Questionable Legality

By Klaus C. Engelen

Is the ECB's new bank supervision role in trouble?

The largest bank health check ever undertaken in terms of the number of banks, their overall size, and their geographical reach is keeping thousands of bankers, supervisors, and auditors in overtime this summer in preparation for the launching of the European Central Bank as the eurozone's lead bank supervisor at the beginning of November. The legality of this most ambitious European integration project since the introduction of the euro at the beginning of 1999 is still being questioned.

Once again, the legal challenges are coming from Germany. The outcome of that legal challenge remains open. As the saying goes, "Before the courts and high seas, we are in God's hands." Ever since European leaders opened the door to European banking union at their June 2012 EU summit in Brussels, the legal battles have been raging, particularly from a German perspective. It is useful to recall what the EU leaders agreed to at that fateful Brussels summit:

> *We affirm that it is imperative to break the vicious circle between banks and sovereigns. The Commission will present Proposals on the basis of Article 127(6) TFEU for a single supervisory mechanism shortly. We ask the Council to consider these Proposals as a matter of urgency by the end of 2012. When an effective single supervisory mechanism is*

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THE INTERNATIONAL ECONOMY

THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY

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Washington, D.C. 20002

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established involving the ECB, for banks in the euro area the ESM could, following a regular decision, have the possibility to recapitalize banks directly. This would rely on appropriate conditionality, including compliance with state aid rules, which should be institution-specific, sector-specific, or economy-wide and would be formalized in a Memorandum of Understanding.

A letter from Germany's chief banking union negotiator, Wolfgang Schäuble, finance minister since 2009, to then-EU Commissioner Michel Barnier, written July 11, 2013, sheds light on Berlin's legal battles with the Club Med-dominated EU Council and EU Commission over the sound legal foundations of the three-stage European banking union.

Haunted by using the questionable Article 127, paragraph 6, of the Treaty on the Functioning of the European Union to enable the ECB to become the eurozone's lead bank supervisor, the German coalition government under Chancellor Angela Merkel insisted—against strong opposition from the European Parliament's majority—on intergovernmental agreements as legal foundations for the Single Resolution Mechanism and the Single Resolution Fund. "Germany has made clear that under the current treaties, the Commission does not have the competence to run such a central authority or act as a resolution body," said Merkel. "If we want new competences then they must be linked to treaty changes."

Merkel may have learned her lesson. To the horror of most German-speaking EU law experts, she took the position, advanced by the French, the EU Commission, the ECB, and Club Med leaders, that Article 127(6) TFEU would do as a legal basis for transferring national bank supervisory powers to the ECB. By simply ignoring the problem with the legal basis for the Single Supervisory Mechanism, Merkel signaled to her party followers and a docile German bureaucracy to keep quiet about its illegality. A debate over breaking EU law by transferring bank supervision and a large hunk of German sovereignty to the ECB might have unsettled the German public with national elections looming on the horizon. Also, the major opposition parties, the Social Democrats and the Greens, did not raise this legal issue for fear of being attacked as anti-European on the campaign trail.

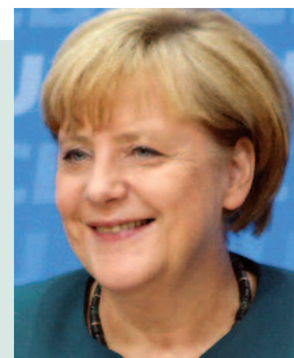
For the first time, the Merkel coalition government openly admitted that Article 127(6) was no proper legal basis for making the ECB the euro area's leading bank supervisor.

The main thrust of the Schäuble letter centers on the reasons why Germany can never accept using Article 114 TFEU as the legal basis for a centralized European bank resolution mechanism and fund, with their enormous fiscal implications

What Legal Problem?

