# The principle of proportionality as an area of national discretion

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# The principle of proportionality as an area of national discretion (*)

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ABSTRACT

*It has already been discussed in detail in CEBS's technical advice to the European Commission on options and national discretions of 2008: the principle of proportionality has been an important theme for the application of national discretions by Member States addressing banking supervision rules. With the Europeanisation of the rules for banks and other financial undertakings, but especially with the creation of the Single Rule Book, the wide scope that existed in the past for Member States but also for national competent authorities has been reduced. What now remains is still a significant number of options and discretions that can lead to discretionary decisions, with a series of applications of the principle in supervisory practice aimed primarily at creating tailor-made solutions to address domestic specific circumstances. These tailor-made solutions are mainly found in cases where the objectives intended to be achieved by the application of rules can also be realised in another, often less onerous, way. However, with the increasing centralisation of the supervision of entities in the financial sector, this room for discretion appears to be further restricted, and there is an inherent urge to apply such national discretions restrictively in order not to put pressure on the intended harmonisation of the applicable legal framework, but above all to monitor and promote the level playing field in Europe.*

## 1 Introduction

The subject of national discretions in European banking law, and in particular reducing their number, has been on the agenda for about 15 years. In the era before the introduction of not only the Single Rulebook but also the Single Supervisory Mechanism ('SSM'), national discretions played a particular role in the debate whether the large number of discretions as contained in the 2006 Capital Requirements Directive[1] ('CRD 2016') did not prevent further harmonisation of the applicable rules of banking law within the European Union. In particular, the lack of harmonisation would also endanger the level playing field for banks in Europe, and

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1 Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast), OJ *EU* L 177, of 30 June 2006, pp. 1–200 ('CRD') and Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast) OJ *EU* L 177, of 30 June 2006, pp. 201–255 ('CAD') will jointly be referred to as CRD 2016 in this chapter.

as an aside, this also analysed the extent to which tensions could arise in this area in terms of the system of mutual recognition of supervision exercised by national supervisors, and the extent to which national law in the Member States had uniformly implemented the directive provisions of CRD 2016.

Barely a year after CRD 2016 came into force, the European Commission issued the Call for Advice to the Committee of European Banking Supervisors ('CEBS') to explore ways of addressing the large number of national options and discretions in CRD 2016, on the assumption that these national options and discretions stood in the way of a truly harmonised European banking law. This led to the large-scale project undertaken by CEBS in the years 2007 and 2008, and in the autumn of 2008 CEBS delivered its first advice to the European Commission[2] ('2008 CEBS Advice'). As a follow up on the 2008 CEBS Advice, the Commission requested further advice from CEBS on a concrete set of approximately 10 national options and discretions which was delivered to the Commission in June 2009[3].

Not only as a result of input in the consultation by all National Competent Authorities ('NCA'), but especially also as a result of input by the trade associations and a handful of institutions participating in the consultation, it emerged that there was broad support among supervisors but also the industry, that the 152 identified national options and discretions needed to be reduced to a significantly smaller number. CEBS advised the European Commission to cut the rules so that around 70% of the national options and discretions could be removed, and turned into rules from which, under normal circumstances, no more deviations or exceptions would be permitted.

Remarkably, CEBS then concluded that to the extent that the shrinking of national options and discretions would create bottlenecks in practice, then solutions to those bottlenecks would have to be found based on application of the principle of proportionality. CEBS advised the European Commission as follows:

> "*The possibility of removing options and national discretions rooted in local market conditions should also be examined, e.g., by looking at the possibility of achieving the same purpose by applying an existing proportionality provision. […].*"[4]

The attentive reader will have noticed, the work of CEBS and the Commission on the issue of national options and discretions took place amid the evolving Global Financial Crisis. With some irony, perhaps, it can be noted that all the work done by

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2 CEBS's technical advice to the European Commission on options and national discretions, 17 October 2008, to be consulted at https://www.eba.europa.eu.

3 CEBS's second advice on options and national discretions, 10 June 2009, to be consulted at https://www.eba.europa.eu.

4 Point 27(g) 2008 CEBS Advice.

CEBS and the Commission on that issue provided a perfectly good underpinning to the firm observation made in response to that GFC by the High Level Group De Larosière in February 2009, that as one of the factors that further inflamed that large-scale crisis in financial markets, appears to have been the lack of uniform rules or at least their uniform application in Europe. De Larosière noted:

> "*The present regulatory framework in Europe lacks cohesiveness. The main cause of this situation stems from the options provided to EU members in the enforcement of common directives. These options lead to a wide diversity of national transpositions related to local traditions, legislations and practices.*
>
> *This problem has been well-identified since the very beginning of the single financial market process. But the solutions have not always met the challenges. The fundamental cause for this lack of harmonisation is that the level 1 directives have too often left, as a political choice, a range of national options. In these circumstances, it is unreasonable to expect the level 3 committees to be able to impose a single solution. Even when a directive does not include national options, it can lead to diverse interpretations which cannot be eliminated at level 3 in the present legal set-up*."[5]

The rest of the episode is well known, it led to a large-scale and in-depth reorientation of the use of the legislative instrument of European regulations and the creation of a Single Rule Book, although it should be noted right away that there are many Single Rule Books. But the focus of this paper will be on the Single Rule Book for banks, namely on the 2013 Capital Requirements Regulation[6] ('CRR') and the 2013 Capital Requirements Directive[7] ('CRD4'). Next comes the introduction of the SSM which aims to centralise bank supervision, with a prominent role given to the European Central Bank ('ECB') for banks based in the Eurozone.

Now this chapter is not about analysing the ECB's work on the national options and discretions[8], nor is it about analysing the remaining options and discretions, and

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5 Points 102 and 103 in The High-Level Group on Financial Supervision in the EU chaired by Jacques De Larosière, Report 25 February 2009, to be consulted at ec.europa.eu/economy_finance/publications/pages/publication14527.

6 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ *EU* L 176, of 27 June 2013, pp. 1–337 as last amended by Regulation (EU) 2022/2036 of the European Parliament and of the Council of 19 October 2022 amending Regulation (EU) No 575/2013 and Directive 2014/59/EU as regards the prudential treatment of global systemically important institutions with a multiple-point-of-entry resolution strategy and methods for the indirect subscription of instruments eligible for meeting the minimum requirement for own funds and eligible liabilities, OJ *EU* L 275, of 25 October 2022, pp. 1–10.

7 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC OJ *EU* L 176, of 27 June 2013, pp. 338–436 as last amended by Directive (EU) 2021/338 of the European Parliament and of the Council of 16 February 2021 amending Directive 2014/65/EU as regards information requirements, product governance and position limits, and Directives 2013/36/EU and (EU) 2019/878 as regards their application to investment firms, to help the recovery from the COVID-19 crisis OJ *EU* L 68, of 26 February 2021, p. 14–28.

8 The ECB's work is precipitated in the following regulations and policy rules (Recommendations and Guidelines): Regulation (EU) 2016/445 of the European Central Bank of 14 March 2016 on the exercise of the options and discretions available under Union law (ECB/2016/4), OJ *EU* L 78, 24 March 2016, pp. 60-73 and Regulation (EU) 2022/504 of the European Central Bank of 25 March 2022 amending Regulation (EU) 2016/445 on the exercise of options and discretions

the extent to which the work of CEBS and the Commission in 2008 and 2009 as mentioned above has led, through the Single Rulebook, to an effective reduction of the set of national options and discretions. In this paper, I am focused on analysing the rationale of national discretions in the perspective of proportionality. And then especially also the (still) admitted individualised decisions by the NCAs or the ECB regarding application of rules to individual institutions on a case-by-case basis. What is noteworthy is that there is a significant number of cases in which institutions put the plea forward invoking the principle of proportionality, in order to arrive at a decision by the relevant competent authority that they find conducive.

