The ECB's guide on pecuniary penalties in banking supervision: Increased transparency on its (still) limited powers

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1. Introduction

On 2 March, the European Central Bank (ECB) published its Guide to the method of setting administrative pecuniary penalties pursuant to Article 18(1) and (7) of Council Regulation (EU) No 1024/2013. This (voluntary) initiative is particularly welcome, as it contributes to enhancing transparency and allows credit institutions to know better what to expect if they breach EU rules on prudential regulation (or, in the ECB's words, it 'ensure[s] the transparency and impartiality of the ECB's decisions'). This is all the more welcome as the ECB's sanctioning powers were subject to judicial review for the very first time ever in July of last year (cases Crédit Agricole v ECB (T-576/18), Crédit Agricole Corporate and Investment Bank v ECB (T-577/18), and CA Consumer Finance v ECB (T-578/18) discussed by Christy-Ann Petit in an op-ed and case VQ v ECB T-203/18).[2] Although confirming the ECB's interpretation of the applicable legal provisions and the breaches it had found in the first three cases, the General Court partially annulled the ECB's decisions on the ground that they did not sufficiently reason how the administrative sanctions imposed had been calculated. Indeed, the Court considered that the justification contained in the ECB's decisions was not sufficiently detailed, despite this being particularly necessary in view of the large discretion left to the ECB in setting the amount of the pecuniary penalties, and of their potentially high level as examined further below. Among other things, the Court specifically considered that the absence of a publically available methodology for the calculation of the fines only made the threshold for the ECB to comply with its duty to justify its calculation higher.

Against this background, the ECB's decision to publish detailed information on the method of calculation of its administrative penalties appears to seek to remedy to the shortcomings underlined by the Court, and thereby to prevent future judicial disputes. It is particularly remarkable as the ECB had argued before the Court that '*l'absence, dans la décision attaquée, d'explicitation de la méthodologie permettant de déterminer le montant exact de la sanction avait pour but de préserver le caractère dissuasif de ladite sanction. Il conviendrait d'éviter que les établissements de crédit puissent prévoir le montant des sanctions pouvant être prononcées, ce qui pourrait réduire l'incitation au respect des réglementations prudentielles*' (CA Consumer Finance v ECB, par. 115). In summary, the ECB justified the absence of in-depth explanation concerning the methodology it applied in calculating the fine by the fact that this would deter the fine's dissuasive effect as credit institutions' incentive to comply with prudential requirements could be diminished.

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[2] See on VQ v ECB: L. Wissink, 'The VQ case T-203/18: administrative penalties by the ECB under judicial scrutiny' in C. Zilioli and K.-P. Wojcik (ed.), *Judicial review in the European Banking Union*, Edward Elgar, 2021, 542-550. It is interesting to note though that the Administrative Board of Review (ABoR), an ECB internal body in charge of reviewing decisions adopted by the ECB Governing Council in supervisory matters, had examined decisions on administrative sanctions (incl. the one subject to the VQ case) prior to these decisions by the General Court (see for instance ECB Annual Report on supervisory activities 2018 p. 77).

The strong wording of the General Court's decisions apparently has since incentivised the ECB to change its stance on this matter, and transparency, as well as the rights of credit institutions, have thus been improved.

However, as will be discussed in conclusion, it remains the case that the ECB's sanctioning powers within the Single Supervisory Mechanism (SSM) are (still) potentially too circumscribed in any event and that their reinforcement would perhaps be in order with a view to enhancing the efficiency of banking supervision within the European (Banking) Union (E(B)U), thereby contributing to the stronger resilience of the EU's financial sector.

This long read is structured as follows. First, the ECB's sanctioning powers are re-situated in the E(B)U's supervisory regime (3). The next sub-section examines the content of the ECB's new Guide (2). The final section concludes (4).

2. Re-situating the ECB's sanctioning powers in the E(B)U's supervisory regime

Since the establishment of the EBU in 2013, and the subsequent creation of the SSM, the ECB has been in charge of banking supervision in the EBU. It supervises larger credit institutions (i.e. Significant Institutions (SIs)) directly, whilst National Competent Authorities (NCAs) supervise smaller credit institutions (i.e. Less Significant Institutions (LSIs)) under the oversight of the ECB. Supervisory tasks have thus been conferred upon the ECB, and it has been attributed all necessary powers to carry out these tasks, although some of these powers may be indirectly exercised through instructing NCAs that consequently adopt decisions to implement the ECB's instructions. As a result of this, the ECB now has to veil for the respect of prudential requirements contained in both directly applicable Union law (the Capital Requirements Regulation (CRR)) and in national norms implementing an EU directive (the Capital Requirements Directive (CRD)).