German Chancellor Angela Merkel may have learned her lesson. To the horror of most German-speaking EU law experts, she took the position, advanced by the French, the EU Commission, the European Central Bank, and Club Med leaders, that Article 127(6) TFEU would do as a legal basis for transferring national banking supervisory powers to the ECB. By simply ignoring the problem with the legal basis for the Single Supervisor Mechanism, Merkel signaled to her party followers and a docile German bureaucracy to keep quiet about its illegality. A debate over breaking EU law by transferring bank supervision and a big hunk of German sovereignty to the ECB might have unsettled the German public with national elections looming on the horizon. Also, the major opposition parties, the Social Democrats and the Greens, did not raise this legal issue for fear of being attacked as anti-European on the campaign trail.

—*K. Engelen*



German Chancellor
Angela Merkel

Crucial Admissions

If Germany's constitutional judges in Karlsruhe accept the Europolis complaint and examine the Single Supervisory Mechanism's constitutional legality, they would find—for instance—crucial admissions by Germany's key negotiator on European banking union, Finance Minister Wolfgang Schäuble, about the shaky basis of Article 127(6) for transferring bank supervision from the national authorities to the European Central Bank.

—*K. Engelen*

The Second Senate of Germany's Federal Constitutional Court at Karlsruhe. From left to right: **Peter M. Huber, Peter Müller, Doris König,** *President* **Andreas Vosskuhle, Ulrich Maidowski, Monika Hermanns, Sibylle Kessal-Wulf,** *and* **Herbert Landau.**

for the financially and economically strongest eurozone member state. It also explains why the Berlin government sees the urgent need for treaty changes in order to expand Article 127(6) TFEU as a sound legal basis for enabling the ECB with the Single Supervisory Mechanism.

ENTER THE EUROPOLIS "GROUP OF FIVE"

On July 28, 2014, the reliable guardian of global investors, the *Financial Times,* sounded the alarm: "EU banking union challenged. German court case creates uncertainty—policy seen as vital response to crisis."

This followed a long report in the weekly *Welt am Sonntag* on the details of the constitutional complaint lodged at the Karlsruhe Federal Constitutional Court challenging the legal basis for transferring bank supervision, bank resolution, and resolution financing from the national to the European level. "Kerber doesn't let loose—Berlin's professor Markus C. Kerber again is marching before the Federal Constitutional Court. Again he is about to topple a mega-project of the euro rescuers."

The plaintiffs challenge the use of Article 127(6) TFEU as a legal basis. This section allows the EU Council to delegate "specific tasks" to the ECB in connection with prudential supervision of banks.

The Europolis group, a euroskeptic think tank headed by Kerber, argues that the Single Resolution Mechanism exceeds the remit of Article 127(6) by a wide margin, especially since the ECB assumed the power to put every single bank in the eurozone under its supervision. The plaintiffs also point to the inherent conflict of interest of the ECB's Governing Council, which under the TFEU is legally the only decision-making body of the ECB. The treaty stipulates only that the Governing Council must follow a price stability objective, which would conflict with a bank supervisory role. Although the ECB is trying to circumvent this conflict through a bank supervisory board, the Governing Council remains ultimately responsible. Furthermore, the plaintiffs take the position that a banking union would have required a change in the European treaties, something that member states avoided, fearing that they would not get the support of a majority of their citizens. Therefore, the plaintiffs accuse governments of trying to hide the risks, since banking union constitutes an indirect form of fiscal transfer.

The move to transfer their banking supervision to the ECB was "a bigger loss of sovereignty" than the introduction of the euro.

The *Welt am Sonntag* article draws attention to a seventy-nine-page legal opinion on the constitutional and European legal limits of monetary and banking union by Udo di Fabio, a respected German former constitutional judge, commissioned by Stiftung Familienunternehmen, a lobby group for small- and medium-sized private enterprises. Di Fabio comes to the conclusion that banking union would indeed require treaty changes.