## 2 What are national discretions?

So, what is a 'national discretion'? This concept is often mentioned in the same breath as national options. Yet in its nature, there is a fundamental difference between the two. What these concepts mean is not clearly framed in the laws and regulations. In its May 2008 consultation paper, CEBS provides the following consideration:

> "*CEBS understands that "options and national discretionary powers" can be interpreted broadly or narrowly. The narrow definition limits options and national powers to those provisions in the CRD that permit a Member State or its competent authorities to (i) choose how all relevant institutions in the jurisdiction should comply with a particular provision, by choosing from a range of alternatives set out in the directive; and (ii) choose whether or not a particular provision should be applied to all institutions in the jurisdiction. In these cases, the level playing field between institutions may be compromised, and for - institutions and banking groups operating across borders, this may result in additional burdens to reconcile different approaches in each of the* Member State*s where they operate. Where the proposals in the annex refer to national competences, they refer to this limited definition*."[9]

Through the public information provided by the Swedish regulator in this area, the following further definitions can be provided:

> "*'Option' refers to a situation where competent authorities or Member States are given a choice on how to comply with a given provision selected from alternatives set out in the Directive.*

available in Union law (ECB/2016/4) (ECB/2022/14), OJ *EU* L 102, of 30 March 2022, pp. 11-15, Guideline (EU) 2017/697 of the European Central Bank of 4 April 2017 on the exercise of the options and discretions available under Union law by national competent authorities in relation to less significant institutions, (ECB/2017/9), OJ *EU* L 101, 13 April 2017, pp. 156-163, European Central Bank Recommendation of 4 April 2017 on common specifications for the exercise of certain options and discretions available in Union law by national competent authorities in relation to less significant institutions, (ECB/2017/10), OJ *EU* C 120, 13 April 2017, pp. 2-9, and most recently ECB Guide on options and discretions available in Union law, March 2022, to be consulted at www.bankingsupervision.europa.eu.

9 CEBS, Consultation Paper on CEBS's technical advice to the European Commission on options and national discretions, 22 May 2018, point 22, to be consulted at https://www.eba.europa.eu.

> *'Discretion' or "National Discretion" refers to a situation where competent authorities or Member States are given a choice as to whether to apply a given provision*."[10]

Now I must be careful not to put words in the mouth of the Swedish regulator that it did not intend to put down on the publication. The regulator's relevant webpage refers to these definitions coming from the European Banking Authority, but at the same time I could not retrieve them on EBA's website. And by referring to the EBA definitions, the Swedish authority no doubt intended to do nothing more and nothing less than refer to the definitions used by EBA (and its predecessor CEBS) in a narrow sense, not in the broad sense I have in mind.

The narrower definition given here by CEBS may be the most appropriate for the topic covered in academic work on the analysis of application of national options and discretions in practice. For dealing with the subject matter of this paper, I seek a broader definition that also addresses the possible trade-offs that could be made by the relevant competent authority in terms of compliance by institutions on an individual basis, or making a decision (based on proportionality) that would permit the institution in question to not be able or not need to fully comply with a particular rule. So, on that front, I am looking for a broader definition.

CEBS' work was focused on the exercise of national options and discretions by the Member States and national competent authorities leading to a particular application of the rules for the group of institutions established in the relevant Member State that have to comply with the same rules. One example is the rule in 178(1)(b) CRR concerning the determination of the situation when a customer/debtor of an institution is 'in default'. The second sentence of that paragraph provides that:

> "*competent authorities may replace the 90 days with 180 days for exposures secured by residential property or SME commercial immovable property in the retail exposure class*."

As is well known, this discretion has not been applied by the ECB, and pursuant to Article 4 of the ECB Regulation of 2016[11], it has been clarified that all significant banks for the purpose of determining whether their client/debtor is in default should be based on the case where the obligor is more than 90 days past due. For LSIs established in one of the member states where the SSM is being applied, the ECB

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[10] www.fi.se/en/bank/supervision/supervisory-disclosure/options-and-national-discretions.Using the same definitions: Central Bank of Ireland, *Implementation Notice for Competent Authority discretions in the Capital Requirements Regulation and Capital Requirements Directive*, December 2022, p. 2 to be consulted at www.centralbank.ie.

[11] Regulation (EU) 2016/445 of the European Central Bank of 14 March 2016.

has cast a guideline that the NCAs apply this discretion accordingly for all the LSIs established in that member state[12].

Recital (5) of the 2017 ECB Recommendation[13] aptly articulates the area of tension in this regard:

> "*A common set of specifications for the individual exercise of options and discretions is necessary, on the one hand, in order to promote consistency, effectiveness and transparency in the supervision of less significant institutions within the SSM and, on the other hand, to foster, where needed, equal treatment of significant and less significant institutions as well as a level playing field for all credit institutions across the participating Member States. At the same time, the principle of proportionality and the legitimate expectations of supervised credit institutions must be taken into account*."

This paper deals with the exercise of (options and) discretions on a case-by-case basis either following individual assessment of applications by credit institutions or in cases where the relevant competent authority is asked to take a decision or is required to take a decision in relation to an individual institution, without a generic application of the rules to (the same group of) institutions. Such a decision may therefore result in a result of non-application of a rule for the individual institution concerned or the rule should be applied in a unique way, while other institutions should apply the same rule or in a different way than is the case for the institution subject to the individual decision. An example concerns decisions relating to Article 8(1) CRR concerning liquidity waivers at cross border level. Institutions may ask the competent authority for a waiver from the obligations to apply the rules of Part 6 CRR for all or some of the subsidiaries established in the Union through which supervision takes place on the basis of a single liquidity (sub-)group. The provision of Article 8(1) CRR confirming this application of the discretion is then formulated as follows:

> "*The competent authorities <u>may waive</u> (emphasis, BJO) in full or in part the application of Part Six to an institution and to all or part of its subsidiaries in the Union and supervise them as a single liquidity sub-group as long as they fulfil all of the following conditions […]*"

This is a good example of the type of national discretions envisaged to be covered in this paper. It is thus a discretion exercised in respect of an individual institution (included in a group of institutions or other companies). It is also a fine example of the method by which the legislature aims to frame the exercise of discretion, i.e. to bind the relevant competent authority to limits on the exercise of discretion. Indeed, applying the rule is subject to strict conditions. It is those conditions that must be met

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12 Article 4 of Guideline (EU) 2017/697 of the European Central Bank of 4 April 2017 on the exercise of the options and discretions available under Union law by national competent authorities in relation to less significant institutions, (ECB/2017/9).

13 European Central Bank Recommendation of 4 April 2017 on common specifications for the exercise of certain options and discretions available in Union law by national competent authorities in relation to less significant institutions, (ECB/2017/10).

by the institution concerned for it to be eligible for the application of the waiver, otherwise the waiver may not be granted. In my view, the trend in recent years has been that the legislator has increasingly worked with this type of tied discretions, which has an effect on uniformity of application of prudential rules for credit institutions in the Union, and which also creates better conditions for the level playing field.

Other (non-exhaustive and arbitrarily chosen) examples of such exercisable discretions (although sometimes presented in the legal text as “options” rather than discretions) are:

- The rule in Article 7(1) CRR regarding the derogation from the application of prudential requirements on an individual basis intended for subsidiaries in the group that are themselves banks but included in supervision on a consolidated basis;
- The rule of Article 31(1) CRR where in emergency situations, competent authorities may permit institutions to include in Common Equity Tier 1 capital instruments that are not fully meeting the requirements of Article 28 CRR, but where such instruments are issued by institutions in the context of state aid operations;
- The rule in Article 49(1) CRR on the requirement for deduction of capital instruments held in financial sector entities if consolidation, supplementary supervision or institutional protection schemes are applied, where competent authorities may permit the deduction of such instruments to be omitted under conditions;
- The rule in Article 78(3) CRR where competent authorities may permit institutions to withdraw, redeem or at least cancel, from the volume regulatory capital, Additional Tier 1 or Tier 2 instruments in certain cases if at least five years have elapsed since their issue;
- The rule of Article 244(3) CRR where authorities may permit the originator institution to recognise the significant credit risk transfer of a securitisation, which does not fully comply with the conditions of ordinary significant risk transfer transactions, provided certain strict conditions are met;
- The rule under Article 396 CRR where competent authorities may permit an excess of the limit on concentration of exposures for a limited period of time (where the circumstances warrant it);
- The old rule under Article 429(14) CRR which allowed the competent authority to permit an institution to exclude from the exposure amount for the

calculation of the leverage ratio certain exposures, subject to strict conditions[14];

- The rule of Article 21b CRD4 on the permission to establish multiple intermediate EU parent undertakings instead of one single EU parent undertaking, for groups where the ultimate parent undertaking is established in a third country; and
- The regime of Article 69 (1) CRD4 on the publication of administrative penalties, where the authorities are empowered to defer such publication when the circumstances that led to the irrevocable imposition of the administrative penalty will cease within a reasonable period of time.