To ensure compliance with prudential requirements, the possibility to impose administrative penalties is foreseen in Art. 18 SSM Regulation. Both the ECB and NCAs may henceforth be called to impose administrative sanctions on supervised entities. This is so because, as was recently noted, 'supervisory measures, administrative measures and administrative sanctions all aim at pursuing the objectives entrusted to supervisors'.[3] Articles 66(2) and 67(2) CRD IV define minimum common rules in imposing administrative measures and sanctions in cases of breaches of authorisation requirements and requirements for acquisition of qualifying holdings, and in all the cases enumerated in art. 67(1) CRD IV.

As stated by a member of the Supervisory Board of the ECB (Edouard Fernández-Bollo) and the Director General SSM Governance and Operations (Pedro Gustavo Teixeira) in a very recent blogpost,

> '[t]he allocation of sanctioning powers within the framework of the SSM is complex, as it depends on three different elements: (i) the type of provision breached (i.e. directly applicable law or national law implementing directives imposing prudential requirements); (ii) the persons responsible for the breach (i.e. legal persons or individuals); and (iii) the type of penalty to be imposed (i.e. pecuniary or non-pecuniary).'

Before considering in detail the kinds of penalties the ECB may impose, it bears emphasizing that its powers in this domain are circumscribed to limited circumstances only: where an ECB decision or regulation has been breached (either by a SI or a LSI); where a breach by a SI relates to a requirement contained in the directly applicable CRR; and where such a breach may be attributed

[3] R. D'Ambrosio, 'The legal review of SSM administrative sanctions' in C. Zilioli and K.-P. Wojcik, *Judicial review in the European Banking Union*, Edward Elgar, 2021, p. 317.

to a legal person and may be sanctioned by a pecuniary penalty. In matters concerning a SI, the ECB may nonetheless require that the NCAs open proceedings where natural persons are involved, where the requirement breached is contained in national law transposing the CRD, or where it believes that non-pecuniary penalties available in national legislation should be imposed (art. 18(5) SSM Regulation and art. 134 SSM Framework Regulation). As a consequence of this, and as appears very clearly from the useful scheme contained in the blogpost previously mentioned, even with regard to SIs – which are supervised by the ECB directly – its powers to impose sanctions on them are limited as it is the NCAs that remain in charge in most cases. NCAs may not start proceedings on their own initiative, but they may still present a request in this sense to the ECB. Hence, the ECB alone is in charge of the launch of the procedure, but it is the NCAs that conduct them independently, that is the ECB's influence stops after the NCA has started to act as Art. 18(5) SSM Regulation indeed provides that 'the ECB may *require* national competent authorities to open proceedings with a view *to taking action* in order to ensure that appropriate penalties are imposed' (emphasis added) whilst art. 134(3) SSM Framework Regulation – which details this procedure – reads '[a]n NCA of a participating Member State shall notify the ECB of the completion of a penalty procedure initiated at the request of the ECB […]. In particular, the ECB shall be *informed* of the penalties imposed, if *any*.' (emphasis added).[4] Between 2017 and 2020, ten institutions were sanctioned by the ECB directly, whilst ten others were by NCAs (ECB blogpost and ECB Annual reports on supervisory activities: all sanctioning decisions have to be published as per art. 18(6) SSM Regulation as detailed in art. 132 SSM Framework Regulation).

The sanctions imposed by the ECB itself may be of two kinds: 'administrative pecuniary penalties' foreseen in art. 18(1) SSM Regulation and 'fines' contained in art. 18(7) SSM Regulation. Administrative pecuniary penalties shall be imposed 'where credit institutions, financial holding companies, or mixed financial holding companies, intentionally or negligently, breach a requirement under relevant directly applicable acts of Union law in relation to which administrative pecuniary penalties shall be made available to competent authorities under the relevant Union law'. That is to say that the ECB will only be able to impose penalties where the requirement therefor was breached by a legal person and is contained in an EU regulation, those enshrined in EU directives remaining under the purview of NCAs as already mentioned. A maximum amount is also set by this article: it may not exceed 'twice the amount of the profits gained or losses avoided because of the breach where those can be determined, or up to 10 % of the total annual turnover, as defined in relevant Union law, of a legal person in the preceding business year or such other pecuniary penalties as may be provided for in relevant Union law'. Art. 18(3) SSM Regulation further provides that '[t]he penalties applied shall be effective, proportionate and dissuasive […and that i]n determining whether to impose a penalty and in determining the appropriate penalty, the ECB shall act in accordance with Article 9(2)'. No further details are contained as to how these penalties are supposed to be calculated by the ECB. Art. 18(7) SSM Regulation additionally sets out that '[w]ithout prejudice to paragraphs 1 to 6, for the purposes of carrying out the tasks conferred on it by this Regulation, in case of a breach of ECB regulations or decisions, the ECB may impose sanctions in accordance with Regulation (EC) No 2532/98' As a consequence of the co-existence of the two kinds of penalties, the ECB's powers in this regard are governed by both the SSM Regulation (art. 18(1)) and by the Council Regulation concerning the powers of the ECB to impose sanctions (art. 18(7)) with the relationship to the Council Regulation being defined in the SSM Framework Regulation (Title 1). Indeed, the possibility for the ECB to impose administrative sanctions has existed since its creation as per art. 34.3 ESCB Statute which also sets as a condition that the ECB acts within the limits defined by the Council (i.e. those contained in the Council Regulation previously mentioned which were amended after the ECB became the EU's banking supervisor).

