⁵⁶ Ampudia et al., "The Architecture of Supervision."

Bibliography

- Ampudia, Miguel, Thorsten Beck, Andreas Beyer, Jean-Edouard Colliard, Agnese Leonello, Angela Maddaloni, and David Marques-Ibanez. "The Architecture of Supervision." ECB Working Paper Series No 2287, 2019.
- Angelini, Paolo, Sergio Nicoletti-Altimari, and Ignazio Visco. "Questioni di Economia e Finanza: *Macroprudential, Microprudential and Monetary Policies: Conflicts, Complementarities and Trade-Offs.*" Banca d'Italia Occasional Paper No 140, 2012.
- Beck, Thorsten, and Daniel Gros. "Monetary Policy and Banking Supervision: Coordination Instead of Separation.", European Banking Center Discussion Paper No 003, 2013. ISSN 0924-7815.
- Bundesverfassungsgericht. "ECB Decisions on the Public Sector Purchase Programme Exceed EU Competences." Press Release No. 32/2020, May 5, 2020. On the Bundesverfassungsgericht website, <https://www.bundesverfassungsgericht.de>, accessed June 10, 2020.
- Caravita, Beniamino. "L'arroganza del Tribunale di Karlsruhe che sgambetta la UE e favorisce i sovranisti.", *Il dubbio*, May 8, 2020. <https://www.ildubbio.news>, accessed on June 9, 2020.
- Carboni, Giacomo, Matthieu Darracq Pariès, and Christoffer Kok. "Exploring the Nexus Between Macro-Prudential Policies and Monetary Policy Measures: Evidence from an Estimated DSGE Model for the Euro Area." BFI Working Paper Series No 005, 2013.
- Cassola, Nuno, Christoffer Kok, and Francesco Paolo Mongelli. "The ECB After the Crisis: Existing Synergies Among Monetary Policy, Macroprudential Policies and Banking Supervision." ECB Occasional Paper Series No 237, 2019.
- Cœuré, Benoît. "Monetary Policy and Banking Supervision." Speech, Frankfurt, February 7, 2013. <https://www.ecb.europa.eu>, accessed June 7, 2020.
- Dabrowski, Marek. "Interaction Between Monetary Policy and Bank Regulation." European Parliament Monetary Dialogue, September 23, 2015.
- ECB. "ECB Website". <https://www.ecb.europa.eu>, accessed June 12, 2020.
- Fabbrini, Federico. "Eurozona e diritto dell'Unione: verso la battaglia decisiva." *Centro Studi sul Federalismo*, Comment No 178, May 6, 2020. <http://www.csfederalismo.it>, accessed on June 9, 2020.
- Gerlach, Stefan. "Banking and Fiscal Union." Speech, Florence, January 21, 2013. <https://www.centralbank.ie>, accessed June 8, 2020.

- Goodhart, Charles. "The Organisational Structure of Banking Supervision." FSI Occasional Paper No 1, 2000.
- Goodhart, Charles, and Dirk Schoenmaker. "Should the Functions of Monetary Policy and Banking Supervision be separated?", Oxford Economic Papers No 47, 1995.
- Masciandaro, Donato. "Monetary Policy and Banking Supervision: Still at Arm's Length? A Comparative Analysis." *The European Journal of Comparative Economics*, Vol. 9, n. 3, pp. 349-366, 2012. ISSN 1824-2979.
- Pezzuto, Antonio. "Le implicazioni della sentenza della Corte costituzionale tedesca per l'eurozona." *Magistra Banca e Finanza*, May 20, 2020. <https://www.tidona.com>, accessed June 9, 2020.
- Smets, Frank. "Financial Stability and Monetary Policy: How Closely Interlinked?" ECB Paper, 2013.