The discretions provided for in various provisions of the prudential framework to address the procedural side are expressly disregarded. For example the discretions given to competent authorities in Article 22 CRD4 on the notification and assessment of proposed acquisitions of qualifying holdings, where the competent authority has the discretion to extend certain deadlines in individual cases, if only that this discretion is in many cases given in favour of the competent authority and not the one subject to the procedure.

Discretions of competent authorities that are rather related to the design and application of generic exception rules that can be applied by institutions that are all in the same circumstances or to which the same facts apply (however those generic exception rules are named in local law, be it explicit exemptions, exception rules, exclusions from the scope of applicability and the like more) are also disregarded. It should be kept in mind that it is exceedingly rare that competent authorities can make such binding rules, and it is rather up to the legislature in the Member States to determine how that generally binding rule will be embedded in the country's legal system. An example of such rules is, among others, Article 129 CRR on the levels of required overcollateralisation in the design of covered bonds.

I am therefore using the above cited definitions in the abstract, in order to arrive at my points in this paper, because my purpose is to delve into the question of whether, and if so to what extent, based on rules of banking law and banking supervision, competent authorities can have sufficient discretion, based on

[14] The relevant discretion whether or not to apply the discretion to derogate from the rule of Article 429(14) CRR has been removed by the amendments introduced by Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012, Pb EU L 150 of 7 June 2019, pp. 1-225. The amendments concerned also impacted the subject matter of application of the derogation by the ECB in the case of French banks which will be discussed in Paragraph 4.

considerations of proportionality, to make decisions aimed at the individual institution. The ultimate consequence of this may be, that for this institution, based on such a decision, a different application of the rules takes place compared to the way the same rules are applied with regard to other institutions. If such a decision aimed at an individual institution could be based at all on application of the principle of proportionality, it will have to be at least with the discretion given to the assessing authority under the applicable regulations. At least for EU institutions, this was confirmed in Landeskreditbank Baden-Württemberg v ECB[15]. This point will be further explored in Paragraph 4 of this paper.

## 3 Proportionality in the context of national discretions

Proportionality as a general principle of EU law as set out in Article 5(4) of the TEU implies that three questions must be considered: first, whether the act in question is appropriate or adequate to achieve the aim pursued; and second, whether the measure is necessary to achieve that aim, or whether that aim can be achieved by a less burdensome method. The third question to be responded is, sometimes referred to as proportionality *strictu sensu*: whether the disadvantages caused are not disproportionate to the aims pursued. When Member States invoke reservations or derogations in respect of EU law introducing measures that restrict fundamental freedoms, proportionality is applied more strictly.[16]

The objective of this paper is not to cover the extensive developments in European law on the application of the principle of proportionality in all its facets. This much is certain, both in European administrative law and in national administrative legal systems, this principle plays a prominent role, both in the way vertical relations between the European institutions and the Member States are managed, and in horizontal relations between the (enforcing) European institutions and legal subjects when the application and enforcement of Union law by national authorities is similarly shaped.

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15 ECJ 8 May 2019, C-450/17, paragraph 53 and the following case-law cited therein: ECJ 12 December 2006, C-380/03, Germany v. European Parliament and Council. See for another reference to this rule, ECJ 7 December 2022, Case T-330/19 PNB Banka AS v. ECB, point 196.

16 See, among other judgments, ECJ 10 September 2002 C-491/01, British American Tobacco v. Secretary of State for Health, ECJ 9 March 2010 C-379/08 *et seq.* ERG and others, ECJ 22 January 2013 C-283/11, Sky Österreich v Österreichischer Rundfunk, ECJ 16 June 2015 C-62/14, Gauweiler c.s. v. Deutscher Bundestag, ECJ 4 May 2016 C-547/14 Philip Morris c.s. v. The Secretary of State for Health, ECJ 6 September 2017 C-643/15, Slovakia and Hungary v. European Council, ECJ of 8 May 2019, in Case C-450/17-P, Landeskreditbank Baden-Württemberg-Förderbank v. ECB, and ECJ 7 December 2022, T-275/19, PNB Banka AS v. ECB, (Decision ECB to conduct an inspection at the premises of a LSI); T-301/19, PNB Banka AS v. ECB (ECB decision classifying the Bank as SI); T-330/19, PNB Banka AS v ECB (Opposition ECB to approve acquisition of Qualifying Holding in the Bank) and T-230/20, PNB Banka AS v. ECB (Decision to withdraw the authorisation).

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The intriguing aspect of recent developments in the area of the Single Rulebook and the SSM is, that there can be found in a more accessible way an understanding of how this principle works in the relationships between firms operating within the financial system and the role of supervisory authorities. This builds on the previously constituted law, where disclosure of the legal rules will mostly be based on the research into the formation of law in other areas of law (*e.g.*, competition law, public health law, fundamental freedom of expression).

So, the advent of the Single Rule Book, as well as the preparatory work of CEBS on the subject of national options and discretions discussed here, and the discourses and work in the context of the SSM, as it were, also lead to a better understanding of the subject we are dealing with in this paper. It should not be ruled out that the way in which legal formation develops in this area will possibly deviate here and there from the local insights and local law in certain Member States, but the essence is, that the unifying effect of the foundation of the European System of Financial Supervision, the roles of EBA and the other European supervisors in this area, the advent of the Single Rule Book but above all because of the principles and rules of the SSM, there is a trend of convergence also in the area of the interpretation of the important principle of proportionality.

But there is also, in my view, a new and unique dimension in terms of the application of the principle of proportionality, in terms of the organisation of the SSM and the application of the rules contained in the SSM Regulation[17] and the SSM Framework Regulation[18]. That new dimension, of course, has to do with the distinction between significant institutions ('SI') and less-significant institutions ('LSI'), where it would be wrong to assume that prudential supervision rules should be applied more rigorously or comprehensively for SI institutions, and that there would be room, on the grounds of proportionality, to arrive at a more lenient application of those rules in respect of LSIs.

The above quote from the 2017 ECB Recommendation also clearly reflects this area of tension. In any case, the ECB's work on national options and discretions has focused on clarifying that there cannot be a varying application of prudential supervision rules as regards SIs on the one hand and LSIs on the other. In this regard, the ECB has provided further clarifications with the 2017 Recommendation

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17 Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, OJ *EU* L 287, of 29 October 2013, pp. 63-89.

18 Regulation (EU) No 468/2014 of the ECB of 16 April 2014 establishing the framework for SSM cooperation between the ECB, the national competent authorities and the national designated authorities, OJ *EU* L 141, of 14 May 2014 pp. 1-50.

and the 2017 Guideline[19] on the need to achieve uniform application by NCAs in their supervisory practices towards LSIs of the principles expressed in the 2017 Regulation and the ECB Guide for SIs[20].

## 4 Discretionary powers of the assessing authority

It is clear that the competent authority's consideration of a decision aimed at an individual institution, with the proportionality principle then playing a role in the considerations, will become relevant if the authority in question has also been given that discretion under the substantive law provisions. Otherwise, a complaint about insufficient balancing, including a consideration of whether the application of a rule is proportionate, will quickly end in the inadmissibility of the claim. It is the legislature that makes the choices in this area in which cases discretion is given to the relevant executive or applying authority. In other words, the legislature is thus the first to decide in which cases rules should be applied fully and without exceptions, and it is the legislature that primarily has the discretion in terms of creating the level of applicable laws and regulations.