[4] Interpretation supported for instance by S. Allegrezza and Olivier Voordeckers, 'Investigative and sanctioning powers of the ECB in the framework of the Single Supervisory Mechanism', Eucrim, 4, 2015, p. 157 and R. D'Ambrosio, 'Due process and safeguards of the persons subject to SSM supervisory and sanctioning proceedings' Quaderni di ricerca giuridica della consulenza legale, Banca d'Italia, 74, 2013, p. 49.

3. Introducing the content of the ECB's Guide

In the Guide published on 2 March, the ECB details the two-step methodology for the calculation of pecuniary penalties it already alluded it, and partially explained, in the framework of the procedures before the General Court.

Before setting out those criteria though, it first recalls the 'wide margin of discretion' it enjoys in defining pecuniary penalties as well as the fact that they should be 'effective, proportionate and dissuasive' as was also confirmed by the General Court. It additionally insists on the need to take 'all relevant circumstances relating to the breach' into account. To this end, 'the impact of the breach and […] the supervised entity's misconduct [,…its] size […] and, whenever relevant in a given case, the benefits derived from the breach' must be considered.

The ECB hence follows a two-step approach in determining the amount of the applicable pecuniary penalty whereby a base amount is calculated first, before it is adjusted upwards or downwards if and as appropriate.

To calculate the base amount for the penalty, the severity of the breach is evaluated and classified as 'minor', 'moderately severe', 'severe', 'very severe' or 'extremely severe'. The classification in one category or the other depends on the impact of the breach and the degree of misconduct, which may be considered to be 'low', 'medium' or 'high'. The Guide establishes how the final outcome is determined as, for example, two 'low' grades will lead to a 'minor' breach. The system provided is, however, not fully comprehensive and does not seem to imply that the classification in one or the other category is automatic. This is so because it refers to the fact that a breach '*may*' be considered to belong to one category or the other thus implying that no classification is automatic or fully determined in advance. Moreover, the system proposed only foresees some of the possible scenarios and leaves undetermined what the final classification may be in all the other possible configurations.

It is furthermore interesting to note that the Guide provides quite detailed indications as to the criteria that may be taken into account when conducting this assessment. These include, for example, the 'duration of the breach' or the 'actual and potential consequences of the breach on the reputation of and confidence in the banking sector'. Although the criteria defined leave some margin to the ECB in their application, this is only in line with the ample margin of appreciation the General Court has recognised to it, and arguably also necessary to their proper application in individual cases.

Once the severity of the breach has been assessed, the base amount is set. Two methods of calculation may be applied. If the breach is 'extremely severe', the penalty will be a percentage of the supervised entity's annual turnover. The method of calculation of this percentage is specified too. By contrast, in all other cases, the base amount will be fixed either based on a penalty grid in which supervised entities are divided in different groups in accordance with their total amounts of assets or on the basis of the profits gained or the losses avoided. To ensure that the penalty imposed based on the grid remains proportional, the amount it contains is then adjusted taking account of the size of the average supervised entities in the group to which the fined entity belongs, and the average entity in the group above or below, depending on whether it is larger or smaller than the size in its group, respectively. Specific provisions are included for the banks that belong to the smallest and the largest groups. Where the benefits gained or the losses avoided may be calculated by the ECB, it '*may*' – this points again to the freedom left to the ECB in its choice – also decide to set the penalty at a level that is equivalent to an increase of up to two-thirds of this amount depending on the severity of the breach. In any case, the penalty must be at least equal to the amount gained or saved, and it should be 'proportionate, effective and dissuasive'.

After the base amount has been calculated, it is then adjusted and may be increased or reduced depending on the existence of aggravating or mitigating circumstances. The list of mitigating circumstances contained in the Guide appears to be closed, while the aggravating circumstances named therein are

simply qualified as 'examples'. If multiple breaches derive from the same set of facts, the ECB may also decide to adjust the amount of the penalty to ensure that proportionality is respected.

The Guide sets the maximum amount of the penalty to 10% of the total annual turnover of the supervised entity in the preceding year, or to twice the amount of the profits gained or losses avoided thanks to the breach.