Says Kerber, a finance professor at Berlin Technical University who was party to other major suits against the European Stability Mechanism, "Schäuble deceives German taxpayers about the risks of the banking union." In the ESM case, supported by 37,000 backers, the Federal Constitutional Court ruled that the European Stability Mechanism was legal as long as the German parliament had enough control to protect German taxpayers. But in the recent high-profile complaint, the court in Karlsruhe separately referred a different part of the case relating to the ECB's plan to purchase the government debt of euro-zone countries through "Outright Monetary Transactions" to the European Court of Justice. (See "Draghi's German Nightmare," *TIE,* Winter 2014). This complaint has not yet been finally adjudicated.

In a press release, Kerber and his euroskeptic think tank experts argue, "In view of the German governmental and parliamentary consent to banking union which goes far beyond the authorization by Article 127 TFEU, the Europolis group has lodged a constitutional complaint at the Federal Constitutional Court. As soon as the regulation for the single resolution mechanism and the single resolution fund enters into force the constitutional complaint will be enlarged. The banking union project compared to the different Euro rescue measures implies unacceptable risks for those countries like Germany with a functioning banking supervision system. Countries like Germany with her cooperative and savings bank sectors will share the risks of banking mismanagement in France and southern Europe. It is astounding to witness how the federal government and the German parliament under the conditions of the coalition between Christian Democrats and Social Democrats have led Germany into the trap of a far-reaching mutualization of liability. The banking union is the worst of all cases of European Union acts going beyond the powers conferred to it by the Treaties (*"ultra vires"*)."

One of the plaintiffs, Johann Heinrich von Stein, a professor of banking, expressed the widely held view that "European banking union is such a complex construct that even experts are getting lost." Along with the other plaintiffs, von Stein sees a wide-ranging lack of parliamentary control in the European decision-making process that raises the question also asked by many German taxpayers: who to turn to, since the Federal Constitutional Court seems to be the only rescue anchor left.

From a German perspective in particular, the legal battles over the complex banking union issues may have just started.

The current complaint of the Europolis group only relates to the Single Supervisory Mechanism, the first stage of European banking union, which transfers bank supervision from national authorities to the ECB.

But the plaintiffs are also planning to take the Single Resolution Mechanism and the Single Resolution Fund to the constitutional court. They propose combining their complaint with that of a bank that is supervised under the Single Supervisory Mechanism. That way, actual supervisory actions and decisions could be used to demonstrate the lack of an adequate legal basis.

After the fateful June 2012 EU summit when Merkel—to the surprise of most of Germany's political, financial, and legal establishment—let herself be blackmailed into opening the door to transferring bank supervision to the ECB in order to use the euro rescue funds for a €100 billion Spanish bank recapitalization program, many close observers expected much earlier legal, political, and institutional challenges.

How could EU leaders and the EU Commission totally ignore the expert advice not to transfer bank supervision to the ECB given in the Larosière Report they themselves had mandated?

Jacques de Larosière, former Bank of France governor and former managing director of the International Monetary Fund, heading the "High-Level-Group on Financial Supervision in the EU,"

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A Lot of Constitutional Questions

The Schäuble-Barnier letter sheds light on the political and legal battles raging in the euro area since the June 2012 EU summit opened the door to European banking union. After jolting Germany's banking sector by yielding to the mega-project of European banking union—which happened under heavy pressure from Chancellor Angela Merkel and her politically influential "Europe First" advisers in the chancellery—Finance Minister Wolfgang Schäuble started redefining the limits on how far Germany can go. Since no reform project on the European stage can get very far without Germany as the largest and financially strongest economy, Schäuble—with new backing by Merkel—has been moving center stage on the chaotic construction of European banking union by setting "red lines."