This importantly played a role in the Court case Landeskreditbank Baden-Württemberg v ECB. The claimant in the case dealt with by the General Court[21,] amongst others, submitted to the Court that notwithstanding the balances made by the legislature in terms of the design of the criteria in Articles 6(4) SSM Regulation and Article 70(1) SSM Framework Regulation, it did not preclude an independent interpretation, based on the principle of proportionality, as to whether the granting of the SI status was appropriate and thereby applying ECB's discretion[22.] The ECB and the Commission submitted among other reasoning, that the principle of proportionality had already been taken into account by the legislature when the SSM Regulation was drafted, by the division of tasks between the ECB and the NCAs as regards their respective roles in respect of significant institutions ('SI') and less significant institutions ('LSI').[23] They contested the merits of the interpretation as suggested by Landeskreditbank Baden-Württemberg. Now interpretation of a legal rule, is different from a decision to balance proportionality notwithstanding the

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19 Guideline (EU) 2017/697 of the European Central Bank of 4 April 2017 on the exercise of the options and discretions available under Union law by national competent authorities in relation to less significant institutions.

20 ECB Guide on options and discretions available in Union law, March 2022.

21 ECJ, General Court judgement of 16 May 2017, Case T-122/15.

22 As reflected in paragraph 35 of the judgement of the Court of 16 May 2017 Landeskreditbank Baden-Württemberg stated: "Moreover, the wording of those two provisions does not preclude an examination of the proportionality of the classification of an entity as significant."

23 As reflected in paragraph 37 of the judgment of the Court of 16 May 2017 and confirmed in the appeal case Judgement of de ECJ of 8 May 2019, in Case C-450/17-P (Landeskreditbank Baden-Württemberg-Förderbank (appellant) v. ECB (defendant at first instance), paragraph 59.

interpretation of the legal rule. The relevant passages in the Court's judgment therefore address the former issue but not yet the latter.[24]

It is well known that in this case the claimant relied on the wrong premise that what is provided in Article 70(1) SSM Framework Regulation, which permits for an effective consideration of the appropriateness of the ECB's classification as a SI, is based on a division of powers between the ECB and the Member States, denying the grant on an exclusive basis of powers to the ECB. Thus, the claimant's argument, which purported to complain about the absence of application of the discretion that the ECB should have applied, was short-circuited because it was based on that incorrect reading of the SSM Regulation and therefore assumed that the ECB was required to make other considerations. To that extent, then, this case is not entirely conclusive as to whether notwithstanding a particular interpretation of the legal rule, a further balancing of interests based on proportionality can be made.[25]

The case does, however, provide insight into the legal rules that exist with regard to such an application of discretionary powers. First, it confirmed that such discretionary power must actually have been granted to the relevant (EU) institution.[26] If it has been granted, and the relevant (EU) institution is reproached for not using it, it will be able to be held accountable for it in court. If discretion has been given to the competent authority, it must also make full use of it.[27] Exercising that

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24 As reflected in paragraphs 39 *et seq*. of the judgment of the Court of 16 May 2017 where the Court considered that this interpretation (i) "requires account to be taken not only of its wording but also of its context and of the objectives pursued by the body of rules of which it forms part" (referring, *inter alia*, to ECJ, 7 June 2005, C-17/03, VEMW and Others) (ii) "where the textual and historical interpretation of a regulation, in particular of one of its provisions, does not make it possible to assess its precise scope, the regulation in question must be interpreted by reference to both its purpose and its overall structure" (referring to ECJ 31 March 1998, C-68/94 and C-30/95, France and Others v. Commission, and ECJ 25 March 1999, T-102/96, Gencor v. Commission) and (iii) "where a provision of secondary EU law is to be interpreted, preference should as far as possible be given to the interpretation which brings the provision into conformity with the Treaty and the general principles of EU law" (ECJ 4 October 2007, C-457/05, Schutzverband der Spirituosen-Industrie, ECJ 10 July 2008, C-413/06 P, Bertelsmann and Sony Corporation of America v Impala and ECJ 25 November 2009, T-376/07, Germany v. Commission).

25 See for an elaborate discussion of this case: Antonia Luca Riso, *A Prime for the SSM before the Court: The L-Bank Case*, Chapter 29 in in Judicial Review in the European Banking Union, Edited by Chiara Zilioli and Karl-Philipp Wojcik, Elgar Financial Law and Practice, Edgar Elgar Publishing, Cheltenham, ((2021), pp. 494-503.

26 The General Court considers in paragraph 68 of the judgement of 16 May 2017 as follows "the assessment of the proportionality of a measure must be reconciled with compliance with the discretion that may have been conferred on the EU institutions at the time it was adopted" referring to ECJ 12 December 2006, C-380/03 Germany v Parliament and Council. This judgement has been upheld in the appeal case, Judgement of de ECJ of 8 May 2019, paragraph 53. See on this important point: Michael Ioannidis, *The Judicial Review of Discretion in the Banking Union: From 'soft' to 'Hard(er)' Look?*, Chapter 9 in Judicial Review in the European Banking Union, Edited by Chiara Zilioli and Karl-Philipp Wojcik, Elgar Financial Law and Practice, Edgar Elgar Publishing, Cheltenham, ((2021), p. 134.

27 See the General Court's considerations in this regard in paragraph 139 of the judgement of 16 May 2017 with reference to ECJ 14 July 2011, T-357/02RENV, Freistaat Sachsen v. Commission and ECJ 10 July 2012, T-304/08, Smurfit Kappa Group v Commission.

discretion presupposes the taking into consideration of all the relevant factors and circumstances of the situation the act was intended to regulate[28].

These rules played a fundamental role in the six identical cases brought to the ECJ by French banks in respect of the application of Article 429(14) CRR about the potential exclusion of exposures of institutions from the calculation of the total exposure measure for the purposes of the leverage ratio.[29] The applicants in these cases contested the decision of the ECB to refuse granting the derogation applying Article 429(14) CRR. More importantly the applicants in these cases considered, that the ECB erred in law by depriving the possible application of a derogation of Article 429(14) CRR from its practical effect, by using the discretion.[30] In accordance with the General Court's judgement, firstly the provision of Article 429(14) CRR must be interpreted:

> "as conferring on the competent authorities a discretion to refuse to grant the derogation which it establishes even when the conditions set out in that provision are met."[31]

The General Court found that the application of the discretion by the ECB on grounds that would deprive the provision of Article 429(14) CRR from its practical effect and make the provision virtually inapplicable cannot be permitted.[32] The General Court concluded that the decision of the ECB is vitiated by an error of law by not considering all the circumstances and making further assessments in order to apply the derogation set out in Article 429(14) CRR. The General Court also concluded that the reasoning of the ECB by refusing to apply the derogation was manifestly incorrect and that the pleas of the applicants must be upheld and the contested decisions of the ECB to be annulled.[33]

Leaving aside the need for the exercise of discretion to find its basis in a power explicitly given to the competent authority and the scrutiny that may be laid upon by the courts when the discretion is not being applied or is applied in an incorrect

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28 Paragraph 139 of the judgement of 16 May 2017 referring to ECJ 7 September 2006, C-310/04, Spain v Council.

29 ECJ 13 July 2018, T-733/16 (Banque postale v ECB), ECJ 13 July 2018, T-745/16 (BPCE v ECB), ECJ 13 July 2018, T-751/16 (Conféderation nationale du Crédit mutuel v ECB), ECJ 13 July 2018, T-757/16 (Société Générale v ECB), ECJ 13 July 2018, T-758/16 (Crédit agricole v ECB) and ECJ 13 July 2018, T-768/16 (BNP Paribas v ECB). See extensively on these cases, Ioannidis, Ibid., page 140. 13 July 2018, T-733/16 (Banque postale v ECB)

30 See General Court's considerations in this regard in paragraph 76 of the judgement of 13 July 2018, T-733/16 (Banque postale v ECB).