The Final considerations of the Guide grant the ECB some leeway to depart from a strict application of the method of calculation devised. First, the financial situation of the entity and the impact of the penalty thereon will be considered 'in order to ensure that the penalty does not cause the supervised entity to become insolvent, cause it serious financial distress or represent a disproportionate percentage of its total annual turnover'. Second, the possibility remains for the ECB to impose a symbolic administrative pecuniary penalty only. No details are given as to when this might occur; the justification for such a decision should only be contained in the relevant decision. Third, the possibility to generally depart from the established method still remains where 'the particularities of a given case or the need to impose an effective, proportionate and dissuasive penalty in a particular instance' so justifies.

4. Concluding remarks

In light of the Final Considerations contained in the Guide, and of the indeterminacy that remains in the application of the method it devises, it appears that some lack of clarity and foreseeability remains even after the publication of the Guide. However, it undoubtedly provides a useful point of reference to the supervised entities, at the same time as it will allow the ECB to provide less detailed justifications of its decisions in the future.

As already anticipated in the introduction, and even if this evolution is surely both positive and important in contributing to the stability of the E(B)U's financial sector, it remains the case that the impact of this advancement is perhaps bound to be limited, and that a reform of the sanctioning regime in the area of banking supervision should potentially be considered altogether. It has even been argued in this regard that '[a]nother structural problem that plagues the SSM is the insufficiency of the ECB's enforcement powers'.[5]

Indeed, as shown in section 2, the circumstances under which the ECB may impose pecuniary penalties directly remain circumscribed to some of the instances in which breaches may occur only. Even if the ECB may demand that the responsible NCA opens a case and even if it is the only one that can decide whether a procedure has to be started at all which reflects its exclusive competence within the SSM, it still has no influence on the outcome of the procedure conducted by the NCA. This outcome, as well as for example the level or the type of the sanctions imposed, will depend on the applicable national laws and the NCAs' dedication in pursuing the case.[6] In this regard, and even if this divide of responsibilities between ECB and NCAs could not be avoided in as far as the ECB could, for example, hardly replace

[5] M. Lehmann, *Single Supervisory Mechanism without regulatory harmonisation? Introducing a European Banking Act and a 'CRR light' for smaller institutions*, EBI Working paper series no. 3, 2017, p. 15.

[6] M. R. Götz and T. H. Tröger note in this respect that 'even with regard to significant banks under direct ECB supervision national fragmentation of sanctioning regimes survives within the SSM. The extent and preconditions for sanctioning some of the most relevant violations relating to business conduct, supply of financial services etc. are left to the discretion of national regulators implementing art. 65 et seq. of CRD IV. Yet, since the promulgation of CRD IV, the manoeuvring space for Member States may not be that large in the end […]. The regulatory framework hence does not impede the evolution of uniform sanctioning practices also with regard to the magnitude of the penalties imposed by either the ECB or NCAs. However, a *potentially momentous flaw of the regime follows from the observation, that the power to initiate proceedings could prove rather ineffective in practice, because NCAs might not pursue cases with utmost dedication and vigour if they are not convinced on the merits and only follow ECB orders*' (emphasis added). M. R. Götz and T. H. Tröger, 'Fines for misconduct in the banking sector: What is the situation in the EU?', Scrutiny paper on the Single Supervisory Mechanism provided at the request of the Economic and Monetary Affairs Committee of the European Parliament, PE 587.401, 2017, p. 11.

NCAs in the imposition of sanctions contained in national law only, there still appears to be a mismatch between this situation and the ECB's exclusive competence in banking supervision. As is well known, to fulfil its task, and because some of the rules in the area of prudential regulation are still contained in directives, the ECB has become the first EU institution ever empowered to apply national law. NCAs admittedly continue to play a major role even in the supervision of SIs for which the ECB is directly responsible, not least by means of their participation in the Joint Supervisory Teams. However, this model of cooperation which develops under the ultimate responsibility of the ECB appears to be in stark contrast with the limited powers the ECB has in imposing sanctions. Put differently, there appears to be a discrepancy between the divide of responsibilities in supervising SIs and in sanctioning them if they fail to fulfil their obligations adequately. This discrepancy is all the more likely to lead to differences (i.e. to hamper the establishment of the level playing field among EBU Member States the EBU seeks to establish) as rules, practice and culture may vary among Member States. To remedy this situation, the ECB's influence on, or at least its involvement in, the procedures conducted by the NCAs could be enhanced, which would not only correct the imbalance underlined previously, but also contribute to more homogeneity across the EBU. Alternatively, full harmonisation and thus direct applicability could be fostered by including at least some of the rules currently contained in the CRD in the CRR instead.