—K. Engelen

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11 July 2013
Mr Michel Barnier
European Commissioner for Internal Market and Services
European Commission

Dear Michel,

Let me come back to our numerous fruitful discussions on establishing the building blocks for a European Banking Union. In this context I do indeed appreciate the Commission's efforts to address the main challenges arising from the debt and financial crisis. This is why I concur with you that progress towards a more integrated financial framework for banking supervision and resolution is needed in order to establish a level playing field, restore normal lending to the economy, improve competitiveness and bring about the necessary economic adjustments, particularly in the euro area.

The Commission has now tabled its proposal on a Single Resolution Mechanism and Fund. The rationale for establishing clear rules and procedures to ensure orderly resolutions is strong and Germany is fully committed to making good progress in implementing a credible Resolution Mechanism. However, I believe it is essential to focus at this stage on more realistic steps that can be possibly achieved within the very tight timeframe set by the European Council without requiring changes to primary law yet.

The SRM proposal published by the Commission regrettably envisages too high a degree of centralisation with regard to the boundaries of the existing state of primary law. In other words, the proposal does not match the current legal, political and economic realities and would create major risks. In particular, the suggested comprehensive transfer of executive competences from the Member States to the Commission is not in line with the legal basis of Article 114 TFEU which allows for the harmonisation of law in the EU.

An excessively flexible interpretation of Article 114, transferring far-reaching powers and responsibilities to the Commission, creates serious operational risks for the future system. Article 114 aims to foster the proper functioning of the internal market, which encompasses all Member States in geographical terms. Article 114 does not aim to foster the specific objective of financial stability for just part of the EU 28, namely those Member States participating in the Single Supervisory Mechanism. And in no way does Article 114 foresee the Commission becoming the Resolution Authority for this segment of the internal market, leaving out another major part of the European financial sector. Against this, today's proposal risks to split, rather than complete the internal market.

A second risk pertains to resolution decisions that may factually impact on national budgets. While recognising the

Continued from page 33

had warned, "While the Group supports an extended role of the ECB in *macro*-prudential oversight, it does not support any role for the ECB for *micro*-prudential supervision. The main reasons are:

■ The ECB is primarily responsible for monetary stability. Adding micro-supervision duties could impinge on its fundamental mandate;

■ In case of crisis, the supervisor will be heavily involved with the providers of financial support (typically ministries of finance), given the likelihood that taxpayers' money may be called upon. This could result in political pressure and interference, thereby jeopardizing the ECB's independence;

■ Giving a micro-prudential role to the ECB would be extremely complex because in a crisis the ECB would have to deal with a multiplicity of member states' treasuries and supervisors;

■ Conferring micro-prudential duties on the ECB would be particularly difficult given the fact that a number of ECB/ESCB members have no competence in terms of supervision;

■ Conferring responsibilities on the ECB/Eurosystem, which is not responsible for the monetary policy of a number of European countries, would not resolve the issue of the need for a comprehensive, integrated system of supervision; and

■ Finally, the ECB is not entitled by the Treaty to deal with insurance companies. In a financial sector where transactions in banking and insurance activities can have very comparable economic effects, a system of micro-prudential supervision which excludes from consideration

Commission's effort to limit the impact on national budgets in Article 6 of the draft regulation, much stronger budget protection must be given to participating Member States in order to ensure legitimacy and compliance with constitutional requirements. Under no circumstances would it be acceptable, especially during the 10-year phase of building up resolutions funds by the banking industry, that Commission's resolution decisions would affect national taxpayers and directly or indirectly oblige national budgets to provide financial support as interim financing. In institutional terms, it would be a major mistake and would create wrong incentives if fiscal liabilities were split from operational responsibilities.

The proposed resolution funding by the banking industry leads to a third risk, again related to the rather limited scope of Article 114. In our understanding, Article 114 does not provide a sound legal basis for raising levies from the European banking industry. In our view, the imposition of European levies by the Union has to be based either on the financial provisions as set out in Articles 310, 311 TFEU or—if they are supposed to be managed outside the Union budget—on the basis of Article 352 TFEU. It would hence expose the future SRM to a major risk of litigation if funding is not ensured under clear legal circumstances.