31 See General Court's considerations in this regard in paragraph 58 of the judgement of 13 July 2018, T-733/16 (Banque postale v ECB).

32 See General Court's considerations in this regard in paragraphs 79 to 93 of the judgement of 13 July 2018, T-733/16 (Banque postale v ECB) referring to ECJ 11 December 2008, C-407/07 Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing.

33 See General Court's considerations in this regard in paragraphs 110 to 118 of the judgement of 13 July 2018, T-733/16 (Banque postale v ECB).

manner[34], the question will then be which element of the proportionality principle in particular may be part of the relevant considerations when applying discretion. In my opinion, that exercise of a discretion will not be permitted, where the executive competent authority is concerned, to consider the question whether the act in question is appropriate or adequate to achieve the aim pursued. After all, the consideration of an objective to be achieved by a legislative rule or measure (i.e. its rationale) is primarily reserved for the legislator.

Once a decision or measure has to be taken simply because it follows from the clear legal rule in question, it would be arbitrary for the competent authority to be able to decide, in other words have a margin of appreciation, not to apply that legal rule because the consequences would be too far-reaching. On that front, the competent authority would deliberately act in violation of the law if an authority would decide not to apply the relevant rule in an individual case, while in other similar cases that rule would be applied. This is because the authority believes that the consequences of applying that rule in that exceptional case would lead to disproportionate effects. The door for arbitrary decisions would then be left open. For example, under a statutory provision, violation of a rule carries an administrative sanction, such as a fine. Then it would not be within the power of the relevant authority to refrain from imposing that fine when the violation has been established, because the consequences would be too detrimental to the institution concerned[35].

This does not mean that in such cases, observing the principle of proportionality, the competent authority will be able to reflect on the ultimate consequences of the decision or measure. For example, in the case where a violation should be sanctioned by a fine, on the basis of a capacity justification, on the basis of the duration of the infringement, on the basis of the gravity of the infringement and such other considerations, it may adjust the amount of the fine accordingly downward[36]. If, for example, a statutory provision provides that when imposing a fine the

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34 See for this important doctrine: Ioannidis, Ibid., paragraphs 9.22 to 9.24. He concluded in respect of the cases brought for the General Court by the six French banks (see n 27): “It is true that the Court does not simply defer to the assessment of the ECB and adopts a more searching and elaborate look at the exercise of the discretion. However, two of the basic criteria for reviewing discretion at the case at issue, namely the self-elimination of discretion and consistency, are formal and external to the assessment of the ECB - they do not seek to substitute the substance of supervisory assessment but to discipline its conditions.” For the purpose of his analysis Ioannidis then further explores the question as to whether or not the General Court considered to substitute the ECB decision with its own judgement. This important doctrine on the review of discretion is not further discussed in this paper.

35 See: ECJ 28 June 2005, Dansk Rørindustri A/S, and others v. Commission, Joined cases C-189-02 P, C-202/02 P, C-205/02 P to C208/02 P and C-213/02 P, judgement in paragraph 325.

36 Albeit that the competent authority concerned has no obligation to do so, and must be mindful of the potential distortion that might arise when considering these circumstances when balancing its decision to a more favourable outcome, as this may result in a conflict with the pursued aim of the rules, see: ECJ 28 June 2005, Dansk Rørindustri A/S and others v. Commission, judgement contained in paragraph 327.

competent authority must disclose that imposition as part of a 'naming and shaming' rule[37], then in my view it would not be permissible for the competent authority to waive that disclosure because it would not be proportionate given the individual circumstances of the institution in question. I would argue that this applies, barring explicit hardship clauses, in other words an expressly stated power of balancing in the law for the authority to waive all or part of the rule, often on grounds of proportionality. But it thus presupposes, as highlighted above, an express foundation in the statutory rule that that power of balancing exists. That point is valid, with the exception of the balancing to be made regarding violation of fundamental rights.

In my view, a consideration by the competent authority with due regard to the principle of proportionality will come down to a consideration of whether the aim can be achieved by a less burdensome method. It will then come down to the fact that the competent authority will have several methods at its disposal and will have to choose the one that is least onerous for the institution. It is in the latter cases in particular that in the Court's recent case-law several pleas have been made on the application of the principle of proportionality, which had to have effect in terms of choosing the least onerous method. This doctrine will be discussed further below in Paragraph 6.

## 5 Applying discretion to achieve the legislative aim pursued.

I consider an interlocutory point, which I believe is important to discuss. This, in its nature, involves the case where the executive competent authority proceeds to exercise discretion given to it, in order to arrive at an application of rules and enforcement thereof for which the aim is expressed in the primary law (i.e., the Treaty of the European Union ('TEU') or Treaty of the Functioning of the European Union, ('TFEU') or secondary framework legislation based on the TEU or TFEU (collectively, the 'Treaties'). It could be said that there is then 'reverse discretion' here, i.e. the competent authority applies rules, or adopts policy rules on that application, which are contrary to the individual circumstances of the addressee of the norm, or at least which lead to a uniform application and enforcement of rules, without individual circumstances of the addressee in question altering the choices made in application or enforcement. And where proportionality considerations make no difference in terms of rulings regarding the individual circumstances of the case.

This question arose in the landmark decision of the ECJ of 28 June 2005 (Dansk Rørindustri A/S and others v. Commission)[38] in the extensive appeal case in the field

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37 Such provision implementing the rules of Article 69 CRD4.

38 ECJ 28 June 2005, Joined cases C-189-02 P, C-202/02 P, C-205/02 P to C208/02 P and C-213/02 P.

of enforcement of competition law rules. Here the European Commission, as a result of the exclusive powers expressed in (now) Article 105 TFEU, acts as the supervisory authority. This case involved the following. Pursuant to the mandate given to the Commission in the Treaties[39], the Commission, through its Guidelines on the method of setting fines imposed pursuant to Article 15(2) of Regulation 17 and Article 65 of the ECSC Treaty[40] ('Guidelines'), introduced a new method for determining the level of fines to be applied in the event of violations of Article 85 or 86 Treaty on the European Community[41]. These Guidelines in turn were based on Article 15 of Council Regulation No 17 of 6 February 1962[42].

Dansk Rørindustri A/S and a number of other businesses had been subject to investigations by the Commission in the context of an alleged breach of the European anti-cartel provisions. The businesses concerned were required to cooperate with investigations. The Commission adopted a decision in which it found that the businesses concerned had participated in a series of agreements and concerted practices within the meaning of the anti-cartel provisions of the EC Treaty. The case resulted in the imposition of fines to the cartel-participants.

Ten undertakings disputed that imposition of fines, particularly the amount of the fines. In the court case involved it was not disputed that the amount of the fines was calculated according to the method laid down in the Guidelines. Moreover, it was common ground that the decision of the Commission imposing the fines makes no reference to the Guidelines, that the undertakings concerned were not informed during the administrative procedure that the method set out in the Guidelines would be applied to them and that that method was not mentioned in the preliminary statements of the Commission issued prior to the hearings organised in the context of the case.[43] Finally, with the exception of one undertaking, the fines had been reduced with a certain percentage granted in return for the cooperation given by the businesses concerned.[44]

The fines in this cartel case were of considerable magnitude, in many of the cases amounting to many tens of millions of euros per company. It is therefore understandable that in this appeal before the Court a whole range of defences were put forward, relying on numerous important principles, such as the principle of

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39 Particularly (now) Article 105(3) TFEU.
40 OJ EC C9 of 14 January 1998, pp. 3 *et seq*.
41 Now Articles 101 and 102 TFEU.
42 First regulation implementing articles 85 and 86 of the Treaty, OJ EEC Special Edition 1959-1962, pp. 87 *et seq*.
43 See paragraphs 26 and 27 of the ECJ Judgment of 28 June 2005.
44 The cooperation concerned an agreement not to dispute the essential elements of the infringements or in having contributed, to varying degrees, to establishing the proof of the infringements. See paragraph 28 of the ECJ Judgment of 28 June 2005.

proportionality, the principle of equal treatment, the protection of legitimate expectations (of the businesses concerned) and the prohibition of retroactive effect of rules (of a punitive nature). The main sticking point concerned the application of the Guidelines, in which the Commission laid out a new policy on the extent to which fines could be mitigated in the event of a cooperative attitude on the part of the company accused of violating the antitrust rules. These Guidelines, in short, assume a significantly less mitigating effect of a cooperative attitude than was previously established practice before the Guidelines came into force and were applied.