In order to minimise risks and to gain momentum, I continue to advocate a two-step approach, as you know. In phase one, we should very rapidly approach a practicable solution and focus on a more decentralised approach. Building on a system with national resolution authorities taking coordinated decisions and implementing them would be both more effective and efficient—especially against the fact that not all 28 Member States will be covered by the SRM, but could be heavily affected by the resolution of a cross border bank as well.

A resolution board should ensure quick, effective and coherent decision-making at the central level e.g., through binding mediation, a strong role in resolution planning, the provision of staff, infrastructure with technical expertise and the establishment of technical standards.

This approach would not exclude the Commission. To the contrary, I advocate a decisive role for DG competition to rigorously apply the State Aid rules as minimum standards, and to protect taxpayers' interests.

Consequently resolution financing should be provided mostly through bail-in. Unambiguous bail-in rules need to be in place as soon as possible to establish a predictable hierarchy of liabilities. These bail-in rules should be those agreed in the General Approach to the Bank Recovery and Resolution Directive and should be fully applicable to participating Member States as early as possible, and not as late as 2018. Furthermore, resolution funding should be launched using a decentralised structure i.e. a network of national resolution funds based on contributions by the financial sector itself. This would provide prefinancing over time for an effective private backstop arrangement in combination with ex-post levies, when needed.

While a more decentralised approach would serve as an interim solution we should prepare for a comprehensive, more centralised solution in phase two, based on a revision of the Treaty texts. I suggest working in parallel on a revision of Article 127 paragraph 6 to make the Single Supervisory Mechanism as strong as possible and to create an equivalent legal basis for the SRM, allowing for a substantial strengthening of the institutional structure of both the European Union and the eurozone. The German Ministry of Finance stands ready to discuss and support all efforts in this respect at any time.

I am sending a copy of this letter to the Presidency.

Yours sincerely,

Wolfgang Schäuble
Federal Minister of Finance

insurance activities would run severe risks of fragmented supervision.

Veteran bank supervisors would wholeheartedly agree with the report's warnings and recommendations. They would add that high-quality banking services—as with bank supervision—depend primarily on the quality of people who devote their professional lives to the task. Starting from scratch, and assembling supervisory staff from different countries, different legal systems, and different supervisory cultures in a highly politicized environment, isn't putting the ECB as lead bank supervisor in the pole position.

Never before has banking supervision changed from eighteen national authorities to one supranational body in one stroke in just a few months on a legal basis that appears to be weak. With the banking union proposals, EU leaders and the EU Commission may have put the cart before the horse. And one only has to recall that a key feature of the recent financial crisis was bank supervisory failure. Hoping that progress towards political union will be made as a result of far-reaching mutualization schemes could be a pipe dream with severe side effects. Moral hazard will be huge. But engendering moral hazard is not a solid basis for mechanisms which are expected to create long-term benefits to society.

In his article "Europe's Bailout Politics: An exercise in policy heavy-handedness" (*TIE,* Spring 2011), Roland Vaubel, professor of economics at the University of Mannheim, puts the disregard of European leaders for the adherence to the current EU treaties into a larger context when he states, "It is well-known that the bailouts of Greece, Ireland, and now Portugal are a breach of the

European treaties. Even Christine Lagarde, [then] the French finance minister, and Karel de Gutch, the Belgian EU commissioner, have admitted that."

What is less well known is that the International Monetary Fund, too, by contributing to these loans, is violating its charter. According to the Articles of Agreement, a member state may obtain IMF credits only on the condition that it has "a need to make the purchase because of its balance of payments or its reserve position or developments in its reserves." Greece, Ireland, and Portugal are certainly not short of foreign exchange reserves."

MIXED REACTION TO THE EUROPOLIS SUIT

Open Europe, a think tank with offices in London and Brussels and an independent partner organization in Berlin, pointed out that the Europolis group

> *"are far from alone in raising legal concerns surrounding the basis for the banking union. As we have previously noted, both the German government and the European Parliament have expressed legal concerns over the structure, the former with regard to the fiscal impact and the legal basis for pooling of funding, and the latter with regards to the use of intergovernmental treaties and the circumvention of the European Parliament. (Ironically, such intergovernmental agreements arose in large part to avoid Germany's original concerns.)"*

Reacting to the Europolis move, Eurointelligence observed that "German constitutional lawyers are divided on the issue of banking union legality, with some arguing that the SSM was a legal borderline case. Under the enormous political and market pressures to strengthen the role of the European Central Bank with its big pockets to protect the finance industry and investors, the question of banking union legality—as hotly debated in Germany—has been pushed to the back burner."

When the Finance Committee of the German parliament held hearings on the law on July 3, 2013, not one of the invited German legal experts considered Article 127(6) TFEU as an adequate legal basis. The common view was that this provision only delegates "specific tasks" to the ECB in connection with prudential supervision of banks, but is not meant to be the legal foundation for the ECB assuming bank supervision for the euro area.

In early press reports on the "Group of Five" move to Karlsruhe challenging the Single Supervisory Mechanism, for instance in *Handelsblatt,* Germany's financial and economic daily, legal experts argued that constitutional court action on banking union might be less likely than in earlier complaints from euroskeptics, for instance, against the euro rescue facilities and the ECB overstepping its main mandate to preserve price stability through the purchase of eurozone sovereign debt.

The legality of this most ambitious European integration project since the introduction of the euro at the beginning of 1999 is still being questioned.

Michael Kemmer, managing director of the private banks' association BdB, argues that certain supervisory tasks would remain with the European Banking Authority and with the bank supervisors of the member states. And with respect to the Europolis suit, he asks the important question, "What alternative do the plaintiffs offer?"

Gerhard Hofmann, head of regulation for the cooperative bank association BVR, recalls last year's heated debate over the question of whether European banking union could be established under the existing EU treaties. He reminds those who are upset about euroskeptics such as the "Group of Five" moving to the court in Karlsruhe to check the legality of banking union under the EU treaties, "Such a complaint should be allowed. It would be principally positive if we would get an answer from the Federal Constitutional Court on the legality of banking union under the present EU treaties, however the judges rule on the issue."

Official reactions were, as was to be expected, muted. When asked to respond to the suit against the Single Supervisory Mechanism, a spokesperson at the Eurotower in Frankfurt simply pointed to the provision in the EU treaties that serves as legal basis for the assumption of supervisory duties by the central bank—without going into the crucial and controversial issue that Article 127(6) only mentions "specific tasks" and not the ECB assuming banking supervision for the

whole euro area. And a spokeswoman for the German Ministry of Finance responded that "The banking union laws were written to be watertight against such challenges," adding, "We are very confident that the banking union is not a violation of the German Constitution."

THE JUDGES IN KARLSRUHE HAVE A LOT TO EXPLORE

If Germany's constitutional judges in Karlsruhe accept the Europolis complaint and examine the Single Supervisory Mechanism's constitutional legality, they would find—for instance—crucial admissions by Germany's key negotiator on European banking union, Wolfgang Schäuble, finance minister since 2009, about the shaky basis of Article 127(6) for transferring bank supervision from the national authorities to the European Central Bank.

In the aftermath of the monumental June 2012 EU decisions, Schäuble called Brussels' pan-European banking union plans "anything but thought through." As he admitted to journalists, "Many of his finance minister colleagues were realizing that the single supervisory mechanism does not offer solutions to the problems that have to be solved." He expressed fundamental doubts on transferring banking supervision to the ECB "because of the inherent conflicts of interest with the central bank's monetary policy task and the lack of parliamentary legitimation for becoming a banking supervisor."