My main focus now is the debate in this case about the limits of the Commission's powers in implementing the guidelines in this case, the point about:

> "*the lawfulness of administrative action owing to the Commission's failure, in the exercise of its discretion, to observe the limits on the use of that power laid down in [that], (the Council regulation, add. BJO) provision and also misuse of that power in applying that provision in the present case, owing to breach of the principles of proportionality and equal treatment, to the appellants detriment […]"*[45]

The Commission developed itself in the Guidelines the guiding principles for the imposition of fines in cases of breaches of the competition laws. In the preamble it was stated as follows:

> "*The principles outlined here should ensure the transparency and impartiality of the Commission's decisions, in the eyes of the undertakings and of the Court of Justice alike, while upholding the discretion which the Commission is granted under the relevant legislation to set fines within the limit of 10% of overall turnover. This discretion must, however, follow a coherent and non-discriminatory policy which is consistent with the objectives pursued in penalising infringements of the competition rules. The new method of determining the amount of a fine will adhere to the following rules, which start from a basic amount that will be increased to take account of aggravating circumstances or reduced to take account of attenuating circumstances*.[46]"

In cases involving violations of rules of competition law, the Commission believed that the underlying (primary) legislation confers broad discretion on the Commission, the limit being to set fines at up to 10% of the (overall) turnover. In other words, the Commission's discretion lies within the range of 0% and 10% of (overall) turnover, and as long as it stays within that range, it is up to the Commission to take into account the various circumstances of the case. These may be aggravating, leading to fines in the higher end of the bandwidth, or mitigating, leading to a lower impact of the sanction in question.

It should be expressly stated that the debate in this case is not so much about whether the Commission has the wide discretion as given by the provisions of the

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45 LR GmbH's second plea in law to be found in paragraph 48 of the ECJ Judgment of 28 June 2005.

46 Included in paragraph 6 of the ECJ Judgement of 28 June 2005.

Treaties, but rather whether that discretion goes so far as to permit the Commission, by relying on new policy (as expressed in the Guidelines), to depart from a long-standing practice in terms of fining. Moreover, in the present case, the Commission, when announcing its intention to impose fines, discussing it at the hearings but also in the decision finding the infringement and imposing fines, did not take into account that it intended to apply the rules set out in the Guidelines, i.e. to take a different line from the one it had taken in the past. The appellants in this case complain that this wide exercise of discretion is at odds with numerous principles of European law but also invoke the violation of fundamental rights as given under The European Convention for the Protection of Human Rights and Fundamental Freedoms.

All to no avail for the appellants, the Commission's very far-reaching decisions in terms of imposing very significant fines were all upheld in the appeal case, giving the Commission a very wide discretion to take these far-reaching decisions, citing the Commission's mandate in the Treaties to enforce European competition law. In all appellants' pleadings, the principle of proportionality plays a major role, as the appellants argued the Commission's change in policy through the application of the Guidelines to the present case (and thus the changed method of fining) led to a very significant jump in terms of the size of the fines, compared to the level of fines imposed in similar cases in the past.[47]

## 6 Choice of least onerous method

As argued above, the greatest scope for proportionality considerations for competent authorities is to be found in cases where, for the application of a rule, several methods are available that can ultimately achieve the objective of the rule, which may lead to an assessment of which of the methods is the most appropriate in the individual case. It is not for the executive competent authority to make interpretations, on grounds of proportionality, as to the aim of the relevant provision of substantive law, and, as argued above, the utmost caution will also have to be exercised in assessing whether a decision or measure in respect of the individual undertaking concerned may lead to disproportionate effects or disadvantages. If the rule applies, and the rule is clear, it is not for the implementing or enforcing competent authority to reach a conclusion that the rule need not be applied or complied with, in part or not, because the consequences for the individual institution

[47] See particularly the judgments in paragraphs 245 albeit that the Court founds the plea of one of the appellants that would require the Court the re-examination of the fines in appeal on the grounds that they are disproportionate inadmissible and furthermore the judgments contained in paragraphs 324 *et seq*. and 346/347 of the ECJ Judgment of 28 June 2005 where the Court found that the weighing of the observance of the principle of proportionality was sufficiently supported in the judgements of the Court of First Instance.

concerned would be disproportionate. It would lead to eroding the level playing field, and to distortions in terms of the application of the relevant rules in practice.

In a series of recent Judgments by the ECJ of 7 December 2022 on the issue of the supervision of Latvia's PNB Banka AS (the 'Bank'), an LSI under the criteria of Article 6(4) SSM Regulation, the issue of scrutiny against the principle of proportionality with a view to achieving the least onerous effect has been extensively discussed[48]. These cases provide a very interesting interpretation of the issue addressed in this paper, namely the issue of the exercise of discretion by the supervisor taking into account the principle of proportionality. Readers of the paper will be aware of the myriad of actions brought before the Court, after the ECB declared the Bank 'failing or likely to fail' in August 2019 pursuant to the SRM Regulation[49], the Single Resolution Board subsequently decided not to initiate resolution of the Bank, and the Bank was subsequently declared bankrupt pursuant to application of Latvia's local bankruptcy law. This paper does not cover all aspects of this case, but the paper concerns the analysis of the rules of law regarding the principle of proportionality in relation to the exercise of (national) discretions.

In the *first Judgement of the ECJ of 7 December 2022* in the matter of PNB Banka AS v ECB[50] the Bank challenged the (deemed) adopted decision of the Governing Council of the ECB of 21 January 2019 to conduct an on-site inspection at the premises of the Bank, which decision was taken by the ECB pursuant to Article 6(5)(d) SSM Regulation[51] and to prepare for the taking over of the direct supervision of the Bank from the Financial and Capital Market Commission, Latvia ('FCMC'). The Bank was since 2017 an LSI in crisis and the agreed crisis management arrangement involving close cooperation between the FCMC and the ECB was in place since then. In December 2018, the FCMC requested the ECB to take over the supervision over the Bank. Prior to doing so, the ECB aimed at making an in-depth investigation at the situation with the Bank, and consequently the announced on-site inspection by the ECB with the Bank as LSI was organised[52].

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48 Judgment of the General Court of 7 December 2022, T-275/19, PNB Banka AS v. ECB, (Decision ECB to conduct an inspection at the premises of a LSI); Judgment of the General Court of 7 December 2022, T-301/19, PNB Banka AS v. ECB (ECB decision classifying the Bank as SI); Judgment of the General Court of 7 December 2022, T-330/19 PNB Banka AS v ECB (Opposition ECB to approve acquisition of Qualifying Holding in the Bank) and Judgment of the General Court of 7 December 2022 T-230/20, PNB Banka AS v. ECB (Decision to withdraw the authorisation).

49 Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010, OJ *EU* L 225 of 30 July 2014, p. 1.