An important document in this regard is Schäuble's July 11, 2013, letter to EU Commissioner for Internal Market and Services Michel Barnier, when the EU Commission went ahead with its proposal for the Bank Recovery and Bank Resolution Directive, arguing that from a German perspective this would address "existential national issues."

And as Schäuble's letter to Barnier signals, haunted by the questionable legal basis for the Single Supervisory Mechanism, Schäuble dug in against the EU Commission use of Article 114 TFEU as the legal basis for its proposals for a Single Resolution Mechanism and a Bank Recovery and Resolution Directive (BRRD), insisting on treaty changes. Schäuble argued that using Article 114 TFEU would "create serious operational risks for the future system" since it aims "to foster the proper functioning of the internal market, which encompasses all Member States in geographical terms." "Under no circumstances would it be acceptable, especially during the 10-year phase of building up resolutions funds by the banking industry, that Commission's resolution decisions would affect national taxpayers and directly or indirectly oblige national budgets to provide financial support as interim financing." Also, Article 114 TFEU does not provide a sound legal basis for raising levies from the European banking industry.

What legal experts and other insiders consider remarkable was that for the first time, in Schäuble's letter, the Merkel coalition government openly admitted—as most German and other legal authorities such as the EU Council's legal service have been arguing—that Article 127(6) was no proper legal basis for making the ECB the euro area's leading bank supervisor.

Schäuble was not only addressing the need for a sound legal basis for the Single Supervisory Mechanism, but also insisting on a sound legal basis for the Single Resolution Mechanism and Fund with their possibly huge fiscal implications. And he was expressing German "red lines" that a new Berlin government—with the Social Democrats as coalition partners—would observe. Writes Schäuble: "While a more decentralized approach would serve as an interim solution, we should prepare for a comprehensive, more centralized solution in phase two, based on a revision of the Treaty texts." And he adds: "I suggest working in parallel on a revision of Article 127 paragraph 6 to make the Single Supervisory Mechanism as strong as possible and create an equivalent legal basis for the SRM, allowing for a substantial strengthening of the institutional structure of both the European Union and the eurozone."

But the plaintiffs are also planning to take the Single Resolution Mechanism and the Single Resolution Fund to the constitutional court.

In this respect, the position of SPD legislators became apparent when on June 13, 2013, shortly before midnight, the German Bundestag only needed forty-five minutes to debate and pass the law to transfer bank supervisory powers from the German Federal Financial Supervisory Authority (BaFin) to the ECB at the European level.

The legislative move of the Merkel Christian Democrat-liberal coalition had the backing of both large

opposition parties, the Social Democrats and the Greens, on a broad consensus to use the ECB as lead supervisor for Europe's larger systemically important banks.

But as Sharon Bowles, British Liberal Democrat MEP, who headed the European Parliament's Economic and Monetary Committee, reminded Germans—with their large and complex banking structure—the move to transfer their banking supervision to the ECB was "a bigger loss of sovereignty" than the introduction of the euro (with the Bundesbank losing its independence by becoming part of the European System of Central Banks).

What was largely ignored at the time was how on that fateful day the opposition Social Democrats—although broadly in support of making the ECB the Euroland lead bank supervisor—tried to respond to the problematic use of Article 127(6) as legal basis. In their amendment they demanded that the German government insist on a "sunset clause" in further negotiations so "that the transfer of the European banking supervision to the ECB would be structured as only a temporary move." Manfred Zöllmer, who introduced the SPD amendment, saw a need for EU treaty changes along the line of the Bundesbank's requests.

According to the SPD amendment—this might be very revealing to the constitutional court's judges—"the German government should push for a solid legal basis for SSM and also the other two legs of banking union, the bank resolution and deposit insurance." After such treaty changes, in its proposal, "a new European institution, separate from the ECB, could take over European banking supervision for the euro area from the ECB, thus avoiding the massive conflicts of interest."

When the constitutional judges in Karlsruhe get deeper into how Germany's coalition at the center of the political spectrum pushed through the "ECB Enabling Law" in less than an hour shortly before midnight on July 13, 2013, with their official parliamentary spokesmen putting down any meaningful dissent and discussion, they may not believe what they see. The SPD amendment was voted down by the center-right Merkel coalition by name, but the Single Supervisory Mechanism enabling law was passed by acclamation, not even asking for vote by name. Some observers consider this vote by acclamation a historical low point in Germany's postwar parliamentary evolution. This legislative episode documents, however, the sensitivity of the Social Democrats to the lacking legal basis for the SSM enabling act. As Schäuble's letter to Barnier now signals, the governing Christian Democrats are now also catching up with the need for treaty changes on the road to European banking union—late but maybe not too late.

Never before has banking supervision changed from eighteen national authorities to one supranational body in one stroke in just a few months on a legal basis that appears to be weak.

A CONSTITUTIONAL LEGAL CHECK IS OVERDUE

Therefore, it's time that Germany's constitutional judges have a look at whether the Single Supervisory Mechanism enabling law is in line with the German Constitution and the EU treaties.

The experts of Open Europe have a point when they argue that "as with all eurozone policies, overturning it would likely cause huge market disturbance and shift the eurozone back towards an existential crisis—something the court is usually quite aware of. That said, the court could add caveats in terms of the democratic assent required for banking union and the role of the Bundestag where funds are concerned. It could also pass the judgment on to the European Court of Justice, as it has done with the case over the ECB's bond purchase program, the OMT, not least because it seems to mostly question the legality under EU treaties."

Many insiders on European banking union developments share Open Europe's view on the Europolis "Group of Five" suit: "In any case, this is certainly one to watch and not just from the eurozone perspective. Any ruling could well set a precedent and have a role in determining how far the eurozone can push certain treaty articles in terms of legal bases but also how it fits with national constitutions. In other words, it could be important in determining the issue of euro-ins versus euro-outs as the EU develops."

So from a German perspective in particular, the legal battles over the complex banking union issues may have just started. Whatever the outcome of the Europolis suit is, there are other legal issues on the horizon.

Let's wait until small and large banks get the results of the ongoing bank balance sheet audit, the "asset quality review." Then comes the stress test, run jointly by the

ECB and the London-based European Banking Authority.

Some in the German banking community are fuming. Elke König, president of Germany's Financial Supervisory Authority, has been sounding the alarm in the dispute about "top down" and "bottom up" bank balance sheet auditing.

There is a lot of bad blood. Only German and Austrian banks—it appears from the scarce information available—are forced under their national supervisors to have their balance sheets audited by hiring expensive large auditing firms such as Price Waterhouse, KPMG, or Ernst & Young to perform a "bottom up" audit. German bank insiders estimate that the bottom-up bill will reach €300–€500 million for just the asset quality review.

Guided by the ECB's exclusive and highly controversial consultant firm Oliver Wyman, most other national supervisors allow their banks to do the asset quality review audit on a "top down" basis. This means using peer group averages which may not reflect the balance sheet data of individual bank. At the recent Bundesbank conference on bank supervision, the lack of ECB transparency on the asset quality review implementation was a bone of contention. The German banking industry is haunted by the specter of supplying masses of balance sheet data to the ECB which are not needed or used at all. Gerhard Hofmann of BVR warns: "While plausibility checks based on top-down approaches are widely accepted in the current AQR program, there is growing concern that the ECB will base its judgment to a large extent on such estimates—that are applied in cooperation with mostly central bank supervisors in Spain, France, Italy—without the audited largest systemically important banks having to bear the costs of expensive accounting firms doing the "bottom up" method."

"Using peer group averages does not reflect an individual bank's own data," argues Hofmann, "so we can expect some of the banks under the AQR or the stress test will—when faced with the ECB-EBA results—defend their interests also by legal remedies." ◆