50 ECJ 7 December 2022, T-275/19.

51 In conjunction with Article 12 SSM Regulation and 143 to 146 SSM Framework Regulation.

52 It is by decision of 1 March 2019 that the ECB had decided to classify that Bank as a SI based on Article 6(5) SSM Regulation, and that decision took effect from 4 April 2019. As from that date,

One of the pleas in this case, concerned what the applicant saw as an unnecessary reason to conduct an onsite inspection, that investigation by the ECB had, according to the applicant, been decided for improper reasons, the applicant's contention was that by doing so, the ECB wanted to retaliate to make the Bank understand that exercising criticism of the ECB's views was not permitted. One factor in that plea was the violation of the principle of proportionality, "the ECB should have used the least intrusive means to achieve the objective pursued".[53] Under Article 12(1) SSM Regulation, the ECB may carry out all necessary on-site inspections on premises of institutions subject to prudential supervision, in any case institutions located in one of the participating Member States of the SSM. The wording 'necessary', according to the General Court, presupposes a proportionality assessment, with the General Court including the usual references to that principle in its Judgement.[54] Also with regard to this ECB decision, the General Court notes that when assessing proportionality, the measure must be reconciled with compliance with the discretion that must be conferred on the EU institutions at the time it was adopted. Moreover, says the General Court, referring to ECJ Landeskreditbank Baden-Württemberg v ECB, the ECB has broad discretion when it adopts, a measure relating to the prudential supervision of a credit institution.[55]

The need for an on-site inspection should be assessed against the objectives pursued by the relevant legislation. Those objectives are, "to ensure the safety and soundness of those institutions, the stability of the financial system and the protection of depositors". Ensuring sound management of credit risks (about which there were significant supervisory concerns regarding the Bank) is one of the main objectives of the prudential rules, as reflected in Article 1 CRR, Article 79 CRD4 and Principle 17 of the Basel Committee Core Principles for Effective Banking Supervision. The General Court then elaborates in paragraphs 182 to 186 on the design of the system of ongoing supervision of credit institutions, with onsite inspections supporting the off-site delivery of information and documentation, including in the form of the periodic reports and (annual) accountability under the Supervisory Review and Evaluation Process.

Onsite inspections are not necessarily aimed at detecting possible infringements of regulations but are aimed at confirming the institution's provision of information as part of ongoing supervision. This is, according to the General Court, separate from the rules of Article 13(2) SSM Regulation, according to which if, in the context of the

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the ECB took over the direct supervision on the Bank from the FCMC. See: paragraph 32 of the Judgement of the General Court of 7 December 2022, T-275/19.

53 Paragraphs 172 and 173 of the Judgement of the General Court of 7 December 2022, T-275/19.

54 Paragraph 177 of the Judgement of the General Court of 7 December 2022, T-275/19.

55 Paragraph 178 of the Judgement of the General Court of 7 December 2022, T-275/19.

onsite inspection to be conducted by the ECB, the ECB needs to have recourse to the national judicial authorities to apply coercive measures in that context (e.g. in the case of a refusal to grant access, obtaining a court order to enter), the ECB will in that case be obliged to demonstrate that there is a reasonable suspicion of a breach of prudential rules, and that in that context an assessment of the proportionality of the coercive measures in question will then have to take place. Finally, it follows from the system of onsite inspections that their frequency and intensity should be proportionate.[56]

On balance, the General Court comes to reject the applicant's claim that the decision to institute the on-site inspection violated the principle of proportionality. In an interesting intermediate consideration, the General Court says that the fact that onsite inspections by the ECB are more intrusive than those by national authorities does not mean that they are disproportionate. In this regard, the General Court comes to the final judgment that it has not been shown that the onsite inspection was unnecessary when the ECB exercised broad discretion in this regard, in other words this first element of the principle of proportionality was satisfied. The General Court then concludes that it has not been shown "that the ECB could have used a less onerous measure than the on-site inspection which it carried out or that the problems caused by that inspection measure were disproportionate to the objective pursued." This also tested the ECB's decision on the other elements of the proportionality principle, and found that they had been met in this case.[57]

The *second ECJ judgment of 7 December 2022* in PNB Banka AS v ECB[58] concerns the ECB's decision of 1 March 2019 to classify the Bank as a SI under Article 6(5) SSM Regulation. In its nature this case is 'Landeskreditbank Baden-Württemberg v ECB revisited'. The important differentiator here, obviously, is that PNB Banka is a credit institution that did not *ex ante* meet the criteria in Article 6(4) SSM Regulation to be classified as a 'SI', but that this is a *de facto* LSI for which the ECB, at the request also of the NCA in question, decides to use the discretion contained in Article 6(5) SSM Regulation, and classifies the Bank as a 'SI' after all.

One of the applicant's central contentions in this case concerns the question of whether the ECB did in fact come to exercise the discretionary assessment permitted under Article 6(5)(b) SSM Regulation. That provision assumes that the ECB "may" exercise that power, which presupposes a balancing assessment. Such assessment should be made explicit in the relevant decision, and the applicant claims that this

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56 Paragraphs 188 to 191 of the Judgement of the General Court of 7 December 2022, T-275/19.
57 Paragraphs 200 to 203 of the Judgement of the General Court of 7 December 2022, T-275/19.
58 Judgment of the General Court of 7 December 2022, T-301/19, PNB Banka AS v. ECB (ECB decision classifying the Bank as SI).

assessment does not appear from the language used in the relevant decision of 1 March 2019, because the decision is based on the ground that it was found necessary by the ECB to adopt the decision on the grounds laid out in Article 6(5)(b) SSM Regulation which the ECB considered to be applicable to the case.[59]

Confirming the judgement in Landeskreditbank Baden-Württemberg v ECB, the General Court lays out the rule that:

> "*the ECB has a broad discretion when adopting, as in the present case, a measure relating to the prudential supervision of a credit institution*"[60]

The General Court furthermore states that neither the obligation of Article 296 TFEU to state the reasons for a decision nor any other rule obliges the competent authority to explicitly state in its decision that it does exercise the discretion as laid out in the relevant rule.[61] The ECB cannot be blamed that it wrongfully assumed that it would not have discretionary powers when adopting the decision or that it would be bound by circumscribed powers not leaving any room for the exercise of discretionary power.[62] This plea of the applicant is therefore considered to be unfounded by the General Court.

Also in this case the applicant submitted a plea that the ECB when deciding to apply the provision of Article 6(5)(b) SSM Regulation infringed the principle of proportionality. The ECB failed to make the proportionality analysis according to the Bank, amongst others, as the Bank claims that less intrusive measures had been conceivable, and furthermore that the decision of the ECB failed to consider whether the burden for the Bank was appropriate in light of the underlying problem and the objective to be pursued. Other solutions, for instance the restoring of confidence in the prudential supervision exercise by Latvia's NCA by examining the root causes of the loss in confidence (the subject matter of alleged corruption with certain key officers of the Latvian authorities) should have been capable in resolving the issue and avoiding the intervention by the ECB with the decision of 1 March 2010.[63]

In this Judgement, the General Court found that the contested decision was appropriate for attaining the objective of ensuring a consistent application of high supervisory standards, and moreover, that the decision addressed the concerns from the FCMC, by ensuring direct supervision by the ECB. The replacement of the FCMC by the ECB for supervising the Bank, resolved the issues that arose in the

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59 Paragraph 183 of the Judgment of the General Court of 7 December 2022, T-301/19.
60 Paragraph 185 of the Judgment of the General Court of 7 December 2022, T-301/19. In paragraph 186 the General Court states that this broad discretion is confirmed in the wording of Article 6(5)(b) SSM Regulation citing the General Courts' Judgement in Landeskreditbank Baden-Württemberg v ECB, T-122/15, paragraph 61.
61 Paragraph 187 of the Judgment of the General Court of 7 December 2022, T-301/19.
62 Paragraphs 188 and 189 of the Judgment of the General Court of 7 December 2022, T-301/19.
63 Paragraph 192 of the Judgment of the General Court of 7 December 2022, T-301/19.

context of the local proceedings in Latvia running after the allegations were pursued about involvement of certain governmental officers being involved in corruption. The General Court furthermore confirms that it was not within the power or capabilities of the ECB to conduct investigations as to the corruption case in Latvia, so that that alternative for the direct supervision of the Bank based on the decision on the ground of Article 6(5)(b) SSM Regulation could not be explored.[64]

The alternative measures as suggested by the applicant, if at all possible to be implemented by the ECB, would not have taken away the concerns of the FCMC, as this authority considered that it was not able, given the circumstances at hand, to exercise the same supervisory powers as those conferred to all other supervisory authorities under the SSM. Moreover, the General Court, established that it is not apparent that the ECB decision caused problems for the applicant, and that therefore it can also not be established that the suggested alternative measures by the Bank would be less onerous.[65]

The plea that the ECB infringed the principle of proportionality when deciding to apply Article 6(5)(b) SSM Regulation and classifying the Bank as SI is therefore considered unfounded by the General Court.

The *third Judgement of the ECJ of 7 December 2022* in the matter of PNB Banka AS v ECB[66] addressed the principle of proportionality in the sense that the Bank, the applicant in first instance, challenged the ECB decision of 21 March 2019 to refrain from approving the acquisition of a qualifying shareholding by the Bank in another Latvian bank (‘Target Bank’), by arguing that the ECB, observing the principle of proportionality, had to weigh two alternatives against each other, and choose the least onerous alternative. These were, on the one hand, to reject the acquisition of the qualifying holding, on the one hand, and, on the other, to approve the acquisition and impose additional conditions.

The Court considered in this third Judgement that in cases of prudential supervision of credit institutions, the ECB must be considered to have a broad discretion[67]. In order to ensure the sound and prudent management of the Bank, the ECB had imposed requirements related to the financial health of the Bank in the context of the acquisition of the qualifying holding in the Target Bank. The ECB had firstly questioned this financial soundness. Furthermore, the ECB had questioned whether upon the acquisition of the Target Bank and the new to be established

64 Paragraphs 203 of the Judgment of the General Court of 7 December 2022, T-301/19.
65 Paragraphs 201 and 202 of the Judgment of the General Court of 7 December 2022, T-301/19.
66 Judgment of the General Court of 7 December 2022, T-330/19.
67 Judgment of 7 December 2022, T-330/19, paragraph 144 citing the same rule as laid out in the ECJ Judgment of 8 May 2019 Landeskreditbank Baden-Württemberg v ECB, C-450/17 P.

banking group headed by the Bank would be able to meet the prudential requirements going forward. For that reason, the ECB had not approved the proposed acquisition. It was these circumstances, and the broad discretion that the ECB is entitled to exercise in this regard, that led the Court to conclude that the Bank was wrong to plead breach of the principle of proportionality, in particular also because the Bank had not been able to properly substantiate the alternative that it advocated, namely that the ECB would approve the acquisition of the qualifying holding in the Target Bank but then attach certain conditions to it. The Court found that this alternative route was not sufficiently substantiated, and therefore there was also no reason to weigh the two alternatives against each other.[68]

The applicant also argued, that the ECB had waived the exercise of the broad discretion given to the ECB in making the deliberations not to approve the proposed acquisition, and that the Bank had thus been disadvantaged and deprived from its fundamental right as set out in Article 41 of the Charter of Fundamental Rights of the European Union[69]. But the ECB argued that it did exercise that broad discretion by weighing up that there were problems with the financial soundness of the Bank and that as a result there were concerns that the Bank would be unable to comply with the prudential requirements applicable to it. The ECB objects to the applicant that these trade-offs did not imply that the ECB believed that it did not have broad discretion. The Court rejects the claim that Article 41 of the Charter had been breached as the applicant is not able to provide any evidence capable of demonstrating that the contested decision is vitiated by a lack of impartiality.[70]

The *fourth Judgement of the ECJ of 7 December 2022* in the matter of PNB Banka AS v ECB[71] required the ECJ to assess as to whether or not the proportionality assessment given by the ECB in its decision dated 17 February 2020 to withdraw the authorisation of the Bank had been established in accordance with EU law. In such assessment the ECB established that there was no less intrusive measure possible as alternative for the withdrawal of the authorisation, as the Bank was not in compliance with certain core prudential requirements. A further weighting had been made by the ECB of the interests of the Bank and its shareholders against the public interest. All other arguments submitted by the Bank were insufficient to call in question the proportionality of the withdrawal of the authorisation.[72] The claim

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68 ECJ 7 December 2022, T-330/19, paragraphs 197-201.
69 Every person has the right to have his or her affairs handled impartially, fairly and within a reasonable time by the institutions, bodies, offices and agencies of the European Union.
70 ECJ 7 December 2022, T-330/19, paragraph 209.
71 Judgment of the General Court of 7 December 2022, T-230-20.
72 Paragraph 126 of the Judgment of the General Court of 7 December 2022, T-230-20.

of the Bank that the ECB infringed the principle of proportionality was therefore rejected by the General Court.

## 7 Conclusions

This paper should conclude with some reflections on the essence of national discretions in the light of proportionality. The reader will have noticed that the argument is mainly based on the treatment of the subject in ECJ case law, and that I have hardly touched upon issues of national law and national circumstances. First, this is related to the fact that I lack sufficient subject-matter expertise to deal with the legal systems of Member States other than the Dutch legal order.

Here, secondly, a further justification for orienting on ECJ case law comes to the table. Namely, that I am familiar with the practice in my own jurisdiction and the customs and mores that exist within the Dutch financial sector. These boil down to the fact that, to a much lesser extent than is the case in other Member States, financial firms are prepared to draw knives in disputes with the competent authorities.

Apart from some major cases at the ECJ related to state aid granted during the GFC in the context of bailouts, one will also rarely see ECJ case law where Dutch financial institutions challenge the decisions of the competent authorities. When it then comes to the interpretation of certain concepts of administrative law, the ever-growing jurisprudence in the context of ECJ cases brought by institutions based in other Member States, particularly in matters of the SSM and the Single Resolution Mechanism is a very rich source of law discovery. Especially as these cases and ECJ decisions will have a direct impact on the Dutch legal system.

The reader will also be able to object to me that there are gaps in the discussion of case law, very likely there are other cases to be found that would have fit into the analysis and reading on the subject dealt with in this paper. I therefore in no way claim completeness or comprehensiveness of the ECJ's jurisprudence on the subject matter.

However much there are explicit rules which presuppose, if a (European) institution has been given a mandate to exercise discretion in cases where a tailor-made solution is required, it is obliged to use that discretion to the full[73], the tenor of the case law I examined is more likely that disputes over the exercise of discretion, have to do with the adverse effects that the exercise of discretion has entailed, rather than the reverse case. Of course, it is also a logical consequence of the nature of discretions applied. They will undoubtedly be applied to a large extent in the

[73] See: paragraph 4 and the ECJ case law referred to in footnotes 24 and 25.

European Union, but when that leads to a favourable outcome for the institution concerned, it will not be obvious for it to complain about it in court. But what is also missing, as far as I have been able to assess, is complaints about discretions applied that result in unequal treatment, or undermine the level playing field or competitive relationships.

With regard to cases complaining about the disproportionate treatment of companies by the relevant competent authority using its discretion to impose certain measures, the ECJ applies the doctrine of proportionality developed over the years, noting in particular that provided the relevant rules are clear, the discretion is more likely to be curtailed rather than expanded by the courts. This touches on my point that it is not up to the competent authorities, for reasons of proportionality, to arrive at an application of the rules that is contrary to the intentions of the legislator. Similarly, curtailing the consequences of application of a rule, clear in its nature, to mitigate disproportionate consequences, is not readily obvious. If the rule is given and it is not or not sufficiently observed, then it will be an obligation of the competent authority to enforce that rule accordingly, and to ensure that it is complied with. Most room, as I have argued, is in making discretionary considerations as to available alternatives. Where there are several alternatives for complying with a particular rule, it will be a matter of examining which alternative produces the least onerous outcome. However, as the case law discussed above has shown, these alternatives must be viable and the relevant authority must have sufficient powers to apply this alternative, and must demonstrably achieve the aim of the relevant rule in a similar manner. Also the less onerous effect of the alternative measure must be substantiated. If the relevant subject of law fails to present the alternative method, and in particular to show that that alternative method leads to the same result but with less onerous effect, a complaint based on violation of the principle of proportionality for failure to exercise discretion will fail.

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